ALERT MEMORANDUM

U.K. Supreme Court Decision Answers the Question: What Law Governs Your Arbitration Agreement?

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In an important decision for arbitration users, the U.K. Supreme Court has clarified how English law will determine the governing law of an arbitration agreement which provides for an English seat in the absence of an express choice of law. In its 9 October 2020 decision in *Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb" & Ors* [2020] UKSC 38, the Supreme Court reaches the same outcome as the Court of Appeal, while employing slightly different reasoning.

The *Enka* case arises from a typical trap for the unwary. When drafting arbitration agreements, practitioners are well advised to provide for the governing law of the main contract, the law of the arbitration agreement and the seat of arbitration. Where the parties have not done so, particularly if the law of the main contract and of the arbitration agreement are meant to be different, serious and unintended problems of interpretation may arise.

The decision is notable among other reasons in view of the international discussion and controversy surrounding the issue of which law should apply to the arbitration agreement, the frequency with which England is provided for as the seat in arbitration agreements, and the infrequency with which parties make an express choice of law to govern the arbitration agreement itself. Considering that the law governing the arbitration agreement may be directly relevant to issues of scope and enforceability of the arbitration agreement as well as the enforceability of any ensuing award, the decision is likely to have significant ramifications going forward for domestic and international arbitrations with an English seat, and perhaps even beyond English borders.

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The U.K. Supreme Court found by a 3-2 majority that English law, which in the case at hand was the law of the seat, governed the arbitration agreement in question. In so doing, the Supreme Court set out the following principles for determining the governing law of an arbitration agreement placed before it:

- The law of the arbitration agreement will be either the law chosen by the parties to govern the arbitration agreement or, if there is no choice of law, the law with which the arbitration agreement is most closely connected.
- Where the parties have expressly or impliedly chosen the governing law of the *main* contract (without reference to the arbitration agreement), this choice will generally apply to the arbitration agreement.
- In the absence of any choice of governing law over the main contract, the governing law of the arbitration agreement will generally be the law of the seat.

A. Factual Background

On 1 February 2016, a massive fire broke out at a power plant in the Krasnoyarsk region of Russia. Enka was the sub-contractor for the construction of the power plant. The insurance company Chubb Russia had insured the owner of the power plant against damage and paid out approximately $400 million as a result.

Enka's contract provided for disputes to be resolved under the ICC Rules of Arbitration and that the place of arbitration was to be London. However, there was no clause specifying which law governed the contract as a whole or, more specifically, the arbitration agreement. However, there were certain references to Russian law throughout the contract and Russian law was defined as the "Applicable Law".

In May 2019, Chubb Russia brought proceedings against Enka and the subcontractors in the Russian courts for claims in tort in order to recover the amount paid out under the insured event. Chubb Russia contended that Enka was jointly liable for the damage caused as Enka had been engaged in the design and construction of the power plant. Enka applied to the Russian court to dismiss the claims on the basis that the Russian court proceedings were brought in breach of the arbitration agreement. Enka applied to the English Commercial Court seeking an anti-suit injunction restraining the Russian proceedings.

B. Previous Rulings at the English High Court and Court of Appeal

On 20 December 2019, the English High Court decided not to grant an anti-suit injunction against Chubb Russia. It held that the English court was not the *forum conveniens* for the dispute and that it was more appropriate for Russian courts to determine questions about the scope and applicability of the arbitration agreement. The High Court considered that a London seat of arbitration did not give the English court jurisdiction to enforce obligations to arbitrate.

On 29 April 2020, the Court of Appeal reversed the High Court's decision and held as follows:

(i) that the English court, as the seat of arbitration, was the appropriate court to grant anti-suit injunctions; and

(ii) that the arbitration agreement was governed by English law.

The Court of Appeal held that the arbitration agreement was to be governed by the law of the seat of the arbitration, unless there was an express choice of the parties indicating otherwise.

In rendering its decision, the Court of Appeal applied the 'three-stage test' from *Sulamérica Cia Nacional de Seguros SA v. Enesa Engenharia SA* [2012] EWCA Civ 638 to determine the governing law of an arbitration agreement, namely:

(i) is there an express choice of law;

(ii) if not, is there an implied choice of law; and

(iii) if not, with which system of law does the arbitration agreement have its closest connection.

However, the Court of Appeal departed from the *Sulamérica* decision in the way that it applied the test. The Court of Appeal concluded that, as a general rule,

the law of the arbitration agreement should be the curial law, or the law of the seat of arbitration, as a matter of implied choice. Using this reasoning, the Court of Appeal established at the second stage of the 'three-stage test' that there was an implied choice of English law.

The Court of Appeal's reasoning in this decision was an example of the courts' inconsistent approach, both in English jurisprudence and compared to approaches outsides of England, when deciding how to approach the absence of a party choice of the law to govern their arbitration agreement.

C. The U.K. Supreme Court Decision

The U.K. Supreme Court's decision on 9 October 2020 provided much-needed clarity in this area. A majority consisting of Lords Hamblen, Leggatt and Kerr reached the same conclusion as the Court of Appeal while employing a different approach.

In the first instance, the court majority applied English law as the law of the forum to ascertain whether the parties had made a choice of governing law applying to the arbitration agreement. The decision held that the Court of Appeal was wrong to apply the principles of construction of the law governing the main contract to make this determination.[1]

The court majority confirmed that the 'three-stage test' under English common law rules applied when determining the governing law of the arbitration agreement. It gave as its reasoning that the Rome I Regulation expressly excludes arbitration agreements (thus following the Court of Appeal's approach in this regard).[2]

However, the majority held that where the governing law of the contract and the curial law of the seat are different (as is often the case and also was the case in *Enka*), nine principles should govern the determination of the applicable law (summarised at paragraph 170 of the judgement). The key principles are described below:

- Whether the parties have agreed on a choice of law to govern the arbitration agreement is ascertained by construing the arbitration agreement and the main contract containing it, as a whole, applying the rules of contractual interpretation of English law as the law of the forum.
- Where the law applicable to the arbitration agreement is not specified, the law chosen to govern the main contract will generally also apply to an arbitration agreement which forms part of that contract.
- However, the choice of law governing the main contract will not apply to the arbitration agreement where: (a) any provision of the law of the seat indicates that, where an arbitration is subject to that law as a result of agreement to that seat, the arbitration will also be treated as governed by that country's law; or (b) a serious risk exists that, if governed by the same law as governs the main contract, the arbitration agreement would be ineffective.
- In the absence of any choice of law to govern the arbitration agreement, the arbitration agreement is governed by the law with which it is most closely connected. Where the parties have chosen a seat of arbitration, this will generally be the law of the seat, even if this law differs from the law applicable to the parties' substantive contractual obligations.

D. Analysis

Firstly, when determining the parties' choice of law to govern the contract, the decision of the majority confirmed that ordinary English rules of contractual interpretation will be applied.[3] This helpfully avoids an additional layer of complexity in determining the rules which should apply when in turn assessing the governing law of the arbitration agreement.

Secondly, the Supreme Court found that it would not be in a "*minority*" of cases that an express choice of law

[1] *Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb" & Ors* [2020] UKSC 38, ¶34.

[2] *Enka*, ¶27.

[3] *Enka*, ¶34.

for the main contract should be construed as a choice of law to govern the arbitration agreement. The court indicated here that the Court of Appeal placed too much reliance on the well-recognized principle of separability (i.e. that the arbitration agreement is to be treated as conceptually distinct from the main contract) in its reasoning. The Supreme Court majority contended that it does not necessarily follow from the separability principle that an arbitration agreement should generally be regarded as a "*different and separate agreement*" or that a choice of governing law in the main contract should not generally be interpreted as also applying to an arbitration agreement in that contract.[4]

Thirdly, the majority also disagreed with the so-called "*overlap argument*" to the effect that parties that choose England as the seat of arbitration are also impliedly choosing English law as the governing law of the arbitration agreement.[5] In this light, the court considered Section 4(5) of the Arbitration Act 1996, which holds that if foreign law governs the arbitration agreement (due to express choice or under the *Sulamérica* closest connection test), the non-mandatory provisions of the Arbitration Act 1996 will not apply to the arbitration process. The Arbitration Act 1996 therefore specifically provides for a situation where the parties have chosen England as the seat but the foreign law governing their arbitration agreement will nevertheless displace substantive non-mandatory provisions of English arbitration law. The court concluded from this that the Arbitration Act 1996 does not support an inference that a choice of England as the seat of arbitration implies a choice of English law to govern the arbitration agreement.[6]

However, the decision does identify limited circumstances where choice of seat would in fact also imply a choice of law governing the arbitration agreement.[7] For example, as examples of express statutory regulation, both section 6 of the Arbitration (Scotland) Act 2010 and section 48 of the Swedish Arbitration Act specify that in absence of a choice of governing law for the arbitration agreement, the governing law will be the law of the seat. The UK Supreme Court also confirmed the application of the well-recognized validation principle in determining the law applicable to an arbitration agreement. Accordingly, it held that a purposive interpretation of the contract should be applied to give effect to the parties' intentions because it is unlikely that commercial parties would have intended a choice of governing law clause to apply if, as a result, there was a serious risk of significantly undermining the agreement.[8]

Finally, if there is no express or implied choice of law to govern the arbitration agreement, the majority confirmed that the court must determine the system of law 'most closely connected' to the arbitration agreement. Notably, the majority held that, in general, the arbitration agreement will be most closely connected with the law of the seat of the arbitration. It cited multiple reasons for this conclusion:

(i) the seat is the place of performance of the arbitration agreement (legally, if not physically) and common law places the greatest weight on this connecting factor[9];

(ii) this default rule is consistent with both legislative policy and international law, such as Article V(1)(a) of the New York Convention[10];

(iii) this default rule is likely to uphold the reasonable expectations of contracting parties who have chosen to specify a location for the arbitration without choosing the law to govern the contract[11]; and

(iv) this default rule provides the legal certainty of a clear default rule in the absence of choice.[12]

[4] *Enka*, ¶61.
[5] *Enka*, ¶73.
[6] *Enka*, ¶82.
[7] *Enka*, ¶¶70-71.
[8] *Enka*, ¶106.
[9] *Enka*, ¶¶121-124.
[10] *Enka*, ¶¶125-141.
[11] *Enka*, ¶142-143.
[12] *Enka*, ¶144.

E. Application to the Facts

It was not disputed by either party that a system of law had not been chosen to govern the arbitration agreement in the main contract and that the contract itself did not contain a governing law clause.

The UK Supreme Court could not identify any express or implied choice of law, particularly because if the parties had intended for the contract to be governed by Russian law as defined as the "Applicable Law", it would have been simple to provide as such. There were also numerous rights and obligations established by the contract which made no reference to the "Applicable Law".

As a result, it was necessary to identify the law with which the arbitration agreement was most closely connected. The Supreme Court first applied the Rome I Regulation and determined that the law applicable to the main contract was Russian law given that it involved a Russian company, performance of construction work in Russia, compliance with Russian laws and regulations, Russian language taking precedence and payments to be made to a Russian bank account.

The Supreme Court applied the general rule that the arbitration agreement was to be governed by the law of the seat of arbitration in absence of a choice of law. This is despite the fact that, on analysis, the governing law of the contract was Russian law and there was otherwise a strong nexus to Russia as opposed to England. The choice of London as the seat empowered the English court to restrain Russian legal proceedings via an anti-suit injunction. The UK Supreme Court thus affirmed the decision of the Court of Appeal, but overturned its decision on the proper law.

F. Comments

The *Enka* decision provides clear rules under English law as to how the governing law of the arbitration agreement will be determined in absence of choice. Nevertheless, *Enka* should remain as a cautionary tale that parties should be careful when drafting the dispute resolution and governing law clauses, particularly where the governing law of the main contract and the law of the seat of arbitration are different, as is frequently the case in international commercial contracts.

The ongoing *Kabab-Ji (Lebanon) v. Kout Food Group (Kuwait)* saga, involving both English and French law, squarely illustrates the difficulties that may arise when parties choose an arbitral seat, and thereby a *lex arbitri*, that is different from the substantive law governing the main contract. In that case, a dispute arose under a Franchise Development Agreement ("FDA") which provided for English law as the substantive law of the agreement while containing an arbitration agreement which provided for ICC Rules arbitration with a seat in Paris. In a September 2017 award, an ICC arbitral tribunal held that French law applied to the arbitration agreement, irrespective of the main contract's governing law clause, and that under that law, non-signatory Kout was bound by the arbitration agreement. Following initiation of set aside proceedings in the Paris Court of Appeals by Kout, as well as cross-applications in the English Court of Appeal by Kabab-Ji seeking enforcement of the award and by Kout contending that the first-instance English High Court had erred by failing to deny enforcement and failing to hold that Kout was not a party to the arbitration agreement, the two courts disagreed on whether English or French law was applicable to the arbitration agreement. The English Court of Appeal held that the parties' selection of English law as the law governing the main contract constituted an express choice of the law governing the arbitration agreement, and that under English law non-signatory Kout was not bound by the arbitration agreement.[13]

Subsequently, the Paris Court of Appeal disagreed and held that it was competent to rule on the issue and not bound by the foreign court's prior ruling. It then held that "[t]he designation of English law as generally governing the [main contract] does not suffice to establish the parties' common intention to submit the arbitration agreement to English law" and, further, that

[13] *Kabab-Ji SAL (Lebanon) v. Kout Food Group (Kuwait)* [2020] EWCA Civ. 6 (Jan. 20, 2020), ¶¶ 8, 62.

"in applying the substantive law of the place of the seat of arbitration, in accordance with generally recognized principles of law, the arbitral tribunal did not apply a rule that would contradict the strict wording of the [main contract]."[14]

The French Court of Appeal's holding is consistent with the French so-called "substantive approach" Under that approach, the arbitration agreement is considered to be independent from the main contract in which it is contained such that its existence and validity must be determined in accordance with the common intention of the parties. Furthermore, that intention can be deduced solely from the circumstances of each specific case – without reference to domestic law and subject only to the mandatory rules of the seat of the arbitration and to international public policy.[15]

On July 8, 2020, a three-judge panel granted the request of Kabab-Ji, the award creditor to appeal the English Court of Appeal's decision to the UK Supreme Court. It remains to be seen how the UK Supreme Court may apply its own recent *Enka* decision as precedent to reconcile – or not – the English and the French courts' positions on this matter at least as reflected in the *Kabab-Ji v. Kout Food Group* saga.

G. Conclusion

The *Enka* decision in any event serves as an indirect confirmation of the basic importance and advisability of including an express and effective choice of the law governing the main contract, particularly where the contract involves parties of different nationalities and it includes an arbitration agreement. This is the case at least for contracts providing for an English seat of arbitration, as is frequently the case in international commerce.

The *Enka* decision may be seen as limited to its particular facts involving the absence of an express choice of law to govern the main contract. At the same time, it is likely to be marshalled to support the position, already found in certain statutes, case law and commentary outside of England, that in the absence of a choice of governing law for the arbitration agreement, the governing law of the arbitration agreement will be the law of the seat. This would include for the purposes of jurisdiction of the courts at the seat over anti-suit injunctions and other ancillary measures, as in the case of *Enka*.

Of course particularly in international commercial arbitration, the seat is often chosen precisely as a compromise neutral venue which otherwise has no close connection to the parties, their centers of gravity or the place or places of characteristic performance of the main contract. For that reason alone, it continues to behove parties to such international commercial contracts and arbitration agreements to exercise appropriate care and diligence in selecting a seat of arbitration, even in cases where they believe they have also entered into a valid and effective choice of law to govern their main contract.

Where that choice of law for the main contract is later found not to be valid and effective for whatever reason, and therefore "absent", the parties may be faced with an application of the law of the seat of arbitration which does not comport with one or more of the parties' original intentions. And where, as a result of the dynamics of the original contract negotiations or otherwise, the parties -- intentionally -- leave out any express choice of law to govern their main contract but do include an express choice of an English seat of arbitration, the *Enka* decision will be of direct importance. This is certainly the case with regard to whether a court at an expressly chosen English seat is empowered to restrain court proceedings outside of the seat via an anti-suit injunction.

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[14] *Kabab-Ji SAL (Lebanon) v. Kout Food Group (Kuwait),* CA Paris, Pôle 1, ch. 1 no. 17/22943 (June 23, 2020), p. 5.

[15] *Kabab-Ji SAL (Lebanon) v. Kout Food Group (Kuwait),* CA Paris, Pôle 1, ch. 1 no. 17/22943 (June 23, 2020), p. 7 ("Pursuant to a substantive rule of international arbitration law ("règle matérielle du droit international de l'arbitrage"), the arbitration agreement is legally independent from the underlying contract in which it is contained, either directly or by reference, subject to the mandatory rules of French law and international public policy; its existence and validity are determined in accordance with the common intention of the parties, without it being necessary to refer to a domestic law.")

Ultimately, time will tell whether courts in other leading international arbitral venues outside of England, particularly those which have not yet resolved the governing law issue squarely through legislation or case law, take heed of the *Enka* decision in factual circumstances similar to the ones in that dispute.

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