The Supreme Court’s decision in Enka Insaat: Full Circle on the Law Applicable to the Arbitration Agreement

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“Given the uncertainty that remains in this area of law, if the [defendant] seeks leave to appeal, the Supreme Court should review the case so that it can make a more unequivocal endorsement of the traditional approach to this issue and re-establish the effective presumption in favour of the proper law of the contract. This will provide the maximum level of certainty to commercial parties when negotiating their contracts.”

The above is a quotation from an article I wrote eight years ago following the decision of the Court of Appeal in Sulamerica Cia Nacional De Seguros S.A. and others v Enesa Engenharia S.A. and others [2012] EWCA Civ 638. That case was one of a long line of cases before and since grappling with the issue of what law should govern an arbitration agreement where the parties select a seat that is different from the law that governs the underlying contract. The court in that case found the law of the seat applicable as the law most closely connected to the arbitration agreement after finding the parties had not made an express or an implied choice. In the event, Sulamerica never reached the Supreme Court and the uncertainty of approach persisted. The wheels of justice do indeed grind slowly.

This year English arbitration practitioners have experienced a bit of whiplash as the courts have taken up this issue in earnest with several decisions, some finding the proper law applicable and some the law of the seat. I myself have recently argued a dispute over the applicable law of an arbitration agreement which began when Sulamerica was the most recent pronouncement by the Court of Appeal on the issue before two further Court of Appeal decisions came down in the course of submissions, first in Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait) [2020] 1 Lloyd’s rep 269 and then in Enka Insaat Ve Sanayi A.S. v OOO “Insurance Company Chubb” and ors [2020] EWCA Civ 574.

In Kabab, the Court of Appeal found the law of the underlying contract applicable as an express choice based on the language of the choice of law clause in that case which it determined was wide enough to encompass the arbitration agreement despite it being separable from the underlying contract. In Enka Insaat, the Court of Appeal found the law of the seat applicable as an implied choice on the basis that, since the arbitration agreement is separable, the law of the underlying contract has little if anything to say about the parties’ choice of the law of the arbitration agreement and that, in cases where the law of the seat and the law of the underlying contract are different, it should be presumed that the parties chose the law of the seat unless there are strong countervailing factors. No doubt by pure coincidence, the law found to be applicable to the arbitration agreement in Sulamerica, Kabab and Enka Insaat was English law.

The Court of Appeal in Enka Insaat recognised what had been a clear need for “order and clarity” in this area of English law and sought to impose it with a presumption in favour of the law of the seat. The Supreme Court granted permission to appeal and has now finally issued an authoritative pronouncement providing much of the needed clarity but not towards the law of the seat as envisioned by the Court of Appeal, but rather, towards the law governing the contract. However, as discussed below, a third consideration: under which law is the arbitration agreement most likely to be valid? may ultimately be the most prevalent determining factor in practice.

The case

In Enka Insaat, Chubb Russia became subrogated to the rights of its insured under a construction contract for a power plant in Russia with Enka Insaat as the developer after a fire substantially damaged the plant. The contract contained a dispute resolution clause providing for arbitration under the ICC rules with seat in London. Unusually, it did not contain a governing law clause. Chubb Russia commenced proceedings in a Moscow court and Enka Insaat sought an anti-suit injunction from the English courts on the basis of the arbitration clause. The high court (Baker, J) dismissed Enka Insaat’s claims on the basis that the appropriate forum to decide whether the claim fell within the arbitration agreement was Russia.

On appeal, the Court of Appeal (Flaux, Males and Poppelwell, LJJ) allowed the appeal on the basis that the arbitration agreement was governed by English law and that the appropriate forum was therefore in England. As mentioned above, the court sought to clarify the application of English conflicts principles to determine the law applicable to the arbitration agreement in situations where the parties choose a seat that is different from the law applicable to the underlying contract. It proposed a default presumption that the parties had impliedly chosen the law of the seat that could only be overturned by powerful countervailing factors. The court justified this approach on the basis that it should be presumed that the parties would have wanted the same law to govern what the court called the “arbitration package” in which it included the law governing the arbitration agreement and the curial law that governs and
provides judicial support to the arbitration process. It considered the underlying contract and arbitration agreement to be separable and directed to entirely different purposes which meant that a choice of law to govern the former had little to say about whether there had been a choice to govern the latter. The one potentially countervailing factor mentioned by the Court of Appeal is a situation where the arbitration agreement would be invalid under the law of the seat which is in essence an expression of the common law "validation principle" of contractual interpretation.

The Supreme Court rejected the Court of Appeal’s approach as giving too much weight to the doctrine of separability and not enough weight to party autonomy.

The starting point: the choice of law for the underlying contract

The Supreme Court (Lords Hamblen and Leggatt with whom Lord Kerr agreed) preferred the approach of previous cases such as Sulamerica in which the analysis starts with the presumption in favour of the law chosen to govern the contract. It is an interesting feature of the case that it based a large part of its pronouncements intended to add clarity to the law in this area on a contractual feature that was not present in the case: i.e., an express choice of law clause.¹

Nevertheless, the majority did their best to set out broadly applicable principles that would apply in cases where the parties had expressly chosen an applicable law to govern the contract and an arbitral seat in a different jurisdiction. At paragraph 43, Lords Hamblen and Leggatt said the following:

"It is rare for the law governing an arbitration clause to be specifically identified (either in the arbitration clause itself or elsewhere in the contract). It is common, however, in a contract which has connections with more than one country (or territory with its own legal system) to find a clause specifying the law which is to govern the contract. A typical clause of this kind states 'This Agreement shall be governed by and construed in accordance with the laws of [name of legal system].' Where the contract also contains an arbitration clause, 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 to be governed by the specified system of law."

The decision of the court as to the correct presumption on which to ground the analysis came down to its view, contrary to that of the Court of Appeal, that it makes more logical sense from the point of view of the parties that the law governing the arbitration agreement be the same as the law governing the contract as opposed to the same as the curial law governing the arbitration process. This was based on the reality that the parties were unlikely to have in mind when drafting their contract the doctrine of separability which is a legal fiction more the concern of specialist arbitration lawyers. The court did not consider the potential overlap between matters governed by the curial law and the law governing the arbitration agreement sufficient to justify a presumption that the parties would have intended they be the same.

It is clear in light of the decision that in the common situation where the parties include a broad applicable law clause that includes the whole contract within its definition and an arbitration clause providing for a different seat, the governing law clause would normally constitute a choice of law for the arbitration agreement as well. This is consistent with Kabab in which the Court of Appeal analysed the definition of “Agreement” in the contract referred to in the governing law clause and found it to be broad enough to include the arbitration agreement. It would appear in light of Enka Insaat that even where the contract does not have an express definition of the words “agreement” or “contract” referred to in the governing law clause, it can be presumed that the parties intended the law chosen to also govern the arbitration agreement. While the court in Kabab treated the former as one of express choice, the court in Enka Insaat appeared to treat the latter as a matter of implied choice. The difference is significant because an express choice ends the analysis and must be recognised without reference to other factors whereas, in the case of an implied choice, other factors pointing away from the law governing the underlying contract might lead to a different conclusion as discussed below.

¹Such guidance might technically be considered obiter but I doubt whether that will significantly undermine its value in future cases.
It is worth mentioning that there will of course be other cases where the language of the governing law clause will not be broad enough to encompass the arbitration agreement, so it is vital to interpret the specific language used.

The validation principle

What factors in a given case might overturn the presumption that the parties intended the law governing the contract to also govern the arbitration agreement? The principal factor addressed in the Supreme Court’s opinion is the common law “validation principle”, i.e., an interpretation that upholds the validity of a transaction is to be preferred to one under which the intended transaction is invalid.

This doctrine was applied (and was dispositive) in the Sulamerica case where the arbitration agreement in that case would only have been enforceable against the respondent with its permission if it was governed by the law chosen to govern the underlying contract (Brazilian law), whereas it would have been enforceable by either party under the law of the seat (English law). The Court of Appeal found that, since there was a serious risk that the arbitration agreement would be seriously undermined if governed by the law chosen to govern the rest of the contract, the parties were unlikely to have chosen that law to govern the arbitration agreement as well.

This approach was endorsed by the Supreme Court in Enka Insaat where the majority said at paragraph 109:

“"We cannot improve on the formulation of Moore-Bick, L.J. in the Sulamerica case, para 31, that commercial parties are generally unlikely to have intended a choice of governing law for the contract to apply to the arbitration agreement if there is ‘at least a serious risk’ that a choice of that law would ‘significantly undermine’ that agreement."

Therefore, in a typical case where the contract includes a choice of law clause and an arbitral seat in a different jurisdiction, absent other significant factors, the presumption in favour of the governing law of the contract is likely to be overturned where there is a serious risk that the arbitration agreement will be significantly undermined if governed by that law. That might lead to the conclusion that the parties had impliedly chosen the law of the seat or that there was no implied choice, in which case it would be necessary to determine which system of law has the closest connection to the arbitration agreement. As the Supreme Court confirmed, this would invariably lead to the law of the seat in any event.²

It is significant that in Sulamerica, had the arbitration agreement been governed by Brazilian law, it would still have been valid, however by application of Brazilian law, either party would not have been required to arbitrate the dispute that had arisen without its express further consent. This was enough for the court to conclude that the arbitration agreement would be “significantly undermine[d]” and that therefore the parties must not have impliedly chosen Brazilian law to govern it. Therefore, the way in which the validation principle was applied in Sulamerica (which was endorsed by the Supreme Court in Enka Insaat) goes beyond the pure validity of the arbitration agreement to also touch on its applicability in a given dispute. The additional formulation provided by the Supreme Court in its summary is “the existence of a serious risk that, if governed by the same law as the main contract, the arbitration agreement would be ineffective”.

The New Approach

The Supreme Court provided the following summary of the correct approach to identifying the law applicable to an arbitration agreement in paragraph 170 of the judgment in which I have highlighted the key new principles established in the judgment itself:

(i) "Where a contract contains an agreement to resolve disputes arising from it by arbitration, the law applicable to the arbitration agreement may not be the same as the law applicable to the other parts of the contract and is to be determined by applying English common law rules for resolving conflicts of laws rather than the provisions of the Rome I Regulation."
(ii) According to these rules, the law applicable to the arbitration agreement will be (a) the law chosen by the parties to govern it or (b) in the absence of such a choice, the system of law with which the arbitration agreement is most closely connected.

(iii) Whether the parties have agreed on a choice of law to govern the arbitration agreement is ascertained by construing the arbitration agreement and the contract containing it, as a whole, applying the rules of contractual interpretation of English law as the law of the forum.

(iv) Where the law applicable to the arbitration agreement is not specified, a choice of governing law for the contract will generally apply to an arbitration agreement which forms part of the contract.

(v) The choice of a different country as the seat of the arbitration is not, without more, sufficient to negate an inference that a choice of law to govern the contract was intended to apply to the arbitration agreement.

(vi) Additional factors which may, however, negate such an inference and may in some cases imply that the arbitration agreement was intended to be governed by the law of the seat are: (a) any provision of the law of the seat which indicates that, where an arbitration is subject to that law, the arbitration will also be treated as governed by that country’s law; or (b) the existence of a serious risk that, if governed by the same law as the main contract, the arbitration agreement would be ineffective. Either factor may be reinforced by circumstances indicating that the seat was deliberately chosen as a neutral forum for the arbitration.

(vii) Where there is no express choice of law to govern the contract, a clause providing for arbitration in a particular place will not by itself justify an inference that the contract (or the arbitration agreement) is intended to be governed by the law of that place.

(viii) 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 differs from the law applicable to the parties’ substantive contractual obligations.

(ix) The fact that the contract requires the parties to attempt to resolve a dispute through good faith negotiation, mediation or any other procedure before referring it to arbitration will not generally provide a reason to displace the law of the seat of arbitration as the law applicable to the arbitration agreement by default in the absence of a choice of law to govern it.

The Result

The Supreme Court found that the parties had not made a choice of law to govern the contract. Therefore, the presumption in favour of the law chosen by the parties to govern the underlying contract did not apply. Without an express or implied choice of law to govern the arbitration agreement, the court fell back on the third stage of the analysis to determine the law with the closest and most real connection to the separable arbitration agreement. This of course led to the law of the seat which, once again, was English law.

Comment

The question following the Enka Insaat decision is whether the court was returning to the “traditional approach” as it was called by Moore-Bick, J in Sulamerica which had favoured the law of the underlying contract in most cases or was it, without saying so expressly, endorsing a pure pro-arbitration approach that would ultimately favour whichever law would be most likely to result in the arbitration agreement being effective.

In my view the answer is the latter. Where the arbitration agreement is likely to be effective under either the law governing the contract or the law of the seat, the approach announced by the Supreme Court will favour the law governing the contract. But such cases are not likely to arise with much frequency. In virtually all cases where there is a meaningful dispute over which law is applicable to the arbitration agreement, it is because, on at least one party’s case, the validity or effectiveness of the arbitration agreement would be significantly undermined if subject to one law but not the other. That was enough in Sulamerica to determine the outcome and the Supreme Court in Enka Insaat endorsed this approach. If a party argues with any substantiation that the arbitration agreement is invalid or inapplicable under the law of the underlying contract, then the presumption in favour of the underlying contract is likely to be overturned and the law of the seat applied. If a party argues that the arbitration agreement is invalid or inapplicable under the law of the seat, the presumption is applied, the validation principle points in the
same direction and the law of the underlying contract governs the agreement. Either way, the result is the law under which the arbitration agreement is most likely to be effective.

In my 2012 article I expressed the concern that confusion could arise as a result of competing presumptions: one in favour of the law governing the underlying contract and one (as yet unspoken) favouring the law under which the arbitration agreement is most likely to be effective. Now that the Supreme Court has finally pronounced on these issues, the situation that concerned me has now definitively become the law. However, eight years of further caselaw and the Supreme Court’s recent decision have demonstrated that the two can operate effectively together and, indeed, in order to maintain the English system’s pro-arbitration approach, there really was no choice but to expressly endorse the validation principle as a necessary part of the analysis. This brings the English approach closer to that of jurisdictions which have codified the pro-validation approach into statute such as Switzerland.³

In any event, regardless of the complexities and nuances of sophisticated analysis, the history of the cases in this area suggests that the party seeking the application of English law to the arbitration agreement is at some advantage should the issue reach an English court. Given the pro-arbitration approach of the English courts and the benefits of English law to the arbitration process both commercial parties and arbitration practitioners should take some comfort in that. Indeed, in Enka Insaat itself, the result of the arbitration agreement being governed by English law was that the English court was in a position to determine whether the dispute fell within the scope of the agreement and therefore whether to issue an anti-suit injunction to protect the integrity of the arbitration process.

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³ See Article 178(2) of the Swiss Federal Statute on Private International Law.