Time to Re-Evaluate the Common Law Approach to the Proper Law of the Arbitration Agreement

Kluwer Arbitration Blog
July 5, 2020

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Please refer to this post as: Steven Lim, 'Time to Re-Evaluate the Common Law Approach to the Proper Law of the Arbitration Agreement', Kluwer Arbitration Blog, July 5 2020, http://arbitrationblog.kluwerarbitration.com/2020/07/05/time-to-re-evaluate-the-common-law-approach-to-the-proper-law-of-the-arbitration-agreement/

Three recent decisions of the Courts of Appeal in Singapore and England (*BNA v BNB and another [2019] SGCA 84* ("BNA v BNB"); *Kabab-JI S.A.L v Kout Food Group [2020] EWCA Civ 6* ("Kabab v Kout"); and *Enka Insaat Ve Sanayi A.S. v OOO "Insurance Company Chubb" and others [2020] EWCA Civ 574* ("Enka v Chubb")) provide an opportunity to re-evaluate the common law approach to the proper law of the arbitration agreement.[fn]The English Supreme Court will hear an appeal on Enka v Chubb between 27 to 28 July 2020.[/fn]

All three cases have been discussed on this blog previously, here, here, here, here and here. The focus in this post is whether the English common law approach, going back to the English Court of Appeal decision in *Sulamérica Cia Nacional de Seguros SA and others* v *Enesa Engelharia SA and others* [2013] 1 WLR 102 ("*Sulamérica*"), accords with the New York Convention.

English cases have vacillated between giving primacy to the substantive law of the contract and the law of the seat when implying the proper law of the arbitration agreement; with the caveat that the presumptive law may be rebutted if it invalidates the arbitration agreement. The proper law of the arbitration agreement is most significant where it is invalid under one of the possible applicable laws.

Instead of laying down a presumptive implied law, it makes more sense, and is more transparent, to apply the validation principle which expressly aims to validate the arbitration agreement. This gives effect to the parties' commercial intentions to agree an effective and workable international dispute resolution mechanism. It is also required by articles II and V(1)(a) of the New York Convention.

BNA v BNB, Kabab v Kout, Enka v Chubb

In *BNA v BNB* the Singapore Court of Appeal endorsed the three stage test in *Sulamérica* (also endorsed earlier by the Singapore High Court in *BCY v BCZ [2017] 3 SLR 357* ("BCY v BCZ")):

1. Did the parties express a specific choice of law for the arbitration agreement?
2. If not, is there an implied choice of law? (There is a rebuttable presumption the law of the main contract is the implied choice. If the arbitration agreement is invalid under this law, the fallback implied choice is the law of the seat.)
3. Failing determination of an implied choice, what law has the closest and most real connection to the arbitration agreement?

The *Sulamérica* test follows English contract law precedent for determining the proper law of contracts – it appears this was accepted as "*common ground*" and so was not argued before the court (*Sulamérica* at [9]). This departs from the New York Convention in one aspect; where no express or implied choice of law is found, the Convention provides for the default selection of the law of the seat, not the law with the closest connection – see article V(1)(a) which points to:

1. "*the law to which the parties have subjected it*" (including both express and implied choices of law); and
2. "*failing any indication thereon*", "*the law of the country where the award was made*" (i.e. the law of the seat).

While article V(1)(a) deals with awards, the same choice of law principles also apply to arbitration agreements under Art II.[fn]Gary Born, *The Law Governing International Arbitration Agreements: An International Perspective* (2014) 26 SAcLJ

814 at [30] and [59].[/fn]

The difference in the third leg of the *Sulamérica* test compared to the New York Convention may not have much import on its own. Absent an express choice, the choice of law is most likely resolved by an implied choice (as English precedent recognises, the implied choice usually also has the closest connection to the arbitration agreement (*Enka v Chubb* at [70(2)]); likewise under the New York Convention recourse to the default choice of the law of the seat is rare). However, as *Kabab v Kout* shows, reliance on English contract precedent can potentially lead to greater divergence.

In *Kabab v Kout* (at [70]) the English Court of Appeal questioned, but did not decide, whether the requirement of business efficacy for implied terms can be satisfied under the *Sulamérica* test, or the New York Convention choice of law principles, where there is a fallback default choice of either the law of the country with the closest connection or where the award was made. Counsel for Kabab submitted the *Sulamérica* test did not depend on showing the implied choice of law was necessary for business efficacy. The court queried (at [53]) whether this was correct given the Supreme Court decision in *Marks & Spencer plc v BNP Paribas Security* [2015] UKSC 72; [2016] AC 742 – where it was held a term will only be implied into a contract if it is necessary for business efficacy.

Reliance on English contract law principles conflicts with the choice of law principles in the New York Convention, which calls for consideration of an implied choice.

In *Enka v Chubb* the English Court of Appeal endorsed the three stage test in *Sulamérica* but differed on the weight to be given to the law of the substantive contract versus the seat. The court held there is a strong presumption the parties have impliedly chosen the law of the seat as the proper law of the arbitration agreement. The court gave primacy to the law of the seat for two reasons:

1. The validity, existence and effectiveness of the arbitration agreement is treated (by the separability doctrine) as separate from the main contract; therefore, the governing law should also be treated as separate (at [92] and [94]).
2. The overlap between the law governing the arbitration and the arbitration agreement (e.g. formal validity, separability of the arbitration agreement,

the power of the tribunal to rule on its own jurisdiction, application of choice of law rules) strongly suggests that they should usually be the same (at [96]).

There is, however, authority (*Sulamérica* at [26]; and see also *BCY v BCZ* at [60] and [61]) and commentary[fn]*Choosing the Law Governing the Arbitration Agreement*, Glick and Venkatesan in *Jurisdiction Admissibility and Choice of Law in International Arbitration* (2018), Kaplan and Moser, at [9.05].[/fn] that separability of the arbitration agreement is limited to its validity, existence or effectiveness and does not make the arbitration agreement an entirely separate contract. Moore-Brick LJ said in *Sulamérica* at [26]:

The concept of severability itself, however, simply reflects the parties' presumed intention that their agreed procedure for resolving disputes should remain effective in circumstances that would render the substantive contract ineffective. Its purpose is to give legal effect to that intention, not to insulate the arbitration agreement from the substantive contract for all purposes.

Also, the Model Law (article 16) and English Arbitration Act 1996 (section 7) expressly restrict separability of the arbitration agreement to its existence and validity.

Where the seat adopts the Model Law (which applies the same choice of law principles to the proper law of the arbitration agreement as in the New York Convention) the seat court is required to determine the validity of the arbitration agreement according to the law "*to which the parties have subjected it or, failing any indication thereon*" the law of the seat (article 34(2)(a)(i) of the Model Law). The law of the seat is only applied by default where there is no express or implied selection of choice of law. There is no assumption in the Model Law that the proper law of the arbitration agreement will be the same as the law of the seat (see also *BCY v BCZ* at [64]).

Even though the court said it was time to "*impose some order and clarity on this area*" (at [69]), it is not clear the decision in *Enka v Chubb* achieves this. English authority has vacillated between giving primacy to the substantive law of the contract and the law of the seat. Instead of laying down a presumptive implied law, it makes more sense, and is more transparent, to apply the validation principle as required under articles II and V(1)(a) of the New York Convention.

Conclusion on Validation Principle

In *BNA v BNB* the Singapore High Court rejected the application of the validation principle in Singapore law. The court found the validation principle:

1. Was impermissibly instrumental (*BNA* v *BNB* [2019] SGHC 142 ("BNA HC") at [53]).
2. Could be inconsistent with the parties' intentions (BNA HC at [55]).
3. Was unnecessary because Singapore law already endorsed the principle in the latin maxim *verba ita sunt intelligenda ut res magis valeat quam pereat* e. words are to be understood in a manner that the subject matter be preserved rather than destroyed (BNA HC at [62]).
4. Could create problems at the enforcement stage because article V(1)(a) of the New York Convention contains choice of law provisions for determining the proper law of the arbitration agreement, the starting point of which is the parties' intentions, whereas the validation principle seeks to validate an arbitration agreement without "*necessary regard to the parties' choice of law*" (BNA HC at [65]).

Even though the court rejected the validation principle, it appeared to apply a *validation approach* (by reading "*arbitration in Shanghai*" as designating venue only and not seat). The validation principle is not inconsistent with the parties' intentions; it gives effect to the parties' agreement to arbitrate. There is no conflict between the validation principle and article V(1)(a) (and article II) of the New York Convention as the validation principle is *derived* from the choice of law principles and pro-enforcement policy in both articles II and V(1)(a).[fn]Gary Born, *The Law Governing International Arbitration Agreements: An International Perspective* (2014) 26 SAcLJ 814 at [27], [56] and [59].[/fn]

The Court of Appeal in *BNA v BNB* did not address the application of the validation principle because it was not necessary to do so (at [95]). Since both the New York Convention and Model Law apply in Singapore, when this issue next comes before the court, argument should focus on these instruments and not English authority, which conflicts with both. It is also time for the English courts to reassess the *Sulamérica* test and its confusing progeny and realign with the New York Convention.