Kluwer Arbitration Blog

Enka v Chubb Revisited: The Choice of Governing Law of the Contract and the Law of the Arbitration Agreement

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In its recent decision of 9 October 2020 in Enka Insaat Ve Sanayi AS v OOO "Insurance Company Chubb" & Ors [2020] UKSC 38 (*Enka*), the UK Supreme Court upheld the decision of the England and Wales Court of Appeal earlier this year restraining Chubb Russia from proceeding with parallel court proceedings in Russia, but disagreed with the approach taken by the Court of Appeal to determine the applicable law of the arbitration agreement. In the absence of an express agreement of the parties on the law applicable to the arbitration agreement and where the law of main contract differs from the law of the seat, the Supreme Court gave prevalence as a matter of principle to the parties' intention when agreeing on the law of the main contract. Where the parties have (expressly or impliedly) chosen the law applicable to the main agreement, it would normally govern the arbitration agreement; in the absent of such choice, the arbitration agreement would be governed by the law of the seat as the default rule.

Background

The dispute concerns the request of Enka for anti-suit injunctions to prevent Chubb Russia from pursuing its claim initiated with the Russian courts in alleged breach of an ICC arbitration agreement, providing for London as the seat of arbitration. The underlying dispute arose out of payment by Chubb Russia of aprox. US$400 million to the beneficiary of the works in respect of damages caused by a fire at a power plant, subsequent to which Chubb Russia moved against the subcontractors, Enka included, to recover the amount paid for the insured event.

Enka filed a motion with the Russian courts seeking dismissal without consideration of the claim against it on the basis of the arbitration agreement and also sought anti-suit injunctions before the Commercial Court of London. The Russian court rejected Chubb's claim on the merits and Enka's request for dismissal without considering the merits. In the London proceedings, the Commercial Court declined to grant the injunction on *forum non conveniens* grounds.

The Court of Appeal disagreed and issued anti-suit injunction restraining Chubb

Russia from continuing the Russian proceedings. As further developed in an earlier post, the Court determined that the arbitration agreement is governed by the English law and established that under English law there is a wider approach to what amounts to a dispute falling within an arbitration clause, hence the Russian claim was brought and pursued by Chubb Russia in breach of the arbitration agreement. The Court of Appeal also held that the main contract was governed by Russian law, but not by express choice.

When deciding on the proper law of the arbitration agreement, the Court of Appeal applied the English common law rules for resolving conflicts of law and established at the second stage of the inquiry that there is an implied choice for the seat, and this would be the general rule, subject only to any particular features of the case demonstrating powerful reasons to the contrary. The previous post touches upon reasons why the arguments of the Court and departure from *Sulamérica* were far-fetched.

On 5 June 2020, the Supreme Court stayed the anti-suit injunction pending the outcome of the appeal, which allowed Chubb Russia to file an appeal against the decision of the Russian court dismissing its claim on the merits.

UK Supreme Court's decision and comments

The UK Supreme Court reached the same outcome as the Court of Appeal via a different route. In a judgment of 114 pages, with a close call of majority of three out of five, the Supreme Court overturned the decision of the Court of Appeal on the proper law, the main principles being summarised by the Court in para. 170. Essentially:

- the law applicable to the arbitration agreement will be (a) the law chosen by the parties to govern it (*Kabab-Ji* alike cases included, as discussed by the Supreme Court in paras. 43, 52, 60) or (b) in the absence of such a choice, the system of law with which the arbitration agreement is most closely connected;
- where the law applicable to the arbitration agreement is not specified, a choice of governing law for the contract will generally apply to the arbitration agreement. This would be true except in cases where any provision of the law of the seat indicates that, where an arbitration agreement is subject to that law, the arbitration will also be treated as governed by that country's law, or where there is a significant risk that, if governed by the same law as the main contract, the arbitration agreement would be ineffective;
- in the absence of any choice of law to govern the arbitration agreement, it is governed by the law with which it is most closely connected, generally the seat, if chosen by the parties, even if this differs from the law applicable to the main contract.

The majority considered the position of an implied choice for the law governing the main contract (if the latter was agreed by the parties) to provide certainty, to achieve consistency, to avoid complexities and uncertainties, and avoid artificiality (paras. 53-54). The commercial approach of the majority, that, for the commercial parties, a

contract is a contract, and that they would reasonably expect a choice of law to apply to the whole of that contract, is sensible. It is also consistent with the principle affirmed by the House of Lords in *Fiona Trust & Holding Corpn v Privalov [2007] UKHL 40*, that the "construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of their relationship into which they have entered or purported to enter to be decided by the same tribunal". The majority did not agree with the Court of Appeal argument that the principle of separability is relevant in the assessment. The majority also disagreed with the Court of Appeal that relied *inter alia* on *XL Insurance Limited v Owens Corning [2001]* in what is referred to as the "overlap argument", that, by stipulating for arbitration in London under the provisions of the Arbitration Act 1996, the parties had impliedly chosen English law to govern the validity of the arbitration agreement despite the choice of another law as the governing law of the main contract. The court held that the provisions of the Arbitration Act 1996 do not justify any general inference that parties who chose an English seat of arbitration thereby intend their arbitration agreement to be governed by English law (paras. 73-94).

The Supreme Court took this opportunity to expressly confirm the existence of the validation principle under English law in those cases where the arbitration agreement would be deemed invalid (para. 97). So far the English courts have only alluded to the validation principle (e.g. *Sulamérica* at [30, 31], *XL*, also *Hamlyn & Co v Talisker Distillery* [1984], *Enka* at [71]). The Supreme Court relied on the principle of contractual interpretation that the contract should be interpreted so that it is valid rather than ineffective, "*verba ita sunt intelligenda ut res magis valeat quam pereat*", and on the need to ensure the commercial purpose of the arbitration clause (as commercial parties are generally unlikely to have intended a choice of governing law for the contract to apply to an arbitration agreement if there is "at least a serious risk" that a choice of that law would "significantly undermine" that agreement (*Sulamérica,* at [31]), which should be interpreted on a case-by-case basis. This issue was not decided in the case at hand, as Chubb did not challenge the enforceability or the validity of the arbitration agreement, rather the only question was as to its scope and whether the dispute fell within it. However, this is an important point relevant for future cases.

At the third stage of the inquiry, if there is no choice of the parties (expressly or implied) of the law applicable to the arbitration agreement, the court must objectively determine with which system of law the arbitration agreement has its closest connection. The majority held that the arbitration agreement is most closely connected with the law of the seat if the parties had chosen one. This is so because the seat is where the arbitration agreement is to be performed and this is the most used connecting factor. Also, this is consistent with international law and legislative policy, such as the New York Convention, and it gives effect to commercial purpose.

The arguments referring to the New York Convention, that the majority found compelling reason for treating an arbitration agreement as governed by the law of the seat of arbitration in the absence of choice, will probably be considered a welcome development by those advocating that English courts ought to realign with the New York Convention (according to which absent an agreement of the parties, the

applicable law of the arbitration agreement is the law of the seat, Article V1(a) of the New York Convention; the same in Article 34 2a(i) of the UNCITRAL Model Law).

The argument of the majority, that a reason for applying the law of the seat as a default rule in the absence of a(n express or implied) choice is giving effect to commercial purpose, is an important argument as well, as ultimately parties chose a neutral seat of arbitration that is expected to be supportive of arbitration. When parties chose London as the seat of arbitration, like in *Enka*, they might consider *inter alia* that English courts are known for adopting a pro-arbitration approach and are most likely to grant anti-suit injunctions in support of arbitration by precluding the enjoined party to continue court proceedings in breach of the arbitration agreement. The ultimate purpose is for the parties' commercial agreement to arbitrate to be upheld and parallel litigation prevented.

At the second stage of the inquiry there is an implied choice of the law applicable to the arbitration agreement in favour of the law applicable to the main contract (as opposed to the seat, favoured by the Court of Appeal at this stage). The approach of the Supreme Court is sensible, as it gives prevalence to the intention and choice of the parties, in a process of contractual interpretation. On the other hand, the process of determining at the third stage which is the system of law with which the arbitration agreement has its closest connection is different in nature, as it involves the application of a rule of law in an objective process applied irrespective of the parties' intention.

Applying the above principles to the case at hand, the majority first held, contrary to the Court of Appeal, that the parties have not expressly or impliedly chosen a law to govern the main agreement. Given this, the Supreme Court moved to the third stage of the inquiry and applying the default rule it concluded that the arbitration agreement is governed by the English law, as this is the system of law with which the arbitration agreement is most closely connected, the seat being London.

The analysis of the proper law of the arbitration agreement, even if theoretically fascinating by itself, carries practical consequences, which, in this case refer to the inquiry of whether there has been a breach of the arbitration agreement and whether it is just and convenient to restrain that breach by the grant of anti-suit injunction. As concluded by the Supreme Court, this is to be done under English law. If the Russian law would have governed the arbitration agreement, the English court would have had to determine if under the laws of Russia the arbitration agreement is valid and if the claim by Chubb Russia falls within its scope.

It appears that the parties engaged in extensive submissions on the principles and authorities guiding the determination of the proper law of the arbitration agreement and lost sight of the purpose of these submissions which ultimately was whether the Russian court proceedings were initiated by Chubb Russia in breach of the arbitration agreement and if so, whether anti-suit injunction was warranted to prevent it from pursuing the court proceedings allegedly in breach of the arbitration agreement or not. Chubb Russia did put forward that the arbitration agreement is governed by the Russian law hence the Russian courts are best placed to decide whether or not the arbitration agreement applies to the court claim in Russia, and, as a matter of comity

or discretion, the English courts ought not to interfere with the proceedings by granting the requested injunction. However, it did not put forward an alternative case for the English law governing the arbitration agreement and hence it did not dispute that it was legitimate for the Court of Appeal to exercise discretion whether to grant anti-suit injunction.

The practical take, with the risk of stating the obvious, is that the parties should treat the dispute resolution clause carefully and make an informed decision as to the consequences of choosing or not an applicable law of the arbitration agreement. This also includes a weighted choice of the seat of arbitration, in particular when the law governing the contract and the law at the seat do not converge.

This entry was posted on Sunday, October 11th, 2020 at 9:00 am and is filed under Anti-

suit injunction, Arbitration Agreement, Choice of Law, English courts, International arbitration, Law governing the arbitration agreement, Proper law of arbitration agreement, UK Supreme Court, Validation

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