NOTE FOR THE LAW COMMISSION

POTENTIAL REFORM OF THE ARBITRATION ACT 1996 ("THE ACT") ARISING OUT OF THE RECENT INTERPRETATION OF SECTION 4(5) OF THE ACT IN *ENKA V CHUBB* [2020] UKSC 38

A. Introduction

1. In its decision of 9 October 2020, the Supreme Court decided *inter alia*:

   (a) That, applying English conflict of laws rules, where the Parties to a contract containing an arbitration agreement have made an express choice of law to govern their contract generally, that choice will ordinarily apply to the arbitration agreement; and

   (b) Separately, that that choice of law would – by the effect of section 4(5) of the Act – displace the default provisions of the Act for all non-mandatory sections of the Act (i.e. all sections of the Act, save for those listed in Schedule 1: see section 4 of the Act).

2. With respect to the first decision (effectively preferring the *lex contractus* to the law of the seat as the default rule in the absence of an express choice of law in the arbitration agreement – which very seldom happens in practice), from an international arbitration point of view, one could argue – with the utmost respect – that the analysis is overly contractual, and fails to recognise the transition of arbitration law from contract to (a policy-driven) status post-the 1996 Act, in which the role of the applicable law of the arbitration agreement is principally to determine whether the requisite adhesion to some aspects of that regime has taken place.[1] But, in terms of pure English conflict of laws, the analysis is – as discussed – perfectly plausible and that first decision is not *per se* the subject of this Note.

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[1] See in that respect, *Mustill & Boyd, Companion Volume* at Part I.G.6 : "Conceptually … the Act marks a radical change of direction. No longer are the internal rules to be derived by analysing the contracts between the parties *inter se* and between themselves and the arbitrators. The arbitral process is still consensual to the extent that the proceedings would not take place but for the agreement to arbitrate. But by making this agreement the parties contract into a framework, not chosen by themselves but imposed by Parliament, save only to the extent that they avail themselves of the opportunity to depart from the semi-mandatory provisions."

3. As for the second decision, relating to the effect of section 4(5), the position prior to the *Enka* judgment was, per Longmore LJ in *C v D* [2008 Bus LR 943 at para. 19 (applied by Burton J in *NIOC v. Crescent* [2016] 2 Lloyds' Rep. 146 at paras. 12-18) that *"there has to be a choice of law with regard to the specific provision of the Act which the parties agree is not to apply"*; and it is respectfully submitted that the change operated by *Enka* is problematic when allied to the default rule in favour of the *lex contractus*, and will give rise to serious practical problems which must be addressed.

4. In particular:

   (a) The Supreme Court in *Enka* specifically held that one of the non-mandatory provisions which will be displaced by a general choice of foreign law is section 7 of the Act which provides for separability: see *Enka* at para. 90 (and 87) specifically holding that both *C v D* and *NIOC v. Crescent* were wrong on this point. This means that, in every arbitration seated in England & Wales where the contract contains a foreign choice of law, separability will be governed by that foreign law, and not by section 7 of the Act. As explained below, this poses (i) conceptual problems; and (ii) (more importantly) practical problems which can best be visualised by positing a scenario such as that which arose in the *NIOC* case, where it was contended (by reference to expert evidence of Islamic law) that separability did not exist under the foreign law. Similar issues arise with respect to questions of scope of the clause, and arbitrability.

   (b) Entirely separately, the Supreme Court in *Enka* expressly recognised that its (new) interpretation of section 4(5) would lead to the need to characterise all non-mandatory provisions of the Act as either 'procedural' or 'substantive' in order to determine whether the matter dealt with by that section falls to be governed by the default provisions of the Act as the *lex arbitri* or by the chosen foreign law as the law governing the arbitration agreement: see *Enka* at para. 80. The Court expressly recognised that (in the words of the DAC) that is an *"extremely difficult and complex"* exercise but nonetheless felt that this was the clear legislative intent behind section 4(5) and thus had to be given effect to. This raises the prospect of having to argue out this notoriously vexed distinction on (potentially) every non-mandatory provision of the Act going forward. That cannot, it is submitted, be a desirable position.

5. These two issues are considered sequentially below, before turning to potential solutions.

B. Separability and related issues

6. As just noted, the position post *Enka* is that in every arbitration with an English seat but a foreign choice of substantive law (a very common scenario), the question of whether – and to what extent – the arbitration agreement is separable from the main contract will fall to be governed by the chosen foreign law and not by section 7 of the Act (and thus by *Fiona Trust* principles).

Conceptual difficulties

7. Conceptually, this places separability on a par with, say, questions as to the scope *ratione materiae* or *ratione personae* of the arbitration clause which everyone accepts may well be governed by a foreign law in an English-seated arbitration; and section 2(5) of the Act – which specifically contemplates that section 7 may apply to a foreign-seated arbitration if English law governs the arbitration agreement – could be said to be consistent with such an approach. But separability is usually treated together with the concept of *competence competence* in all arbitration laws and rules (see e.g. UNCITRAL Model Law, Article 16; UNCITRAL Arbitration Rules 2010, Article 23(1); LCIA Rules 2020 Article 23.2; ICC Rules 2021, Article 6), and in academic commentary (see e.g. the seminal article by Prof. Rusty Park, *The Arbitrator's Jurisdiction to Determine Jurisdiction*, ICCA Congress Series, Volume 13 pp. 55 – 153) and does not arguably rest at the same conceptual level as (e.g.) matters of scope of the arbitration agreement. That is consonant with the manner in which it is treated under (for instance) French law[2] or Swiss law[3].

8. Indeed, it could be said that the very reason why a separate conflict of laws analysis is required for the arbitration agreement (separate from that which one would apply to the main contract) is separability; and the *Enka* Supreme Court took into account the effect of section 7 of the Act in its conflict of laws analysis (at para. 40-41) only to reach a conclusion that would disapply that premise in a great number of cases.

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2 In France, the concept of separability is subsumed in the wider material rule (*règle matérielle*) of *'autonomie de la clause d'arbitrage'* which applies to every arbitration seated in France (and which the French courts apply whenever they hear an international arbitration matter, irrespective of is seat).

3 Article 178(3) of the Swiss Private International Law Act postulates a material rule of Swiss law that "[t]he validity of an arbitration agreement may not be contested on the grounds that the main contract is invalid (...)". While it is generally thought that that provision could be contracted out of, that cannot happen through a general choice of law clause in the main contract.

9. Further, even authors such as Gary Born who do not accept this conceptual distinction but would found separability on pure contractual intention, expressly recognise separability as an international principle applicable to all commercial contracts, stemming from the expectations and intentions of the parties that they would expect the arbitration clause to remain effective. So that, even if one were to start from that (purely contractual) premise, separability remains a fundamental principle that ought not to be displaced without the clearest possible expression of intent.

Practical difficulties

10. Beyond those conceptual difficulties, and more importantly, the practical difficulties which arise from the automatic displacement of section 7 by a general choice of foreign law are substantial. Let us posit an English seated arbitration with a choice of foreign law (say of Iran or of Venezuela) which – it is contended – does not know of separability. That is a common scenario in practice (as the NIOC case shows), as a foreign investor will often insist on a neutral arbitral seat, while being prepared to concede a choice of a less stable foreign law (such as that of the State with which it is transacting). This will mean that each and every allegation against the main contract – such as allegations of fraud or corruption – will fall to be entirely relitigated before the English Court as they will be jurisdictional in nature; the very result which *Fiona Trust* was designed to obviate. Is that a desirable outcome and – more importantly – do parties who choose to arbitrate in London expect such a result?[4]

11. Yet further, and relatedly, what is to happen where Iranian law (say) applies to separability and does not recognise separability but the arbitration is otherwise proceeding under arbitration rules which call for the application of the same (as they now all do – see e.g. ICC Rules 2021 Article 6(9); LCIA Rules 2020 Article 23.2; UNCITRAL Rules 2010 Article 23(1))? One then gets into nice arguments as to which regime (that of the chosen law or that of the chosen arbitration rules) prevails; and/or whether the peculiar concept of (non)-separability under the chosen foreign law is mandatory or not under that foreign law? Again that does not seem to be a desirable outcome or one which parties who have chosen to arbitrate in London under commonly used arbitral rules would expect.

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[4] To spell this out in some more detail for the sake of clarity, in the scenario posited: (1) London is the seat; (2) but the chosen foreign law is the applicable law of the contract; (3) therefore an English court would hold that the foreign law governs, in particular, the question of whether there is separability; (d) if (as posited) that foreign law has no doctrine of severability, fraud or corruption in entering the main contract vitiates not only the contract but also the arbitration clause itself; (e) therefore a party alleging that the contract was obtained by fraud or corruption can challenge the jurisdiction of the arbitrators on that basis. It follows that the alleging party will have the right to request the court to decide anew whether the contract was concluded by fraud or corruption as a jurisdictional question under section 67 of the Act. It does not appear that these direct consequences of the decision reached in *Enka* were brought to the attention of the Supreme Court.

12. A similar point can be made about the scope of the arbitration clause. Today, the principle of one-stop adjudication according to which the expectations of all reasonable business persons is that all of their disputes will be resolved by way of arbitration absent clearly contrary language has become a fundamental principle of international arbitration, and one of the key attractions of London as a state-of-the-art arbitral seat. This was recognised by the House of Lords in *Fiona Trust* when it did away with the former literalist approach to the interpretation of arbitration clauses and the old distinctions between different language used in arbitration clauses ("under", "arising out of" or "in connection with"): as a matter of English law, applying *Fiona Trust*, if parties truly wanted to contract out of that fundamental principle, it would have to be by express agreement and in the clearest terms. But the situation post *Enka* is now that that question (interpretation of the clause) will ordinarily be governed by a foreign law with its own idiosyncrasies of interpretation so that users of English arbitration no longer have any certainty in this respect.

13. Similar concerns arise with arbitrability. There are many species of international transaction which, in practical terms, require the choice of the law of one of the parties ("the host law") because of their subject-matter – in particular share and pledge transactions, other forms of security etc. The choice of international arbitration with a seat in a "pro-arbitration" jurisdiction such as England and Wales provides at least some protection for the non-host party in that scenario, and reduces its exposure to the host courts and to species of claim which can only be brought in the host courts. However, some of the intended benefits of that choice may be lost if the law chosen to govern the contract also governs the arbitration agreement, because the fact that particular types of dispute are, as a matter of public policy of the host law, not arbitrable will reduce the scope or efficacy of the arbitration agreement; or indeed potentially obliterate the efficacy of the arbitration agreement altogether.

14. Relatedly, the anecdotal evidence from the Commercial Court is that *Enka* has involved practical difficulties for the Commercial Court as the curial court, introducing an additional layer of cost and complexity in relation to the content of foreign law on applications under sections 44, 67 and 72 of the 1996 Act. That is a matter which could be checked further with the Commercial Court.

C. The introduction of a need to characterise every non-mandatory provision of the Act as 'procedural' or 'substantive'

15. Secondly, and separately, the *Enka* decision has introduced a need to characterise every non-mandatory provision of the Act as 'procedural' or 'substantive'. The majority in *Enka* addressed this issue as follows, at para. 80:

> "We observe that the "recasting" carried out on the recommendation of the DAC did not remove the need individually to characterise the provisions of the Act as substantive or procedural (or partly substantive and partly procedural) whenever the applicable law is in issue - an exercise described by the DAC as "extremely difficult and complex". Nevertheless, the legislative history confirms that sections 2 and 4(5) of the 1996 Act as enacted were intended to have the effect that, where England is chosen as the seat of an arbitration but the arbitration agreement is governed by a foreign law, the non-mandatory provisions of the Act do not apply to any matter concerning the parties' substantive rights and obligations under the arbitration agreement. The fact that the Act contains some provisions which are substantive, or partly substantive, cannot therefore - where those provisions are non-mandatory - support an inference that, by choosing an English seat of arbitration, parties must be taken to have contemplated and intended that the validity and scope of their arbitration agreement should be governed by English law."

16. The majority in *Enka* went on to state (at para. 81) that *"[t]he only mandatory provisions of the 1996 Act are sections 12, 13 and 66 to 68"*. It is not clear what this statement is based on given that Schedule 1 of the Act (which lists the mandatory sections of the Act) contains a great number of further sections.[5] Be that as it may, there will in practice be a number of non-mandatory provisions of the Act such as those dealing with remedies and interest (sections 48 and 49, which were at issue in *Lesotho Highlands Development Authority v. Impregilo SpA* [2005] UKHL 43), section 46 (stipulating which substantive law is to be applied by the Tribunal) or section 58 (stipulating for the binding effect of awards under the Act, which was at issue in *C v D*, supra) which will now fall to be characterised as 'procedural' (in which case the relevant section will apply as the *lex arbitri*) or substantive (in which case it will be supplanted by the relevant rule of the *lex contractus*).[6] It is difficult to see what good the introduction of this

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5 Viz. "sections 9 to 11 (stay of legal proceedings); section 12 (power of court to extend agreed time limits); section 13 (application of Limitation Acts); section 24 (power of court to remove arbitrator); section 26(1) (effect of death of arbitrator); section 28 (liability of parties for fees and expenses of arbitrators); section 29 (immunity of arbitrator); section 31 (objection to substantive jurisdiction of tribunal); section 32 (determination of preliminary point of jurisdiction); section 33 (general duty of tribunal); section 37(2) (items to be treated as expenses of arbitrators); section 40 (general duty of parties); section 43 (securing the attendance of witnesses); section 56 (power to withhold award in case of non-payment); section 60 (effectiveness of agreement for payment of costs in any event); section 66 (enforcement of award); sections 67 and 68 (challenging the award: substantive jurisdiction and serious irregularity), and sections 70 and 71 (supplementary provisions; effect of order of court) so far as relating to those sections; section 72 (saving for rights of person who takes no part in proceedings); section 73 (loss of right to object); section 74 (immunity of arbitral institutions, &c.); section 75 (charge to secure payment of solicitors' costs)."

6 Another example would be *competence competence* under section 30, another non-mandatory section. If, as held by the *Enka* Court, separability under section 7 is substantive and thus displaced by the choice of foreign law, it must be arguable that the related concept of *competence competence* is also substantive and so displaced. Take a London seated arbitration under a contract governed by French law. Does the French law doctrine of negative *competence competence* (which provides that the court of the seat must not hear questions of jurisdiction until the arbitral tribunal has ruled on them) apply? If so, how does that interplay with section 9 of the Act, which is mandatory and which

notoriously vexed distinction, and the prospect of litigation regarding its application to a number (if not all) of the non-mandatory provisions of the Act, can bring to the stability or repute of London as a seat for international arbitration.

D. Possible solutions

17. It is respectfully submitted that the easiest solution, and that which would be most consonant with the nature of English arbitration, would be to introduce a default rule in the Act according to which the law applicable to the arbitration agreement for all arbitrations seated in England or Wales will be that of England and Wales, save where the parties expressly stipulate otherwise in the arbitration agreement itself. As to this:

(a) It would be important to make it clear that this choice of default rule is being made not to depart from, or cast any doubt on, the conflict of laws analysis set out in the judgment of the majority in *Enka*, but for pure policy reasons. While that analysis may, with respect, be perfectly sound as a matter of pure English conflict of laws, it leads to results which are not consonant with the continued development of international arbitration in our jurisdiction.

(b) While English lawyers do not 'do' theory, others around the world do, and have up to now looked to English arbitration as the epitome of the traditional or 'territorial' approach to international arbitration[7] and been

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has consistently been interpreted as leaving the English courts with a case management discretion as to whether to hear the jurisdictional issue before the tribunal, concurrently with it, or after it (see e.g. *Birse Construction v. St David* [1999] BLR 194; *Albon v Naza Motors* [2007] 2 Lloyds' Rep. 1)?

7 In his seminal Hague Lecture of 2007 on the *Aspects philosophiques de l'arbitrage international*, Professor Gaillard posits three alternative models, or conceptual frameworks, for international arbitration: (i) the territorial model; (ii) the multilocalised, or Westphalian, model; and (iii) the delocalised, or transnational, model. The 'territorial conception' is by far the most traditional of the three. The *locus classicus* for this point of view remains the late Doctor Francis A Mann's article of 1967, *Lex Facit Arbitrum*. In the debate which he was then having with (French) Professors Goldman and Fouchard as to the alleged existence of an autonomous 'arbitral legal order', Dr Mann identified the issue as going to the very root of arbitration: is arbitration an autonomous process created by the parties' will, or is it a limited process existing solely through a State's derogation from its sovereign power to render justice? His answer was unambiguous: *" ... it would be intolerable if the country of the seat could not override whatever arrangements the parties may have made. The local sovereign does not yield to them except as a result of freedoms granted by himself."* In other words, arbitration can only exist within the legal framework of a given State, that of its seat. It is fundamentally territorial in nature and is anchored in the national legal order of the seat. It is clear that this territorial conception of international arbitration remains prevalent in a number of legal systems today. England remains a prime example, as do most Commonwealth jurisdictions.

prone to follow English law as a result. The proposed default rule (which already exists in Scotland) would be consonant with that territorial nature, anchoring the arbitration agreement at the seat of the arbitration from whence it is deriving its mandatory effect, and ensuring the plain and smooth application of the entire regime of the Act save where the parties have plainly and deliberately opted out of it (e.g. by expressly stipulating for a choice of foreign law in their arbitration agreement).

(c) A default law of the seat rule will also ensure that the expectations of both parties will be met i.e. that all disputes relating to their contract will be resolved by arbitration, without the arbitration clause being undermined by attacks on the main contract, without fine distinctions arising regarding the interpretation and scope of the arbitration clause under a foreign law, and without issues of arbitrability arising from a host law disrupting the parties' choice of a neutral and safe arbitral seat. If the parties seriously intended to depart from these expectations, then the onus would be on them specifically to provide for that. In other words, the proposed default rule not only meshes with party autonomy but also ensures that the neutrality of the seat chosen by the parties has its intended effect (which is to avoid host state law undermining the arbitration).

18. Alternatively, one could 'fix' section 4(5) alone by amending it to revert back to the pre-*Enka* position. This could be along the following lines (amendments underlined): "The choice of a law other than the law of England and Wales or Northern Ireland as the applicable law in respect of a <u>specific</u> matter provided for by ~~a~~ <u>one or more specific</u> non-mandatory provision of this Part is equivalent to an agreement making provision about that <u>specific</u> matter. For this purpose the choice 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" This fix will however not ensure the comprehensive solution ensuring a smooth functioning of the Act which the default rule proposed in paragraph 17 above will.[8]

19. In the yet further alternative, one could 'fix' the separability problem alone by making section 7 mandatory. But that would not deal with the many further problems noted above and might attract unnecessary attacks from those who would rather keep it notionally non-mandatory in the name of party autonomy. The problem is not with separability potentially being disposed of by agreement of the parties, but with that happening through the mere insertion of a general choice of foreign law in the contract.

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[8] And this fix will in any event be required even with that default rule to cater for cases where the parties have opted out of the default rule.

20. In conclusion, it is respectfully submitted that, if not fixed now, the issues identified in this Note – which did not exist until the judgment of the majority in *Enka* – will provide fertile ground for litigation in years to come, to the detriment of the predictability of English arbitration law and of the stability of London as a seat for international arbitration.

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