HKIArb Webinar:
"Determining the Law of International Arbitration Agreements - new insight from the UK Supreme Court"

Thursday, 24 February 2022 | 6:00pm (HKT)

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Webinar Plan

1. To consider the notion of the governing law of an arbitration agreement;
2. To consider the facts, legal principles and application of the judgment in Enka Insaat Ve Sanayi AS –v- OOO Insurance Company Chubb [2020] UKSC 38
3. To consider the facts, legal principles and application of the judgment in Kabab-Ji SAL (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent) [2021] UKSC 48
4. Takeaway Points
5. Implications for Hong Kong

Key Question

Where a contract specifies its governing law, but is silent as to the governing law of the arbitration agreement, the question arises as to which law governs the arbitration agreement – the governing law of the contract, or the law of the seat?

Enka Insaat Ve Sanayi AS –v- OOO Insurance Company Chubb [2020] UKSC 38

The appeal concerned the determination of the law applicable to an arbitration agreement in the following terms:

- *If [the matter cannot be resolved by negotiations], the Dispute shall be referred to international arbitration as follows:*
- *the Dispute shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce,*
- *the Dispute shall be settled by three arbitrators appointed in accordance with these Rules,*
- *the arbitration shall be conducted in the English language, and*
- *the place of arbitration shall be London, England.*

No express choice of law had been made to govern the arbitration agreement, and the main contract contained no express governing law clause.

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Enka II : The UK Supreme Court (UKSC) Decision - Lords Hamblen, Leggatt and Kerr (majority)

The UKSC held that the parties had not chosen, either expressly or impliedly, a choice of law governing the main contract; and considered that this was unlikely to have been accidental but, rather, that the parties had not been able to agree on a choice of the governing law. The law governing the arbitration agreement was, therefore, to be construed by reference to the place with which it had the '*closest and most real connection*' under the English common law rules. Although the UKSC, like the Court of Appeal, concluded that the law applicable to the arbitration agreement was English law, it differed significantly in its approach to the determination of the issue.

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Enka III: The Putative Applicable Law of the Contract – Determined by the Law of the Forum

In determining whether a contract said to be governed by a foreign system of law is valid, the court applies the "*putative applicable law*", i.e., the law which would govern the contract if it were validly concluded. This requires a backwards theoretical analysis.

The common law rules alone apply - a contract (or relevant part of it) is governed by: (i) the law expressly or impliedly chosen by the parties; or (ii) in the absence of such choice, the law with which it is most closely connected.

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Enka IV

The UKSC, differing from the approach of the Court of Appeal, clarified the position at [34] that the proper approach is:

…"to apply English law as the law of the forum. Where the question is whether there has been a choice of the law applicable to an arbitration clause, the relevant English law rules are the common law rules which require the court to interpret the contract as a whole applying the ordinary English rules of contractual interpretation. The main contract law, if different, has no part to play in the analysis."

Enka V: Dépeçage and the Doctrine of Separability

Whilst English law recognises the conflicts of law principle of dépeçage, the common law will not "*split a contract in this sense readily or without good reason*" (*Kahler v Midland Bank Ltd* [1950] AC 24, 42 per Lord MacDermott; cited at [39]).

The general principle is that, unless there is good reason to conclude otherwise, all the terms of a contract are governed by the same law and applies to an arbitration clause, as it does to any other clause of a contract. Where there is a clear choice of law governing the main contract, this generally is to be construed as applying to an arbitration agreement set out or otherwise incorporated in the contract.

Rather, the doctrine of separability requires that an arbitration agreement is to be treated as distinct from the main contract only for the purpose of determining its validity or enforceability.

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Enka VI

This position is clearly set out at [62]:

"Descriptions of an arbitration clause as, for example, "collateral to the main contract in which it is incorporated" (Paal Wilson & Co A/S v Partenreederei Hannah Blumenthal (The Hannah Blumenthal) [1983] 1 AC 854, 917, per Lord Diplock) or "a separate contract, ancillary to the main contract" (Bremer Vulkan Schiffbau und Maschinenfabrik v South India Shipping Corpn Ltd [1981] AC 909, 998, per Lord Scarman) need to be seen in their context as ways of expressing the doctrine that the discharge by frustration (or for other reasons) of the substantive obligations created by the contract will not discharge the parties' agreement to arbitrate."

Enka VII: Is choice of an English seat an implied choice for English law to govern the arbitration agreement?

It is rare that an express choice of law is identified in respect of an arbitration clause; it is common for such express choice to be made in respect of the contract as a whole. The difficulty of the Enka case was, however, that no such express choice had been made for the contract as a whole.

As a general rule, there is a strong presumption that the parties have impliedly chosen the law of the seat of the arbitration to govern the arbitration agreement (cited at [59]).

Enka VIII: Implied Choice of Law Under The Arbitration Act 1996 and the Common Law of Contract

The UKSC noted that the arbitration laws of several other jurisdictions, notably Scotland and Sweden, provide that a choice of seat amounts to an implied choice of law to govern the arbitration agreement. In contrast, however, the Arbitration Act 1996 contains no such provision, and section 4(5) and its legislative history (discussed at [76]-[80]) specifically provides for a situation in which the arbitration agreement will be governed by a foreign law, notwithstanding that English law governs the arbitration process [73]. No inference could, therefore, be drawn by reference to the Arbitration Act 1996 that the parties impliedly chose English law to govern the arbitration agreement by choosing an English seat for the arbitration.

Note: The Arbitration Ordinance (Cap.609) does not contain such provision.

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Enka IX: The Validation Principle

By contrast, under the '*validation principle*' of English contractual interpretation, the courts may find an implied choice of English law to govern an arbitration agreement if such construction would uphold its validity, rather than defeat its purpose and/or render it null and void. There is a very powerful inference that the parties could not rationally have intended another law to govern the arbitration agreement if the arbitration agreement would be void or of no legal effect under that law.

The Court at [109] endorsed the formulation of Moore-Bick LJ in *Sulamérica* at [31], that 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.

Enka X: The Default Rule Under the "Closest Connection" Test

As the parties had not made any choice of the law governing the arbitration agreement, either expressly or impliedly, the UKSC applied the third limb of the common law rules, i.e. the "*closest and most real connection*" test. The Court noted that this operates as a positive principle of law: if the court cannot ascertain an intention – express or implied – of the parties as to the law which is to govern their agreement:

…"it becomes necessary for the court to proceed to the second stage, of determining itself what is the proper law applicable… this is applied as a positive rule of English law. It is applied not because it is the choice of the parties themselves but because they never intended to exercise their liberty to make a choice or, if they did, they have failed to make their choice clear. (Cie Tunisienne de Navigation SA v Cie d'Armement Maritime SA [1971] AC 572, 603-604, per Lord Diplock, cited at [36])."

Kabab-Ji SAL (Lebanon) (Appellant) v Kout Food Group (Kuwait) (Respondent) [2021] UKSC 48

The UKSC reached the same conclusion as in Enka in the context of enforcement of an arbitral award. In a decision that directly contradicted the findings of the Paris Court of Appeal in parallel annulment proceedings, the UKSC found that the arbitration agreement was governed by English law, being the governing law of the contract - not French law, being the law of the seat, as found by the Paris Court of Appeal.

The case related to a Franchise Development Agreement ("FDA") between Kabab-Ji SAL (Lebanon) ("Kabab-Ji") and Al Homaizi Foodstuff Company ("AHFC"), a subsidiary of Kout Food Group (Kuwait) ("KFG"). A dispute relating to the FDA arose and Kabab-Ji commenced arbitration proceedings against KFG.

II: Kabab-Ji (Facts – continued)

The FDA was expressly governed by English law and contained an arbitration agreement, which provided that the seat of the arbitration would be Paris and that ICC Rules would apply. It did not specify the applicable governing law but stated that "[t]he arbitrator(s) shall also apply principles of law generally recognised in international transactions". The parties agreed that that this referred to the UNIDROIT Principles of International Commercial Contracts. The FDA included 'no oral modification' clauses.

The arbitral tribunal found that French law was the governing law of the arbitration agreement and applying French law KFG was a party to the arbitration agreement. Parallel proceedings were brought by KFG in Paris to annul the award and by Kabab-Ji in England to enforce it.

III: Kabab-Ji (The Judgment)

In a unanimous judgment, the UKSC found in favour of KFG and held that:

(1) English law governed the validity of the arbitration agreement;

(2) Under English law, there was no real prospect that a court would find KFG had become a party to the arbitration agreement; and

(3) Procedurally, the Court of Appeal was justified in giving summary judgement refusing recognition and enforcement of the award.

IV: Kabab-Ji (The Reasoning of the law governing the arbitration agreement)

The UKSC referred to the summary in Enka of Article V(1)(a) of the New York Convention which established that the validity of an arbitration agreement is governed by (a) the law chosen by the parties; and (b) in the event no choice has been made, the law of the country where the award is made.

In Kabab-Ji, the Court confirmed that the principle in Enka that where an arbitration agreement does not specify the applicable governing law, a choice of governing law in the contract containing the arbitration agreement would generally be sufficient indication of the governing law. The UKSC also held that this principle applied not only prior to the issuance of the award but also at the enforcement stage. The governing law specified in the FDA, which was English law, was the applicable law of the arbitration agreement.

Takeaway Points

(1) The English law approach to determining the law applicable to an arbitration agreement is now clear, as first confirmed by the Enka decision and now by the Kabab-Ji decision, having previously been unresolved for many years.

(2) There remains uncertainty at the international level. The Paris Court of Appeal considered the award in Kabab-Ji and reached the opposite conclusion on which governing law applied to the parties' arbitration agreement.

(3) In order to achieve certainty, contracting parties should ensure that they identify the law specifically governing their arbitration agreement, whether or not that is the same law that governs the main contract.

(4) Contracting parties should not assume that the law of the seat will govern the validity of the arbitration agreement, particularly as a matter of English law.

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Implications for Hong Kong

Hong Kong case law would suggest that the Courts may take a similar approach to UKSC. In Klockner Pentaplast Gmbh –v- Advance Technology [2011] 4 HKLRD 262 the Court held "*the starting point must be the terms of the particular clause and the contract in question. First, the contract between the parties including the arbitration clause must be examined to see if there is any agreement, express or implied, by the parties as to both the proper law of contract, or the lex arbitri. It is only if agreement cannot be found that the implication arises from the choice of seat, that the law of that place will be the lex arbitri.*" Taking into account a) the governing law, which was German law as agreed in the contract, b) the parties' agreement that the third arbitrator shall be admitted to practice law in Germany, and c) the fact that the governing law and the arbitration clause were under the same heading, "Governing Law and Jurisdiction," in the contract, the High Court determined that the parties impliedly intended that the governing law of the arbitration agreement should be the law of Germany, *i.e.*, the governing law of the contract.

II: Implications for Hong Kong

However, Johnston and Harris, in The Conflict of Laws in Hong Kong, 3rd Ed suggest that based on the legitimate commercial expectation and separability principles, "if the contract contains a governing law clause and identifies a place of arbitration, then the Hong Kong court should conclude that the arbitration agreement is governed by the law of the place of the arbitration".

The authors opine that the conclusions of the case law are wrong as they are based upon older English decisions handed down before the commencement of the Arbitration Act 1996. They do however agree that in the absence of an express or implied choice of governing law under the contract, but the arbitration agreement expressly or impliedly identifies a place of arbitration, then a Hong Kong court should conclude that the arbitration agreement is governed by the law of the place of arbitration – in accordance with Enka.

Q&A

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