

Reform of arbitration law: the Law Commission's consultation on Enka

A consultation by the Law Commission is underway to determine whether it is necessary to tweak the English Arbitration Act 1996. So far, the consultation responses largely have been along the lines expected, albeit with diverging views expressed on some proposals, and widespread agreement on others such as the summary procedure proposal. One additional proposal has, however, been made by 31 of 118 consultees and has just made its way into the Second Consultation Paper published in March 2023.

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This is on the question whether the decision of the Supreme Court in Enka Insaat ve Sanayi AS v OOO "Insurance Company Chubb" [2020] 2 Lloyd's Rep 449 should be allowed to stand. The issue is here considered by Caroline Thomas, Professor Kabir Duggal and Amanda Lee.

The Second Consultation Paper

According to para 1.8 of the Second Consultation paper, a "significant number" of consultees indicated that the Law Commission "should consider the proper law of the arbitration agreement" in light of the Supreme Court's decision in *Enka v Chubb*. Specifically, as articulated in the Second Consultation Paper (at Question 1), the provisional proposal that has crystallised is that: "a new rule be included in the Arbitration Act 1996 to the effect that the law of the arbitration agreement is the law of the seat, unless the parties expressly agree otherwise in the arbitration agreement itself". The underlined wording has been deliberately emphasised to be further discussed in this article.

This article explains what the current consultation on the 1996 Act seeks to do, discusses why some consultees are concerned by the *Enka* decision, outlines and explains the relevant proposals in the Second Consultation Paper and concludes that, even if the above tweaks to the 1996 Act are adopted, contracting parties should nonetheless always specify the law of the arbitration agreement and arbitral rules should also contain a default choice of law as a fallback to apply "unless the parties expressly agree otherwise". This is because, at the time of concluding an arbitration agreement, it is seldom possible for the parties to accurately predict in which jurisdiction(s) an award will be challenged, let alone enforced.

The deadline for consultation responses to the Second Consultation Paper is 23.59 on 22 May 2023.

What the current consultation seeks to do

London is one of the most popular seats of international arbitration. In terms of its governing framework, the 1996 Act is the principal legislation governing arbitrations in England, Wales and Northern Ireland and, per its recital, was designed "to restate and improve the law relating to arbitration". While, at the time the 1996 Act was drafted, the UNCITRAL Model Law was deliberately not adopted wholesale (because it was considered to have gaps, be untested and lead to an undesirable bifurcation in domestic and international arbitration regimes) the 1996 Act was aligned with the UNCITRAL Model Law as far as practicable. Now the 1996 Act is over 25 years old.

In March 2021 the Ministry of Justice asked the Law Commission to review the 1996 Act. The review was intended, according to its Terms of Reference, to: "determine whether there are any amendments which could and should be made to the current legal framework to ensure that it is fit for purpose and that it continues to promote the UK as a leading destination for commercial arbitrations". It began in January 2022 with the Law Commission receiving written submissions from, and having discussions with, a wide range of stakeholders from which it identified a shortlist of topics on which to publicly consult.

In September 2022, the Law Commission published its first consultation paper ("First Consultation Paper") which focused on the following shortlist:

- (1) privacy and confidentiality of arbitration;
- (2) independence of arbitrators and disclosure;

- (3) discriminatory criteria in the appointment of arbitrators;
- (4) immunity of arbitrators;
- (5) express power to allow summary disposal of issues which lack merit;
- (6) interim measures ordered by the court in support of arbitral proceedings (section 44 of the 1996 Act);
- (7) jurisdictional challenges against arbitral awards (section 67 of the 1996 Act) and whether there should be a rehearing or just an appeal;
- (8) appeals on a point of law (whether section 69 of the 1996 Act needs reforming);
- (9) minor amendments to various provisions of the 1996 Act; and
- (10) at para 11.6, the Law Commission asked consultees to raise other topics not included in the First Consultation Paper.

Largely, consultation responses to the First Consultation Paper focused on the shortlisted topics. However, as we discuss further below, a number of consultees to the First Consultation Paper also took the opportunity to raise concerns relating to *Enka*. The First Consultation Paper had already discussed this issue, under the heading “law governing the arbitration agreement” at paras 11.8 to 11.12, but decided not to shortlist it on the basis that the Law Commission was: “not yet persuaded that the Act needs to introduce a new regime which departs from *Enka*”.

Why some consultees are concerned about *Enka*

Enka related to a fire at power plant in Russia. The subrogated insurer (Chubb) brought court proceedings in Russia against a subcontractor (*Enka*) and others seeking to recover under a contract that provided for arbitration in London (ie an arbitration seated in England). *Enka* in turn applied for an anti-suit injunction from the courts in England and Wales to restrain the Russian proceedings arguing that they breached the arbitration agreement. In a nutshell, the issue in *Enka* was whether the law governing the arbitration agreement aligned with the law of the matrix contract or the law of the seat. At first instance ([2020] 1 Lloyd's Rep 71) Baker J declined to grant the anti-suit injunction, however, the Court of Appeal ([2020] 2 Lloyd's Rep 389) reversed that decision and granted the injunction. The Supreme Court upheld the grant of the injunction – importantly it also set out its approach, which amounted in essence to conducting a three-limbed analysis in order to identify the law governing an arbitration agreement.

The Second Consultation Paper helpfully summarises the Supreme Court's holding in *Enka* at para 2.14 as follows:

- “(1) If there is a choice of law, express or implied, directed to the arbitration agreement itself, then that chosen law will govern the arbitration agreement, unless that choice of law is contrary to public policy.
- (2) If there is no such choice, and if the arbitration agreement forms part of a matrix contract, and if there is a choice of law, express or implied, for the matrix contract, then that chosen law will also govern the arbitration agreement.

However, that chosen law ‘may’ be displaced in the following circumstances:

- (a) where the law of the seat itself provides that the arbitration agreement is governed by the law of the seat;
 - (b) where there is a serious risk that the chosen law might render the arbitration agreement invalid, or not binding on one party, or (according to the majority) of reduced scope – this is known as the ‘validation principle’;
 - (c) where the choice of a seat in England and Wales, in combination with a reference to a local association or practice, implicitly indicates the choice of the law of England and Wales as the governing law.
- (3) If there is no choice of law anywhere, the arbitration agreement will be governed by the law with which it has the closest and most real connection, this being:
- (a) (according to the majority) the law of the seat of the arbitration (but perhaps still subject to the validation principle);
 - (b) (according to the minority) the law governing the matrix contract.”

Some commentators welcomed the Supreme Court's decision in *Enka* as a clarification of the law (one example cited by the Law Commission is para 16-016 of the leading textbook *Dicey, Morris and Collins on the Conflict of Laws* (16th Edition, 2022)). Others took an opposite view (with the Law Commission's examples including para 4.04[A](2)(j)(ii) of Gary Born's *International*

Commercial Arbitration (3rd Edition, 2020)). While the five judges in *Enka* agreed on the applicable approach (summarised above), it is telling that two gave dissenting opinions on how it applied. We have set out the Law Commission's full summary of the three-limbed approach above to make it obvious that in order to apply *Enka* (especially the elements relating to implied choices of law, a matrix contract or the law with which the arbitration agreement has the closest and most real connection), factual evidence and expert evidence on foreign law might be required. That often is costly and causes delay.

Illustrative responses

According to para 2.49 of the Second Consultation Paper, one consultee suggested that the decision in *Enka* should be codified "to make it more accessible to users than having to wade through the very lengthy judgments in that case" and another consultee suggested the approach of the minority in *Enka* be codified.

Enka was discussed at Brick Court Chambers' Annual Commercial Conference held in London on 13 October 2022. Moreover, the suggestion recorded at para 11.8 of the First Consultation Paper (that there should be a default rule that the law governing the arbitration agreement is the law of the seat, save where the parties have expressly agreed otherwise in the arbitration agreement itself) was, it seems, made by some of the authors of the Brick Court consultation response (viz Lord Hoffmann, Sir Richard Aikens, Salim Moollan KC and Ricky Diwan KC) for example in their Note of 7 June 2022.

In their response to the First Consultation Paper Brick Court Chambers reiterated (at para5(c)):

"The changes to English law brought about by the decision in *Enka* have the effect of displacing the framework carefully put in place by our courts to protect the arbitral process under English law in favour of a foreign law of unknown content which may or may not protect the arbitration. This is so for all central aspects of the arbitration including (i) arbitrability; (ii) questions as to the scope of the clause (including the presumption of "one stop adjudication" under English law (4)); (iii) separability; and (iv) further aspects yet to be determined (and which will thus give rise to litigation), which could include compétence-compétence under section 30, remedies and interest under sections 48 and 49, and the finality of awards under section 58. The effect of the decision in *Enka* (even if correct as a matter of pure conflict of laws analysis) is to give a new weapon to recalcitrant parties who can thereby slow down or scupper altogether London-seated arbitrations. This problem should be remedied by adopting a statutory rule that the proper law of the arbitration agreement is the law of the seat with the only exception being where the arbitration agreement itself expressly chooses a different law (the "Law of the Seat Default Rule")."

The response of the Chartered Institute of Arbitrators captures the essence of its position on *Enka*:

"In 2020 the Supreme Court examined the issue of determining the law applicable to arbitration agreements in the cases of *Enka v Chubb* and *Kabab-Ji v Kout Foods* [*Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2022] 1 Lloyd's Rep 24]. These cases sought to provide some clarity on the interpretation of how the law applicable to analysing the validity and effectiveness of an arbitration agreement is determined in the absence of an express provision for disputes seated in England, Wales, and Northern Ireland. This issue has been a source of confusion since before the *Sul América* case and the recent case law has not provided a clear formula. This issue is not unique to disputes seated in England, Wales, and Northern Ireland. Some jurisdictions, including Scotland, have chosen to include language in their governing arbitration law mandating that for disputes seated in that jurisdiction, in the absence of an express provision, the governing law of the arbitration agreement is the law of the seat (see the Arbitration (Scotland) Act 2010, section 6).

The judgments in *Enka* and *Kabab-Ji* may have provided another chapter in the saga of this topic, but, in our view, have not settled the matter. Currently, the only means parties have of protecting against having to battle this issue in the courts is to include express provisions in their dispute resolution agreements, a practice that was rarely considered in the past. We believe this area is ripe for legislative cure. The common law that has developed here, though understandable as to why the courts have treated it as they have, has still not provided the clarity that parties and practitioners seek. We recommend an express provision in the Act, probably along the lines of the Arbitration (Scotland) Act 2010."

While the Chancery Bar Association, in its submission dated 14 December 2022, noted that "Opinions vary as the correctness of" *Enka* and it thus chose to "make no submissions on the point generally", on the subject of trust arbitration (which the Chancery Bar hopes to promote), it warned "since trust arbitration is a relatively new phenomenon and is not provided for in the laws of many trust jurisdictions, applying the law of the trust as the law of the arbitration clause might make numerous arbitration clauses unenforceable. Although in such cases the law of the seat might prevail under the validation principle set out by the Supreme Court majority, "it would be desirable to avoid such uncertainty by providing that, where a trust instrument contains an arbitration clause with a choice of seat in favour of England and Wales, the governing law of the arbitration clause is also English law".

The proposals in the Second Consultation Paper (paras 2.75 to 2.76)

The Law Commission adopted a balanced approach in its Second Consultation Paper. It first discussed the arguments against reform, before it acknowledged: “that the ruling in *Enka v Chubb* is complex; a simple default rule removes much of the opportunity for argument and satellite litigation” and concluded that the arguments in favour of reform carry the day. It further justified its proposal as follows:

“This proposed new rule, applying the law of the seat, has the virtues of simplicity and certainty. The law governing the matrix agreement would be irrelevant. Any doubt over which law governs the matrix agreement would not infect the question of which law governs the arbitration agreement. The new rule would apply whether the arbitration was seated in England and Wales, or elsewhere. It would apply whether the seat was chosen by the parties, or otherwise designated. Where the arbitration is seated in England and Wales, the new rule would avoid the problems which arise from *Enka v Chubb* – *unless the parties explicitly agreed otherwise*, in which case the parties must be taken as facing the consequences with eyes wide open. The ability to agree otherwise preserves party autonomy.” (Our emphasis.)

The purpose of the wording we have underlined in this article as the Law Commission's above explanation notes, is to preserve party autonomy, which is the cornerstone of arbitration. The practical effect of inserting the proposed wording into the 1996 Act appears to be to collapse the *Enka* approach summarised above, boiling it down to a hybrid of limbs (1) and (3)(a). The purpose of the additional word “expressly” (which does not feature in the Scottish precedent legislation) is to further simplify the test (under limb (1)) and remove the possibility that the parties' choice can be implied.

It is still important to always specify the law of the arbitration agreement

Many arbitrations seated in London are international. As we foreshadowed in our introduction, when an arbitration agreement is concluded, the parties often cannot accurately predict where an award might be challenged or enforced. Moreover, a frequently invoked ground for annulment or refusal of enforcement is the invalidity of the arbitration agreement. There is no global consistency in how courts determine the law of an arbitration agreement and (as *Enka* illustrates) conflict of law questions can be complex. Overriding mandatory rules can also play into whether an arbitration agreement is enforceable. Clearly stating the law applicable to the arbitration agreement can help guide the relevant courts. Unfortunately, the current practice is that few arbitration agreements state the applicable law.

As a fallback, therefore, arbitral rules might also contain a default choice of law to apply to the arbitration agreement “unless the parties expressly agree otherwise”. Paragraph 2.47 of the Second Consultation Paper notes: “To the extent that arbitral rules provide a governing law ‘unless the parties agree otherwise’, they potentially face the same possible risk as does the Scottish legislation of being trumped by the *implied* choice of *Enka v Chubb*” Thus including the word “expressly” might be wise to disapply the first limb of *Enka* and the institutions might consider additionally adding “in writing”.

There is debate over whether dealing with this matter in arbitral rules would be effective – but in our view having a fallback (in case parties forget to expressly specify the law of the arbitration agreement) is never a bad idea. The Brick Court Chambers consultation response warns at para 55:

“Paragraph 11.9 of the [First] Consultation Paper refers to Article 6 of the LMAA Terms 2021 and to article 16.4 of the LCIA Rules 2021. Yet, importantly, those rules now find no application post *Enka*. Because the parties' choice of foreign substantive law for the main contract is to be treated as an implied choice made by the parties as the proper law of the arbitration agreement, that specific choice made in the contract itself will oust generic provisions in arbitral rules such as article 6 of the LMAA Terms and article 16.4 of the LCIA Rules. This means that the problems created by *Enka* (noted above) cannot be resolved through amendments to arbitral rules, and can only be resolved through a statutory change.”

However, in footnote 39, the Brick Court Chambers consultation paper concedes:

“Lord Hoffmann takes the contrary view that such amendments could be effective, where they would have the effect of constituting a specific agreement as to the law of the arbitration agreement which would prevail over the choice of law clause in the written document. But it is common ground that (i) there is doubt on the question, which in itself justifies dealing with this in the statute; and (ii) that it would in any event be unrealistic to expect international institutions such as the ICC or UNCITRAL to change their global rules to resolve what is an essentially English problem of very recent creation.”

Accordingly, it is time for the Law Commission to seize this opportunity to recommend statutory certainty and remove any element of doubt. By so doing, it will ultimately be “fixing” *Enka*.

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