SLAUGHTER AND MAY/

19 SEPTEMBER 2023

OVERHAULING THE RULES ON THE LAW OF THE ARBITRATION AGREEMENT?

A DEPARTURE FROM *ENKA V CHUBB* IS AMONGST THE LAW COMMISSION'S PROPOSALS TO FINETUNE THE ARBITRATION ACT 1996

After more than a year of consultation and stakeholder engagement, the Law Commission has published its final proposals on the Arbitration Act 1996, which are designed to preserve England and Wales's position as a leading destination for international arbitration.

While in many areas the Commission has concluded that the current *status quo* represents the optimum balance between party autonomy, speed and cost, on the one hand, and fairness and certainty, on the other, the Commission has recommended some substantive amendments (along with more minor tidy-up changes). Among the most significant of the Commission's proposals is the introduction of a new default rule on the law governing the arbitration agreement, which will have important implications for commercial parties submitting their disputes to arbitration in England and which will require careful consideration to be given to how arbitration agreements are drafted.

New rule on the governing law of an arbitration agreement

The Commission has proposed the introduction of a new default rule in the Act that, unless the parties expressly prescribe otherwise, the law which governs the arbitration agreement is the law of the seat of the arbitration. Significantly, this simplifies the position under the existing rule laid down by the Supreme Court in *Enka v Chubb* which was the culmination of a longstanding debate in the English courts on the issue (see our briefing).

In *Enka*, the Supreme Court held that, where parties had not chosen a governing law for the arbitration agreement, in general, where parties have chosen a governing law for the main contract, that law will apply to the arbitration agreement. Further, a majority found that where parties have not chosen a governing law for the main contract, the governing law of the arbitration agreement will be the law with the 'closest connection' to the arbitration agreement, which will generally - but not always - be the law of the seat of arbitration chosen by the parties. The result of *Enka* is, in the words of the Commission, a "complex and unpredictable" test that leaves significant leeway for argument and would result in many arbitration agreements being governed by foreign law, with parties losing many of the benefits of the Act and the supportive position adopted by English law.

The Commission's proposed approach places particular weight on the choice of arbitral seat as being the decisive factor in determining the law governing the arbitration agreement. However, parties will retain the flexibility to disapply the default rule by expressly agreeing for the arbitration agreement to be governed by a law different to that of the seat.

Importance of the law governing the arbitration agreement

The law governing the arbitration agreement determines matters such as its validity and scope and is therefore of central importance in ensuring an arbitration agreement operates effectively and as intended by the parties. Courts in different jurisdictions take different approaches to questions of governing law and validity, which can result in wildly different outcomes even in identical circumstances. Where the governing law of an arbitration agreement is unclear, this can leave awards rendered pursuant to that agreement at risk of protracted and expensive post-award litigation before multiple courts.

A striking example of this is the case of *Kabab-Ji v Kout Food Group* in which the UK Supreme Court, applying the test in *Enka*, refused to enforce an award in a French-seated ICC arbitration after holding that English law governed the validity of the arbitration agreement whilst the French Cour de Cassation refused to set-aside the same award after finding that French law applied.

While the Commission proposes that the new rule will apply irrespective of the seat, it will clearly still be possible for courts in different jurisdictions to reach a different conclusion on the same issues. Although the English courts are unlikely to be involved in support of arbitrations seated outside of England and Wales, the proposed rule should provide some clarity as to the approach to be taken by the English courts where they are asked to enforce a foreign-seated award (such as in *Kabab-Ji*).

The Commission recognises that there will be question marks over cases where parties have not chosen a seat in the arbitration agreement, but it notes that realistically, by the time such cases reach a court, a seat will likely have been designated and the problem resolved.

What does this mean for parties?

This change, if codified into the Act, will apply only to arbitration agreements entered after the reform enters into force.

Despite the simplification proposed, it will still be important for parties to consider carefully, when drafting arbitration agreements, that clear provision is made as to the governing law of the arbitration agreement. Few institutional rules provide a default law of the arbitration agreement (the LCIA rules, for example, being one such outlier)[1] and many rules (such as the ICC rules) are silent. Although some parties may legitimately expect that by electing a governing law for the main contract this would extend to the arbitration agreement (absent any further indication of a preferred governing law), as may be the case in certain other jurisdictions,[2] such expectations would no longer be satisfied under a reformed Act.

The Commission's proposed change to the Act therefore reinforces the importance of considering the practical implications of choosing the seat of the arbitration and its critical role in ensuring a valid and effective arbitration agreement to avoid the risk of costly and time-consuming satellite disputes.

The Law Commission's other proposals

In addition, the Commission has proposed a number of other changes to the Act, including:

- Codifying an arbitrator's existing common law duty to disclose any circumstances which ought reasonably give rise to justifiable doubts as to their impartiality (as formulated by the Supreme Court in *Halliburton v Chubb* – see our briefing);
- Introducing a power of summary disposal confirming that tribunals have the power to issue awards on a summary basis where an issue has "no real prospect of success" (the test applied by English courts for summary judgment applications). While the Commission recognised that tribunals already have an "implicit power" under the current regime, the introduction of codified rules is intended to empower tribunals which may otherwise have felt constrained by "due process paranoia" and fears of enforcement challenges;
- Streamlining the procedure for challenges of arbitral awards for a tribunal's lack of jurisdiction (section 67) such that where a party has objected to a tribunal's jurisdiction and the tribunal has ruled on its jurisdiction, then in any subsequent challenge to the English court limits will be placed on new objections and evidence that were not raised before the tribunal and on the court's current ability to conduct a full rehearing of evidence. In proposing such amendments, the Commission has sought to strike a balance between ensuring a fair hearing for a party who does not accept jurisdiction and preventing that party from using the hearing before the tribunal as a "dress rehearsal" before a full rehearsing before the court;
- Clarifying the court's powers in support of arbitral proceedings, including express confirmation that the courts can make orders in support of arbitration against third parties and that emergency arbitrators have the same pathways to enforce decisions as are currently available to arbitrators under the Act, e.g. making peremptory orders (typically issued in response to a party failing to comply with a tribunal's order) enforceable by the courts; and
- Strengthening an arbitrator's immunity in situations of resignation or removal.

[1] LCIA Arbitration Rules 2020, r. 16.4.

[2] For example, earlier this year, the Hong Kong courts followed the UK Supreme Court's approach in *Enka v Chubb* in determining the law governing a dispute resolution clause (*China Railway v Chung Kin Holdings*).

What hasn't changed?

Notably, the Commission has not recommended changes to other areas, such as confidentiality (see our previous briefing on this topic), appeals on a point of law, third party funding and "reluctantly" discrimination.

Key takeaways and next steps

Overall, the Commission's proposals represent a welcome finetuning of the existing legislative framework for arbitration in England and Wales. The relatively limited extent of the proposed changes reflects the Commission's conclusion, and the views of arbitration users, that a "root and branch reform is not needed or wanted" but the proposed refinements will help to ensure that England and Wales maintains its position as a leading international arbitration centre.

Whilst the Commission's proposed rule on the law governing an arbitration agreement will not resolve all practical difficulties in this area, the rule, if enacted, will provide some welcome clarity for parties. For certainty, however, it will still be advisable that parties to international contracts specify the law governing arbitration agreements in their arbitration clauses.

Lord Bellamy KC, the justice minister, has promised to respond to the Commission's report shortly recognising the need to "maintain the UK's reputation as a world leader in resolving legal disputes". Assuming the Ministry of Justice agrees to the Commission's proposals, the bill will need to be slotted into what is already a busy legislative agenda due to the run-up to the general election. Depending on those timings, we could see a new Arbitration Act in 2024.

Slaughter and May has a leading arbitration practice and was one of the law firms involved in the Law Commission's consultation surrounding the review of the Arbitration Act 1996.

CONTACT

James Stacey
Partner, Co-Head of Arbitration
T: 0207 090 4124
E: James.Stacey@slaughterandmay.com

Damian Taylor
Partner, Co-Head of Arbitration
T: 0207 090 5309
E: Damian.Taylor@slaughterandmay.com

Peter Wickham
Partner, Disputes and Investigations
T: 0207 090 5112
E: Peter.Wickham@slaughterandmay.com

Smriti Sriram
Partner, Disputes and Investigations
T: 0207 090 3718
E: Smriti Sriram@slaughterandmay.com

William Humphries
Associate, Disputes and Investigations
T: 0207 090 3298
E: William.Humphries@slaughterandmay.com

Samantha Holland
Senior PSL, Disputes and Investigations
T: 0207 090 3674
E: Samantha.Holland@slaughterandmay.com