39 Essex CHAMBERS

OUTLOOK

NEWS AND VIEWS FROM THE
39 ESSEX COMMERCIAL AND CONSTRUCTION GROUP
December 2020

INTRODUCTION

David Hopkins

Welcome to the December 2020 edition of Outlook, a roundup of news and views from the 39 Essex Commercial and Construction Group.

First, on the topic of the proper law of an arbitration agreement, following the handing down of the Supreme Court's judgment in *Enka v Chubb*, and their article in July's edition of Outlook, **Steven Lim, Ben Olbourne, Niraj Modha** and **Philippe Kuhn** consider in detail what the Supreme Court decided and what it may have left open for another day. They also reflect on some of the other cases considered in their earlier piece to see how they might stand in light of the Supreme Court's decision, as well as offering some key practical tips for practitioners going forward.

Next, in part one of a two-article series, **Alexandra Bodnar** and **James Bradford** explore the High Court's recent decision in *Yuanda (UK) Company Limited v Multiplex Construction Europe Limited* which has the potential to shake up the UK construction performance bonds market with its conclusion that an adjudicator's decision is

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sufficient 'to establish and ascertain' the net sums due under the bond. Alex and James outline Fraser J's reasoning and the possible conceptual challenges.

And finally, the substantial cooperation between provider and customer necessary to implement enterprise resource planning (**"ERP"**) software, such as SAP or Oracle, makes it ripe for disputes. **Karishma Vora** considers the common pitfalls which arise when companies enter into contracts for such products.

QUARANTINE QUERIES

The Commercial and Construction team continues to offer our initiative which we hope will help those of you who are working from home or in isolation. We have established a team of silks and juniors who will be available for up to half an hour – free of charge – to talk through the kind of issues that you would previously have mulled over with a colleague at the coffee machine. The discussion will be on a "no liability" and "no names" basis; however, you will be asked to provide some brief details of the query to our clerks so that they can make a barrister available.

If there is a matter that you would like to discuss (Covid-19 related or otherwise) please contact:

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and book a slot with one of our barristers.

THE PROPER LAW OF AN ARBITRATION AGREEMENT PART TWO: MUDDLE RESOLVED? – A DEEP DIVE INTO *ENKA V CHUBB* [2020] UKSC 38

Steven Lim
Ben Olbourne
Niraj Modha
Philippe Kuhn

On 9 October 2020, the Supreme Court handed down its much-awaited decision in *Enka v Chubb* [2020] UKSC 38, in which the central issue was how an arbitral tribunal applying English law should approach the issue of determining the proper law to be applied to questions arising in relation to an arbitration agreement. In an earlier piece, published in July 2020 shortly before oral argument on the appeal took place (see *"The Proper Law of an Arbitration Agreement"*, Outlook, July 2020), we considered this issue and sought to anticipate what the Supreme Court might do. Among other things, we expressed the hope that the Supreme Court might bring certainty, if not also conceptual clarity, to this previously muddled area. As we seek to develop, we feel the Supreme Court has largely achieved this, although understandably there remain at least a few points still to be resolved in future cases.

In this piece, we will first consider in some detail what the Supreme Court did decide and what it may have left open for another day. We will also reflect briefly on some of the other cases we considered in our earlier piece to see how they might stand in light of the Supreme Court's decision. We then move on to consider a number of specific issues that either were considered by the Supreme Court or remain still to be resolved in light of the decision, as well as offering what

we see as some key practical tips for practitioners going forward.

We addressed the significance of this issue as to the proper law of an arbitration agreement in our earlier piece. Accordingly, here we turn straight to the Supreme Court's decision.

PART A: THE DECISION

The facts

The case involved a claim made under a construction contract in respect of a catastrophic fire at a power plant in Russia. Following various subrogations and assignments, the insurer of the project (Chubb) commenced court proceedings in Russia under the construction contract seeking a finding of liability against the party responsible for the design and construction of the plant (Enka). Enka commenced an English-seated arbitration and also commenced an arbitration claim in the English courts seeking an anti-suit injunction to restrain the Russian proceedings on the ground that that the construction contract contained an arbitration agreement providing for arbitration in England. The lower courts in England came to different decisions as to whether or not it was appropriate to grant the anti-suit injunction. In large part, the decisions turned on matters relating to the validity and scope of the arbitration agreement which depended on the answer to the preliminary question of which system of law (English or Russian) was to be applied to determine those questions: where, as was the case here, there was no express choice of law clause in either the construction contract or in the arbitration agreement itself, how ought the proper law of the arbitration agreement be determined and to what issues concerning the arbitration agreement should that law properly be applied?

Analysis of the decision

The Supreme Court's decision was split 3 – 2; the majority upheld the Court of Appeal decision but on different grounds. These divisions may give the appearance that the law remains as confusing as it was. However, while the Supreme Court disagreed sharply with the Court of Appeal's reasoning, the 3 – 2 split in the Supreme Court is much less divided than it appears. The majority and minority agreed on more than they disagreed. There are only two main points of departure between the minority and the majority. These are:

a) The implication of the implied law of the main contract in the absence of an express choice of law clause – a difference on application of principle to the facts and not of principle itself (on the facts the minority took a broader view of implying a choice of law than the majority).

b) The principle to be applied to the choice of law with the closest connection. The majority favoured a default choice of the law of the seat. The minority did not agree there should be a default choice and held in most cases the arbitration agreement would have the closest connection with the main contract law, however determined.

It is also important to bear in the mind the split arose on the rather uncommon facts of the case – there was no express choice of law in the main contract. It was only because there was no express choice of law that:

a) The implication of an implied law for the main contract became relevant; and also

b) In the absence of an implied choice of law for the arbitration agreement, the law with the closest connection became relevant.

All five judges agreed that, had there been an express choice of law in the main contract, this choice of law would either be an express or implied choice of law for the arbitration agreement as well. In our view the Supreme Court decision settles the position for the majority of cases where the main contract contains an express choice of law clause.

The majority took a broad view on the express choice of law clause in the main contract – that it is likely to be an express choice of law for the arbitration agreement as well. On the basis of this authority, there may be more cases finding that an

express main contract law is the express choice of law for the arbitration agreement as well.

All five judges agreed the law of the arbitration agreement is determined by applying English common law rules for resolving conflicts of laws (rather than the Rome I Regulation (**"Rome I"**). The law to be applied to the arbitration agreement will be:

a) The law chosen by the parties to govern it – either express or implied; and

b) In the absence of any choice, the system of law the arbitration agreement is most closely connected to.

There is no difference between an implied choice and an express choice. An implied choice is still a choice which is just as effective.

Whether the parties have agreed a choice of law to govern the arbitration agreement is ascertained by construing the arbitration agreement and main contract as whole, applying the rules of contractual interpretation of English law as the law of the forum.

It is generally reasonable to assume parties intend or expect their contract to be governed by a single system of law. To apply different systems of law to different parts of a contract has the potential to give rise to inconsistency and uncertainty. The choice of a different country as the seat of the arbitration is not, without more, sufficient to negate an inference that a choice of law to govern the contract was intended to apply to the arbitration agreement.

Exceptions to application of the main contract law

Validation principle

All five judges agreed on the application of the validation principle – i.e. the application of the law of the contract to the arbitration agreement may be negated by the validation principle where there is a serious risk that, if governed by the same law as the main contract, the arbitration agreement would be ineffective.

Law of the seat

The majority also considered that the application of the law of the contract to the arbitration agreement may be negated if the law of the seat provides that, in the absence of an express choice, the arbitration agreement will also be treated as governed by the law of the seat (e.g. Swedish Arbitration Act, section 48 – in the absence of a choice of law, the arbitration agreement is governed by the law of the seat – and the Arbitration (Scotland) Act 2010, section 6). The minority was silent on this.

Rejection of "overlap" argument

The Court of Appeal's reasoning hinged on a close connection or "overlap" between the law governing the arbitration agreement and the curial law (or law of the seat). This was one of the primary reasons for the Court of Appeal's decision that the law of the seat, rather than the law of the main contract, would normally be the implied proper law of the arbitration agreement.

The Supreme Court found (all five judges agreeing) that almost all the provisions of the Arbitration Act 1996 (**"AA 1996"**) relied on to support the "overlap argument" (i.e. the connection between the curial law and the law of the arbitration agreement) are non-mandatory. Where the arbitration agreement is governed by a foreign law, by reason of section 4(5) AA 1996, the non-mandatory provisions of the Act which concern arbitration agreements do not apply.

The Supreme Court found the AA 1996 contemplates and specifically provides for a situation in which the arbitration agreement will be governed by a foreign law even though English law governs the arbitration process. Therefore, no inference can be drawn that, by choosing an English seat, and with it English law as the curial law, parties are also impliedly choosing English law to govern their arbitration agreement.

Points of disagreement between the minority and majority

The minority did not agree with the default application of the law of the seat as the law with the closest connection to the arbitration agreement – they preferred the application of the law of the main contract, even if determined as a rule of law by the closest connection – with the application of the validation principle displacing the main contract law, if necessary.

The majority favoured the law of the seat as the law with closest connection because this was consistent with international law embodied in Art V(1)(a) New York Convention, enacted into English law in section 103(2)(b) AA 1996.

The majority recognised the first limb of Art V(1)(a), "law to which the parties have subjected it", includes an implied choice.

The majority also recognised the New York Convention is to be interpreted to apply the same conflicts rule to Art II(3) on recognition of arbitration agreements, i.e. the same choice of law rule applies pre- and post-award.

Another point on which the minority departed from the majority is whether the same choice of law rules applies to the scope as to validity of the arbitration agreement – Article V(1)(c) New York Convention; section 103(2)(d) AA 1996; Article 36(i)(a)(iii) Model Law.

The majority found the general approach in conflict of laws, adopted by both the common law and Rome I, is to treat the validity and scope of a contract (as well as other issues such as the consequences of breach and ways of extinguishing obligations) as governed by the same applicable law. This makes good sense, not least because the boundary between issues of validity and scope is not always clear. Thus, it is logical to apply the law identified by the conflict rules prescribed by article V(1)(a) of the New York Convention, and section 103(2)(b) AA 1996, to questions about the scope or interpretation of the arbitration agreement as well as disputes about its validity. Hence the majority was of the view the validation principle applies to questions of validity and scope of the arbitration agreement. The minority did not agree the same choice of law applied to "scope" as to validity. Lord Burrows and Lord Sales in the minority took a more restricted approach to the ambit of the validation principle. We think the majority's view is supported by the scheme of the New York Convention.

Article II(3) of the New York Convention (enacted as section 9(4) AA 1996) supports the majority view. This requires the court to recognise and enforce an arbitration agreement (and to stay litigation brought in breach of the arbitration agreement) unless the agreement is "null and void, inoperative or incapable of being performed". While not express, the scope of the arbitration agreement must fall within this enquiry – if the arbitration agreement does not cover the dispute then the court is not required to stay litigation brought before it in favour of arbitration. Therefore, the same governing law (and the same means of determining the governing law) should be applied to scope as to validity.

The majority left open whether the validation principle is applicable in the default rule – where the law of the seat applies as the law with the closest connection. The international approach most commonly associated with Gary Born's work in this area would most likely invoke the validation principle as part of an implied choice analysis, so that the law of the closest connection would not normally fall for consideration. All five judges agreed there is no sharp distinction between an implied choice and a default positive rule of law.

The majority also found the fact that the contract requires the parties to attempt to resolve a dispute through good faith negotiation, mediation or any other procedure before referring it to arbitration will not generally provide a reason to displace the law of the seat of arbitration as the law applicable to the arbitration agreement by default in the absence of a choice of law to govern it.

Re-consideration of earlier authorities

Before Enka, cases in the High Court and Court of Appeal had approached the question of the proper law of an arbitration agreement from different perspectives and by applying conflicting presumptions. For that reason, the Supreme Court noted the Court of Appeal's exhortation that *"the time has come to seek to impose some order and clarity on this area of law"*.[1] Can previous decisions be rationalised in light of *Enka*? Lord Burrows said, *"it is very difficult to rationalise all past cases."* In our view, several previous cases can be rationalised in light of *Enka* applying, where there is not clear evidence of an express choice of law for the arbitration agreement, a delicate re-interpretation, focusing on the validation principle and abandoning the 'overlap' reasoning.

The leading Court of Appeal case prior to *Enka was Sulamérica v Enesa* [2012] EWCA Civ 638. In *Sulamérica*, the main insurance contracts contained an express choice of Brazilian law. The dispute resolution clause provided for arbitration in London. The insureds claimed that the law of Brazil applied to the arbitration agreement, with the result that arbitration was ineffective without their present consent. The Court of Appeal held that the express choice of law in the main contracts did not apply to the arbitration clause. The Court did not imply a choice of law to fill the void and went to the third stage of the test, finding English law had the "closest connection" to the arbitration agreement.

The Supreme Court focused on the Court of Appeal's reference in *Sulamérica* to the "serious risk" that the arbitration agreement would be futile if it was governed by Brazilian law. By emphasising the Court of Appeal's implicit acknowledgment of the validation principle in *Sulamérica*, the Supreme Court has delicately re-cast that case.

If *Sulamérica* were decided post-*Enka*, it is most likely the Court would apply the validation principle because of the "serious risk" that the arbitration agreement would be 'significantly undermined' and that presumption that the main contract law would apply would be rebutted in favour of implying the law of the seat as the law of the arbitration agreement. There would be no need to go to the "closest and most real connection". The conclusion would be the same, but the reasoning would be subtly different.

Other cases which pre-date Sulamérica may also be re-interpreted in a similar way. In *C v D* [2007] EWCA Civ 1282, a Bermuda form insurance policy provided for New York law, together with London-seated arbitration. Applying New York law to the arbitration agreement would likely have invalidated it. Longmore LJ commented, obiter, that the law of the seat was "more likely" to have the closest connection with the arbitration agreement than with the law of the main contract. If *C v D* were decided afresh, the majority in *Enka* would no doubt agree with the conclusion, but again, English law would like be implied through the operation of the validation principle rather than the closest connection test.

Likewise, the case of *XL Insurance v Owens Corning* [2001] 1 All ER (Comm) 530, which was another case involving a Bermuda form insurance policy, would be decided by reference to the validation principle and a rejection of the 'overlap' argument. It is clear that any suggestion that the choice of a curial law (by reference to the seat) determines the law governing the arbitration agreement has been firmly discredited.

In our view, abandoning the faulty 'overlap' reasoning, which has been relied upon to justify selecting the law of the seat as the law with the closest connection with the arbitration agreement, and replacing this overtly with the validation principle, explains the decisions in these previous cases.

In our earlier piece, we also considered the Court of Appeal's decision in *Kabab-Ji S.A.L v Kout Food*

1 [4]

Group [2020] EWCA Civ 6; [2020] 1 Lloyd's Rep 269.[2] In that case, there were certain indications relied on heavily by the Court of Appeal that an express choice of law in the main contract was intended to extend to its arbitration agreement as well: the governing law provision in the main contract was broadly worded, further provisions in the main contract were suggestive of an intention that this would extend to include the arbitration agreement, and the arbitration agreement itself contained wording to the effect that a tribunal was to apply *"all provisions"* of the main contract. The Court of Appeal's approach met with the approval of the Supreme Court and, if anything, it is likely that the Supreme Court's emphasis on the significance of the proper law of the main contract will result in a more resolute approach being taken to construing main contract proper law clauses as extending to arbitration agreements contained within them. Some commentators regarded the Court of Appeal's decision in *Kabab-Ji* either as being heterodox or as marking the outer limits of what was permissible as a matter of contractual construction. However, in light of the Supreme Court's decision in *Enka*, it may well be that this is now to be regarded as orthodox and a straightforward application of well-versed English canons of contractual construction.

In our earlier piece, we also touched on the leading authorities in Singapore. It will need to be seen how the Singapore courts will treat the Supreme Court's decision in *Enka* when the proper law issues arises again, however, there may not be all that much practical difference between it and the approach taken by the Singapore Court of Appeal in *BNA v BNB* [2019] SGCA 84. The Singapore Court of Appeal had expressly approved of the approach of the Court of Appeal in *Sulamérica*, moreover, it had highlighted (as had the High Court in *BCY v BCZ* [2016] SGHC 249) the significance of the proper law of the main contract, particularly where there was an express choice, albeit that this was subject to displacement if application of that system of law was likely to defeat the parties' clear intention to submit their disputes to resolution by arbitration. Ultimately, however, the decision in *BNA v BNB* turned on the matter of the identification of the seat of the arbitration rather than the proper law of the arbitration agreement, so assessment of the impact of *Enka* will need to await an appropriate case.

PART B: POINTS FOR FURTHER CONSIDERATION

The Supreme Court did not comment on how its analysis (and reference to the choice of law regime in Rome I) might be affected by Brexit. The decision did not turn on this. Further, the Court agreed English common law rules applied to the choice of law of the arbitration agreement (this choice of law being specifically excluded from the Rome I). Where Brexit might have an impact is on the identification of the choice of law of the main contract. The Court applied Rome I, as it had to. It is conceivable Rome I may cease to apply in the future in the wake of Brexit. Even so, this is unlikely to make a material difference as the common law and Rome I choice of law rules for contracts are closely aligned.

In the next part of this article we consider four points arising from the Supreme Court's decision:

1. Choice of law in deciding the proper law of an arbitration agreement;
2. The approach to multi-tier dispute resolution clauses;
3. Free-standing arbitration agreements; and
4. What is the practical significance of the decision for practitioners, advisers and drafters alike.

Each warrants more detailed treatment than the present format permits.

2 Leave to appeal to the Supreme Court has also been granted in this case; however, the status of that appeal is not presently known to the authors.

Choice of law in deciding proper law
There is at least a query whether the Supreme Court's decision to apply English rules of contractual interpretation, as the law of the forum, to determine whether the parties expressly or implied agreed a choice of law for the arbitration agreement is restrictive and parochial. But putting that to one side, the Supreme Court's decision leaves open whether an arbitrator sitting in England is required to take the same approach.

Under section 34(2)(f) AA 1996, an arbitrator can decide whether to apply strict rules of evidence (or any other rules) as to the admissibility, relevance or weight of any material (oral, written or other) sought to be tendered on any matters of fact or opinion. This suggests an arbitrator has latitude to choose a different choice of law approach.

Under the Model Law:

a) Article 28(2) allows the tribunal to apply the law determined by the conflicts of law rules which it considers applicable to determine the law applicable to the substance of dispute.
b) Article 19(2) gives the tribunal the power to determine the admissibility, relevance and materiality and weight of any evidence.

Taking these provisions together, under the Model Law, a tribunal arguably has a wider latitude to choose a different approach to the choice of law to be applied in determining whether the parties had agreed on a choice of law.

There is an argument for the application of internationally accepted principles of construction (giving as much effect as possible to the pro-arbitration policy of the New York Convention) in determining whether parties had agreed on proper law of the arbitration agreement.

While there is an argument that arbitrators should apply the same rules as the courts of the seat to foster consistency when the seat court reviews the decision in a setting aside or challenge, applying internationally accepted principle of construction may not arrive at a markedly different conclusion on interpretation of the parties' intent.

Multi-tier dispute resolution clauses
The Supreme Court's *obiter* analysis of multi-tier dispute resolution clauses (see in particular Lord Burrows at [235]-[237]) starts from the commonsense presumption that the law of the arbitration agreement and of other aspects of the dispute resolution clause would be intended by the parties to be the same. However, negotiation, mediation and other pre-arbitration dispute resolution obligations may be alien to the law (chosen expressly or impliedly) of the arbitration agreement. For example, the parties may have specifically intended negotiation obligations to be efficacious and a pre-condition to any more formal dispute resolution mechanism by way of escalation, but the drafting may be deficient applying one possible proper law but not others.

Given the developing state of the law and fact-specific construction required for negotiation and mediation clauses, including their relationship with arbitration as the agreed option of last resort, it may well be more difficult to formulate a satisfactory default approach to multi-tier dispute resolution clauses than the Supreme Court's short observations suggest.

The divergent English cases are illustrative of the potential complexity. For example, in *Cable and Wireless plc v IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm) and *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd* [2014] EWHC 2104 (Comm), first instance judges in the Commercial Court supported a departure from the strict approach of the House of Lords in *Walford v Miles* [1992] 2 AC 128 which had deprecated obligations to negotiate as too uncertain to be enforced. In turn, yet more recent Commercial Court decisions have cast doubt over that shift: *Emirates Trading Agency LLC v Sociedade de Fomento Industrial Private Ltd* [2015] EWHC 1452 (Comm) and *DS-Rendite-Fonds Nr 106 VLCC Titan Glory GmbH & Co Tankschiff KG v Titan Maritime SA Panama* [2015] EWHC 2488 (Comm).

By contrast, the Singapore courts have on the whole been more willing to regard negotiation obligations as pre-conditions to agreements to arbitrate, provided the drafting is sufficiently clear and certain: *International Research Corp plc v Lufthansa Systems Asia Pacific Pte Ltd* [2013] 1 SLR 973; [2012] SGHC 226 (upheld on appeal: [2013] SGCA 55). The approaches in civil law jurisdictions are again varied, making this question a potentially topical one.

Free-standing arbitration agreements

Free-standing arbitration agreements are occasionally referred to as submission agreements. They are typically entered into after a dispute has arisen. The starting point is that free-standing arbitration agreements are unusual. *Enka* was expressly concerned with arbitration agreements contained within "main contracts" and does not lay down any principles for determining the proper law of submission agreements.

The decision in *Enka* is clearly premised, in the usual course, on commercial parties being presumed to intend that a clear choice of law in the main contract would generally apply also to the arbitration agreement contained within it. That analysis recognises the close connection between the main contract and the arbitration agreement, notwithstanding the principle of separability (which is limited, per *Enka*, to the arbitration agreement surviving the main contract in the event the main contract is invalid, in effective or has its existence challenged, as provided in section 7 AA 1996).

The approach to free-standing agreements is unlikely to lend itself to a simple presumptive rule. For example, in some cases it will be perfectly sensible to apply an express choice of law in the main contract to a free-standing arbitration agreement (on the footing this was likely to be a drafting oversight or the parties' presumed intention). In other cases, a free-standing arbitration agreement may apply to disputes arising out of a number of contracts between the same parties, governed by different laws; here, an *Enka* presumption is unworkable. In any event, it is more likely that free-standing arbitration agreements would have an express choice of the law governing the arbitration agreement, avoiding these questions.

That said, in the absence of a choice of law (express or implied) the New York Convention choice of law rule would still ask first for consideration of an implied choice (looking at the circumstances of the underlying dispute and perhaps application of the validation principle) and failing that application of the law of the seat.

Practical significance for practitioners

Although the Supreme Court's decision does not resolve all issues, as one would not expect it to, it does provide very substantial clarity and this can only assist practitioners advising parties on potential outcomes when asked to advise on the validity or effect of an arbitration clause. In particular, the combined judgment of Lords Hamblen and Leggatt (with which Lord Kerr agreed) contains, at paragraph 170, a very clear and concise summary setting out the law (as they held it to be) which may well become the starting-point when advising clients hereafter. An important point to bear in mind, in light of the Supreme Court's decision, is that, at the end of the day, irrespective of the approach to be taken to identifying and then applying a system of law to an arbitration agreement, there are simply some arbitration agreements that are "pathological", i.e. they are so poorly drafted that effect cannot be given to them. This is a function of poor drafting and it is not a lacuna in the law relating to arbitration that this may be the unfortunate result in a particular case.

So far as the practicalities of drafting are concerned, the decision certainly clarifies how arbitration agreements and the contracts within which they appear may be construed, and this should factor into their drafting henceforth. One of the practical impacts is that it is now more likely that an express choice of law clause in a main contract will be regarded as extended to its arbitration agreement as well, so, if parties wish for some other law to regulate their arbitration agreement (typically, the law of the seat), they would be well-advised to make this as clear as possible.

We have often heard it said, and indeed have advised ourselves, that there may be merit to including an express choice of law stipulation within an arbitration agreement itself. But some caution needs to be exercised here. It may be that ultimately the application of the law expressly chosen serves only to invalidate the arbitration agreement (cf. Sulamérica) with little room to manoeuvre for a tribunal or court seeking to give effect to the parties' evident intention to submit their disputes to arbitration. On the other hand, not including an express stipulation in the arbitration agreement may leave room for application of the validation principle. The appropriate course to take when it comes to including an express stipulation will of course depend on the parties' bargaining priorities.

In addition, it is not clear from Enka whether there is any room for application of the validation principle in circumstances where there is no express or implied choice of law, and yet applying the law of the seat (at the closest connection stage) will invalidate the arbitration agreement. The minority expressly said the validation principle should apply at the closest connection stage (there being no default presumption). The majority left that point open as it did not arise in the case. In light of this, it may be preferable to ensure that safe seats are selected i.e. seats which have a pro-arbitration policy and which are highly unlikely to invalidate an arbitration agreement on idiosyncratic grounds.

CONCLUSION

The decision in Enka marks a substantial development in the wider international debate on the approach to identifying the proper law of an arbitration agreement. It is unlikely to be the final word on this rich and complex subject, but it is does settle the English law approach for the majority of cases where the main contract does include an express choice of law.

That said, this article has canvassed a number of remaining questions. The proper law debate is likely to remain topical for years to come.

YUANDA AND ESTABLISHING AND ASCERTAINING UNDER THE ABI MODEL FORM OF UK PERFORMANCE BOND: CONCEPTUAL AND PRACTICAL CHALLENGES (PART ONE)

Alexandra Bodnar and James Bradford

In this two part series, Alexandra Bodnar and James Bradford explore the recent decision in *Yuanda (UK) Company Limited v Multiplex Construction Europe Limited* [2020] EWHC 468 which has the potential to shake up the UK construction performance bonds market with its conclusion that an adjudicator's decision is sufficient 'to establish and ascertain' the net sums due under the bond. In Part One, Alex and James outline Fraser J's reasoning and the possible conceptual challenges, before analysing in Part Two[1] the practical difficulties which practitioners and market players will need to be alive to when negotiating and dealing with these bonds in the shadow of *Yuanda*.

SUMMARY OF RELEVANT PARTS OF THE DECISION

Yuanda concerned an amended ABI model form of performance bond. The ABI model form is commonly used in UK construction projects. It is a conditional (rather than an on-demand) form of bond. Clause 1 of the bond in *Yuanda* stated:

> *'The Guarantor guarantees to the Contractor that in the event of a breach of the Contract by the Sub-Contractor, the Guarantor shall subject to the provisions of this Guarantee Bond satisfy and discharge the damages sustained by the Contractor as established and ascertained pursuant to and in accordance with the provisions of or by reference to the Contract and taking into account all sums due or to become due to the Sub-Contractor'*

The underlying building subcontract was based

1 To be published in the following edition of Outlook and available on our website here.

on a JCT Design and Build Sub-Contract 2011. A dispute arose between the main contractor and subcontractor. The main contractor considered that liquidated damages (equivalent to a sum agreed between main contract and employer) were due to it for delays which were the fault of the subcontractor. The subcontractor disputed this and considered that it was entitled to extensions of time, refusing to allow or pay liquidated damages. The subcontract contained common-place wording allowing the main contractor to require payment of/deduct liquidated damages (assuming various pre-conditions had been met), and the subcontractor's failure to pay/allow deduction would be a breach. There was also an indemnity provision which, in essence, required the subcontractor to indemnify the main contractor in respect of losses suffered by the main contractor under the main contract with the employer, arising out of the subcontractor's breach.

The main contractor made a claim on the bond as a result of the subcontractor's breaches. The facts included that the bond was shortly due to expire and, by the time of the final hearing in *Yuanda*, there was an adjudication already on foot between the main contractor and sub-contractor concerning responsibility for delays, with a decision from the adjudicator expected imminently.

Fraser J decided that a valid adjudicator's decision would establish and ascertain the net sums for the purpose of the main contractor's claim on the bond (assuming an adjudicator's decision in the main contractor's favour).[2] Conversely, the main contractor's demand in accordance with the subcontract for payment of liquidated damages and the sub-contractor's failure to pay, would not. In his reasoning, Fraser J emphasised the importance of the terms of the underlying building contract, in particular the fact that the building contract provided for adjudication.[3] He also relied on the fact that the main contractor's demand by definition would not be an assessment by an independent third party/decision maker, in contrast to an independent adjudicator's valid decision.[4]

CONCEPTUAL DIFFICULTIES WITH THE DECISION

At first blush, the decision in *Yuanda* may seem unproblematic as a matter of theory. On the one hand, Fraser J is merely seeking to rely on a simple construction of the underlying building contract and his Lordship was merely following the contractual mechanism provided in said contract which, in the instant case, provided for adjudication. Indeed this is how his Lordship sought to reconcile the previous decision in the case of *Ziggurat (Claremont Place) LLP v HCC International Insurance Company plc* [2017] EWHC 3286 (TCC).[5]

Of course, it is obviously right to look and interpret the contract in accordance with what the parties intended and to start from the position of prioritising the contractual mechanism within the building contract. However, in dismissing the 'non-independent route' as insufficient, this imposes a limitation to the efficacy of some terms. This gives rise to a number of conceptual difficulties.

Firstly, what happens when these two principles (of giving effect to the underlying building contract and ensuring an independent decision-maker) collide? In other words, what happens if the parties have specifically established a non-independent means of certification and to give effect to their contractual intentions would mean permitting this mechanism for 'establishing and ascertaining'. For instance, as has been noted by commentators elsewhere,[6] under the JCT 2016 Design & Build standard form, it is an employer who issues a statement (as opposed to a contract administrator issuing a certificate) after a contractor insolvency/defined breach situation. The equivalent clause

2 [2020] EWHC 468, paragraph 83.
3 [2020] EWHC 468, paragraph 68.
4 [2020] EWHC 468, paragraphs 69–70.
5 [2020] EWHC 468, paragraph 90. 5
6 See Steven Carey's blog on: http://constructionblog.practicallaw.com/yuanda-v-multiplex-ascertaining-damages-pre-adjudication-under-abi-bond/

in the JCT 2016 SBC standard form (the 2011 version of which was in play in *Ziggurat*) provides two options – either the employer can issue a statement or the contract administrator can issue a certificate. In *Ziggurat*, perhaps fortunately, the contract administrator had issued a certificate. But there is no suggestion in *Ziggurat* that the answer would have been different if the employer had issued a statement.[7] The question arises whether, post-*Yuanda*, it will ever be permissible to rely on an employer's statement, despite this being the approach agreed in the building contract.[8]

Secondly, and somewhat similarly, how does the decision of Fraser J fit with some of the older case law and in particular the decision of HHJ Peter Bowsher QC in *Paddington Churches Housing Association v Technical & General Guarantee Company Ltd* [1999] BLR 244? There the underlying building contract provided for the employer to issue a statement setting out an account of what was due between the parties following a determination of the contractor's employment for insolvency or breach. HHJ Peter Bowsher QC reasoned that since no statement had been provided pursuant to that clause, the right to make a call on the bond had not arisen but such a right would exist once the employer had issued that certificate:

> *'… the damages [under the bond] are calculated by reference to the code of the contract which are in any event unlikely to be different to the damages at common law. The accuracy of the employer's statement might be challenged in the courts, but the employer's statement is required before the damages can be said to be ascertained and there is no liability on the defendants until those damages are ascertained'.*[9]

It is unclear how the decision in Yuanda squares with this earlier judgment in *Paddington Churches*.
Thirdly, where different contractual mechanisms are provided for, is adjudication always the preferred route or mechanism? It is not entirely clear what would happen if the contract provided for different mechanisms and this raises the question whether adjudication per se is always the preferable solution in all cases whenever it is provided for within the underlying contract. This is particularly important given that the right to adjudicate will be an express or implied right in most UK construction contracts. It is common to see tiered dispute resolution clauses or a menu of dispute resolution options – agreement between chief executives, adjudication, litigation/arbitration, expert determination – in addition to (in some cases) a contract administrator's certificate.

How is an employer to choose? Would chief executives pass the 'independent decision-maker' test? Probably not. What if a contract administrator's independence is challenged? Does a tribunal then have to deal with the merits of that argument in order to decide whether a certificate issued by that person is valid?

Fourthly, it isn't entirely clear how the concept of adjudication can be reconciled with the fact that, as per the relevant part of the ABI model bond wording ('taking into account all sums due or to become due to the Contractor'), it is only the ***net*** damages which the beneficiary can claim under the bond. Indeed as will be familiar to practitioners, it is for the referring party to set the terms of reference in an adjudication. Frequently, one sees narrow or very specific disputes referred to adjudication, precisely with a view to shutting-out arguments about other matters which may be less advantageous to the referring party. Whilst a responding party is free to raise any relevant defence, that will often not include freedom to ask the adjudicator to determine any cross-claim or determine exactly why sum might be due to the responding party. Consequently, an adjudicator's decision will often (quite legitimately) not consider

7 See *Ziggurat* [2017] EWHC 3286 (TCC), paragraphs 56–57.

8 See also: http://constructionblog.practicallaw.com/yuanda-v-multiplex-ascertaining-damages-pre-adjudication-under-abi-bond/

9 *Paddington Churches Housing Association v Technical & General Guarantee Company Ltd* [1999] BLR 244, per Peter Bowsher QC at paragraph 24.

fully or at all a contractor's cross-claims and so will not result in a Decision which establishes the 'net' sum due.

In *Yuanda*, Fraser J considered the terms of reference in the adjudication at paragraphs 82–83 and noted at paragraph 83: 'a decision by the adjudicator, *when one considers the scope of the dispute referred to him, would undoubtedly qualify …*' (emphasis added). There, the scope of the dispute was wide enough to allow the subcontractor to raise any defences available to it in respect of the claim for LADs. Perhaps, if the nature or scope of the dispute had been different, Fraser J's answer may have been different. But the subcontractor argued before Fraser J that, in addition to its claim for extensions of time, it had additional claims as set out in a final account which had been submitted to the main contractor – which would not be considered in the adjudication.[10] That point was dismissed by Fraser J, albeit it is not entirely clear how the adjudication could have resulted in a true "net" position in these circumstances.

These points highlight the problems that will be explored in the second article in this series: namely that Fraser J's endorsement of adjudication as the answer to the question of how damages are to be 'established and ascertained' might have some real, practical consequences for litigants which need to be considered.

ERP SOFTWARE DISPUTES: COMMON PITFALLS

Karishma Vora

Multinational organisations spend significant money and resources on enterprise resource planning (**"ERP"**) software, such as SAP or Oracle, which automates or streamlines processes in operations, finance and human resource departments. Although ERP software can be supplied off-the-shelf, most customers seek adaptations and some may commission a bespoke product.
The level of cooperation necessary between a customer and supplier to successfully develop and implement an ERP project is set out in *Anglo Group Plc v Winther Browne & Co Ltd* (2000) 72 ConLR 118, in which HHJ Toulmin QC held that the following terms are implied in a "standard" contract: (a) the purchaser communicates clearly their needs to the supplier; (b) the supplier discloses whether or not those needs can be met; (c) the supplier takes reasonable steps to ensure that the purchaser is trained to use the system; and (d) the purchaser devotes reasonable time to understanding how to operate the system.

The substantial cooperation necessary to implement ERP software makes it ripe for disputes. It is no wonder that C-suite executives nervously pore over their ERP contracts. This article discusses common pitfalls to watch out for.

Misrepresentation

ERP software is often heavily pitched by suppliers desirous of winning a project in a competitive market. Sometimes the suppliers may over-pitch and the software fails to meet the functionality promised. A supplier might later be prevented from bringing a claim for breach of licence if it had made pre-contractual representations as to the suitability of the software (see *AFD Software v DCML Ltd* [2015] EWHC 453 (Ch) and [2016] EWCA Civ 425). In order to limit claims against it in relation to over-pitching, a supplier should consider incorporating exclusion or limitation clauses in the contract.

A customer might, nevertheless, find that a claim in misrepresentation may be a way of overcoming exclusion or limitation clauses. In *BSkyB Ltd v HP Enterprise Services UK Ltd* [2010] EWHC 86 (TCC); 129 ConLR 147, the court found that a representation as to how long it would take to deliver a project was a fraudulent misrepresentation where it was false and made without reasonable grounds.

Excess Usage

10 [2020] EWHC 468, paragraphs 85–86.

ERP software is usually licensed, rather than sold outright. Suppliers typically define the parameters within which the licence can be used, such as the purpose for which the software can be used, the number of users or devices, or geographical restrictions. Where the scope is defined by numbers of users, this may be by reference to the maximum number of users permitted to use the software simultaneously ("concurrent" users) or by reference to the size of the user-base as a whole.[1]

Disputes can arise if the supplier believes there has been excess usage, for example, the number of users exceeded what is stated on the licence. In *SAP UK Ltd v Diageo Great Britain Ltd* [2017] EWHC 189 (TCC), SAP granted a licence on a "named user" basis. A few years later, Diageo used a system that enabled its customers to place orders and manage their accounts directly through a call centre ("Connect") and an app ("Gen2"). SAP claimed that Connect and Gen 2 used/ accessed SAP's ERP software and that Diageo owed additional licensing and maintenance fees in excess of £54million.

In a trial on liability (i.e. not on the amount of damages), the English High Court ruled in favour of SAP. It held that Diageo's customers, who were not named users of the software, used the ERP indirectly. *SAP v Diageo* has since become a leading authority on indirect usage.

It is of course advisable to robustly negotiate the most favourable terms rather than subsequently having to grapple for remedies in court. Customers should consider the scope of the licence with care and understand its limitations. They should attempt to avoid hidden costs by paying close attention to the definitions of "use", "access", "direct", "indirect" and so on.

Customers and those advising them should consider what best reflects the actual or intended use of the software. Are there likely uses that will attract payments of increased licence fees to the supplier? Will such costs be absorbed by the customer or passed on to the end customer? Would it be sensible to negotiate a cap on the costs of additional licence usage? Since an ERP system is likely to be in place for several years, if not decades, it is crucial to give proper thought to the customer's IT estate over the life-cycle of the licence.

Delay / defects

The implementation of an ERP project may well fall behind schedule or exceed budget. The customer may be unable to rely on the supplier missing the date for completion where the customer has waived or varied the date, caused part of the delay or asked for additional functions. Nevertheless, where delay cannot be relied upon as grounds for terminating the contract, it may still amount to a breach of contract giving rise to a liability for damages.

The customer may have a claim in tort where no breach of contract claim is available. Section 13 of the Supply of Goods and Services Act 1982 confers on the supplier an obligation to exercise reasonable skill and care, subject to valid exclusion clauses in the agreement. Since the cause of action in tort accrues when loss is suffered (rather than when the breach of contract occurs), such a claim may helpfully have the effect of extending to a later date the expiry of the limitation period.

Finally, even when successfully implemented, it may be that the software is not fit for purpose. In these circumstances, the customer may be entitled to reject the ERP outright and recover the full consideration where the system contains defects which deprive the customer of substantially the whole benefit that was intended. Where the whole system cannot be rejected, a claim may lie for the difference in value between that which was purchased and that which was delivered.

1 *Bullen & Leake & Jacob's Precedents of Pleadings* (19th edn), para 33-13.

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