



ARBITRATION CLAUSES AFTER *WEST TANKERS*: THE UNANSWERABLE CONUNDRUM? PRACTICAL SOLUTIONS FOR ENFORCING ARBITRATION CLAUSES

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Introduction

On February 10, 2009, the European Court of Justice (ECJ) handed down its decision in the *West Tankers* case.¹ It held that anti-suit injunctions which restrained parties from pursuing court proceedings in breach of an arbitration agreement were incompatible with Regulation 44/2001² (the “Regulation”). The result of *West Tankers* is that where a party brings court proceedings in breach of an arbitration agreement and the relevant court determines that it has jurisdiction under the Regulation due to the fact that the substantive subject-matter of the dispute falls within the scope of the Regulation, it will be for that court to decide whether or not there is a valid and binding arbitration agreement. If it determines that there is a binding agreement, it should refer the dispute to the appropriate arbitral body. However, until that determination has been made, the other party is powerless to prevent the party who has referred the matter to court from continuing with the court proceedings.

The decision in *West Tankers* therefore creates uncertainty for parties who are subject to arbitration agreements. It also causes delay and additional costs being incurred for the party forced to respond to court proceedings issued in breach of the arbitration agreement. Furthermore, any jurisdictional hearing will result in a loss of confidentiality, which is often one of the reasons why parties opt for arbitration in the first place.

Given the wide reaching implications of the judgment, it is not surprising to find that there has been a great deal of debate and analysis about the case and the conclusions reached by the ECJ. However, not much has been said about the practical issues facing parties who wish to insert effective arbitration clauses into their business agreements, and the potential solutions available to them. Furthermore, there has been very little practical guidance

for parties who have already entered into arbitration agreements.

This article provides some suggested practical solutions based on English law. A number of these suggestions are relevant at the drafting stage of the agreement, while others come into play when there is either an anticipated or actual breach of the arbitration agreement by the other party. This list is not exhaustive and, although there have been some positive indications from the English courts which will be discussed below, it is too early to say whether or not any of these solutions will work or whether or not the courts will enforce them. However, regardless of their effectiveness, one thing is for certain, parties wishing to enter into arbitration agreements must reconsider their positions in order to ensure that they are prepared for the consequences of *West Tankers*.

Possible solutions

The drafting solutions proposed in this article aim to work in two ways. First, they should provide additional deterrent value, which should help to avoid a breach of the arbitration agreement in the first place, i.e. be preventative. Secondly, in the event of a breach of the arbitration agreement, they should work to assist the party responding to the breach, i.e. be responsive.

However, it should be pointed out at the outset that, in the event of one of the parties breaching the arbitration agreement by issuing court proceedings, the innocent party³ will need to wait until that court has made a determination before it knows whether or not it can enforce the terms of the agreement. If that court determines that it has jurisdiction under the Regulation and then subsequently determines that the agreement does not contain a valid and binding arbitration agreement, any provisions in the agreement which have been inserted to support the arbitration agreement, such

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¹ *Allianz SpA (formerly Riunione Adriatica di Sicurtà SpA) v West Tankers Inc* (C-185/07) [2009] 1 All E.R. (Comm) 435.

² Regulation 44/2001 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2001] OJ L12/1.

³ In considering the potential options available to parties, this article refers to the “innocent party” to mean that party which will need to respond to an actual or anticipated breach of an arbitration agreement by the other party to the agreement.

as the undertakings and indemnities referred to below, will also be void.

On the other hand, if the court refers the dispute to arbitration because it decides that it does not have jurisdiction when applying the “subject-matter” test or that it does have jurisdiction but that there is a binding arbitration agreement, the innocent party will be free to enforce the terms of the agreement in the arbitration and sue for damages for any breaches. Until that determination has been made, these provisions should continue to provide deterrence value.

Undertakings

Parties should devote as much drafting time and attention to the arbitration provisions of an agreement as they do to other important provisions when negotiating and drafting its terms, especially in the light of the *West Tankers* decision. One way of protecting the innocent party is to insert appropriate undertakings in the agreement pursuant to which the parties undertake not to bring court proceedings in breach of the arbitration agreement. The parties may wish to include a list of the countries which are subject to the Regulation (as well as a list of the EFTA countries which have similar obligations under the Lugano Convention⁴) in the wording of the undertakings so that the parties undertake not to bring proceedings in those specific jurisdictions. The advantage of drafting the undertakings in this way is that the innocent party will have specified more precisely in advance of a dispute the nature of the obligations owed by the breaching party. This should make it easier and quicker to enforce the terms in the event of a breach.

In the event of one of the parties breaching the undertakings by issuing court proceedings, the innocent party must wait to see if the court decides to refer the matter to arbitration (see above). If there is a referral to arbitration, the innocent party may sue for breach of the undertakings in the agreement. To ensure maximum recovery of any losses incurred as a result of such a breach, parties may wish to insert appropriate indemnity and/or liquidated damages provisions in the agreement. This is discussed further below.

In addition to the undertakings in the agreement, parties may wish to bolster their relative positions by obtaining personal undertakings from the directors and/or senior employees of the respective companies, thereby making those individuals party to the agreement. Companies may be less likely to take steps in breach of the arbitration agreement if those in control of the company and those making the relevant decisions are personally bound by the relevant obligations. These personal undertakings would mirror those given by the company and would involve, for instance, an undertaking not to cause the relevant company to bring proceedings in breach of the arbitration agreement. The parties’ positions may also be strengthened by obtaining financial guarantees from the directors and/or senior employees of the company.

4. The Lugano Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters September 16, 1988.

In the event of a breach, the position is the same as at the company level (see above), but in this situation, the innocent party sues the individuals concerned.

Indemnities and liquidated damages

To ensure that the innocent party is able to recover its costs and damages in the event of a breach of the arbitration agreement and any associated undertakings (see above) parties may wish to insert appropriate indemnities and/or a liquidated damages clause.

The indemnity provisions should provide that the breaching party will indemnify the innocent party for all losses in the event of a breach of the arbitration agreement, and/or for a breach of any of the other relevant provisions, such as the undertakings. For instance, the parties may agree to indemnify the innocent party for the legal costs, loss of management time, and travel costs incurred in having to fight the jurisdictional hearing. Parties should consider the different types of losses that their businesses are likely to suffer as a result of a breach of the arbitration agreement and draft the indemnities accordingly.

In addition to the indemnities, or as an alternative, the parties may wish to insert a liquidated damages clause in the agreement. This will quantify in advance the losses that will be incurred by the innocent party following a breach of the arbitration agreement and any other relevant provisions (such as the undertakings). For instance, the parties may wish to quantify the likely cost of lost management time. For example, the innocent party may calculate that the jurisdictional hearing will take four months before the court reaches its conclusion, and that for one of its managers to work on the case will cost the company £5,000 per month in terms of salary, and £20,000 per month in terms of lost profits. Therefore, based on these figures, it would cost the innocent party £100,000 for one of its managers to be diverted to deal with the jurisdictional hearing. If the innocent party reasonably estimates that two managers will be required to deal with the jurisdictional hearing, this pre-estimate would be revised upwards to £200,000 for the lost management time. As with the indemnity provisions, parties should consider the different types of losses that their businesses are likely to suffer as a result of a breach of the arbitration agreement.

The advantage of inserting indemnities and/or a liquidated damages provisions in the agreement is that it brings certainty for the innocent party as it will know in advance of a dispute, to some extent, which losses it will be able to recover under the agreement. Furthermore, unless the clauses are considered by the courts to be unenforceable, these clauses will allow the innocent party to recover for types of losses which may otherwise be struck out for being unforeseeable or too remote. A further advantage of indemnities and/or a liquidated damages clause is that it will make it quicker and easier for the innocent party to bring a claim for the losses it has already identified and quantified.

As with the undertakings discussed above, in the event of a breach of any undertakings or the arbitration agreement, the innocent party must wait to see how the court determines the jurisdictional issue and the issue of the validity of the arbitration agreement. If the matter

is referred to arbitration, it can sue for damages and recover its losses under the indemnities and/or liquidated damages provisions.

Pre-emptive proceedings

The option of bringing preemptive proceedings is often cited as one of the ways in which the innocent party may avoid the consequences of *West Tankers*. If the innocent party reasonably believes that the other party will issue court proceedings in breach of the arbitration agreement, it may wish to issue preemptive proceedings in a jurisdiction of its choice in order to take advantage of the first-seised rule under art.27 of the Regulation. This is an important consideration as different jurisdictions may answer the question of validity of the arbitration agreement in different ways depending on their own domestic laws. Furthermore, if the relevant court determines that there is no valid arbitration agreement, it may decide to hear the case itself. This may result in an unfavourable judgment for the innocent party due to the nature of the different laws which may apply.

Although this option may, prima facie, involve a breach of the arbitration agreement by the innocent party, the purpose of issuing the proceedings is in fact to enforce the arbitration clause. By issuing preemptive proceedings, the innocent party is merely ensuring that a court of its choice will make the determination as to whether or not the arbitration agreement is valid once it has accepted jurisdiction under the Regulation.

However, before embarking on this course of action, the innocent party must bear a number of important considerations in mind in the light of the English High Court's decision in *National Navigation v Endesa*.⁵ First, it must ensure that the court has jurisdiction under the Regulation to hear the dispute. If the Court does not have jurisdiction under the Regulation, it is likely that it will award indemnity costs as happened in that case.

Secondly, when issuing preemptive proceedings, the innocent party must ensure that they are not renouncing or repudiating the arbitration agreement through their conduct. The test is whether an objective observer would conclude that the innocent party had evinced to the other party an intention not to be bound by the arbitration agreement.⁶ However, resort to legal proceedings in itself does not constitute a repudiation of the arbitration agreement, as was confirmed by the Court in *National Navigation v Endesa*. Nevertheless, if an innocent party decides to issue preemptive proceedings, he must bear this consideration in mind.

Right for one party to issue proceedings

In order to give one of the parties to an arbitration agreement time to issue preemptive proceedings where there is a risk that the other party will breach the agreement by issuing court proceedings, the parties may wish to insert a

provision in the agreement which provides that only one party may formally commence arbitration proceedings once it is notified of a potential claim by the other party. Such a clause does not prevent the other party from having the right to bring a claim but simply gives the right to instigate the arbitral proceedings in the first instance to one party only. When that party is notified, it will be obliged to commence arbitration if that is the wish of the other party. If it fails to do so, the other party should be able to commence proceedings. Although such a clause is not guaranteed to prevent the other party from issuing court proceedings in breach of the notification requirements and in breach of the arbitration agreement, it will nevertheless provide some deterrence value.

Notice of claim

An alternative way of improving the preemptive options available to the innocent party is to insert a provision in the agreement which obliges the parties to give notice of a potential claim to the other party. This is distinct from the provision suggested earlier whereby only one party is entitled to instigate arbitration proceedings following notification of a potential claim. Since the notice provision is binding on both parties, such a provision should be easier to negotiate and agree. Although this will not in itself prevent the breaching party from issuing proceedings, it may make the breaching party think twice before issuing proceedings. In the event of notification of a claim, and if there is a risk that the other party may bring court proceedings in breach of the arbitration agreement, the innocent party may decide to issue preemptive proceedings. However, the same note of caution mentioned above in relation to issuing preemptive proceedings is repeated here.

Arbitration in a non-Regulation country

In an attempt to avoid the effects of *West Tankers* parties may wish to insert provisions in the agreement which provide for arbitration in a non-Regulation country. This will allow the innocent party to invoke the powers of the non-Regulation court (which is not bound by the Regulation) should the other party issue court proceedings in breach of the arbitration agreement.

Representation that there is a valid and binding arbitration agreement

Under the Regulation,⁷ and as confirmed by the ECJ in *West Tankers*, conventions such as the New York Convention⁸ will continue to have full effect. Under art.II(3) of the New York Convention, a court seised with the action in a matter shall refer the parties to

5. *National Navigation Co v Endesa Generacion SA* [2009] EWHC 196 (Comm).

6. See *National Navigation v Endesa* [2009] EWHC 196 (Comm) at [115], per Gloster J.

7. See recital 25 to Regulation 44/2001: "Respect for international commitments entered into by the Member States means that this Regulation should not affect conventions relating to specific matters to which the Member States are parties."

8. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed in New York on June 10, 1958.

arbitration at the request of one of the parties where there is a valid arbitration agreement unless the arbitration agreement is null and void, inoperative or incapable of being performed. Therefore, it may be useful to have express acknowledgements in the agreement whereby the parties acknowledge that they have sought independent legal advice in relation to the validity of the arbitration agreement and acknowledge and agree that it is valid, binding and operable as against each one of them.

This may not prevent a party from bringing court proceedings in breach of the arbitration agreement, but in the event that the relevant court decides that the subject matter of the dispute brings it within the Regulation, these express acknowledgements may provide additional and compelling evidence of the existence of a valid and binding arbitration agreement. These acknowledgments may therefore convince the court to refer the matter to arbitration in accordance with the parties' agreement. Furthermore, these acknowledgements may speed up the process of determining jurisdiction, and thus save the innocent party time and costs. They may also deter a party from commencing court proceedings in the first place.

Further solutions applying English case law

Position before West Tankers

Before the ECJ's decision in *West Tankers*, parties could enforce their arbitration agreements by applying to the English courts (where England was the seat of the arbitration) for an anti-suit injunction and/or by claiming the costs of the court proceedings brought in breach of the arbitration agreement in arbitration proceedings. However, following *West Tankers*, anti-suit injunctions are no longer available in this context and it is unclear whether or not costs may still be recovered.

Nevertheless, recent case law of the English courts provides authority for a number of alternative ways of avoiding the consequences of the ECJ ruling and these cases are instructive of the problems that are being encountered in practice. In each case, the innocent party brought proceedings in arbitration following a ruling of a Member State court. In both instances, the English court held that it was not bound by the decision of the foreign court for the reasons which will be discussed below.

Position after West Tankers

CMA v Hyundai and National Navigation v Endesa

The English High Court's decision in *CMA v Hyundai*⁹ provides authority for the proposition that an innocent party may sue the breaching party in arbitration for a breach of an arbitration agreement despite the fact that an EU court has already delivered an earlier judgment in favour of the breaching party. Although *CMA v Hyundai* was decided before the ECJ's decision in *West Tankers*, the proposition that the English courts are not necessarily

bound by earlier decisions of other EU courts is supported by the more recent decision of the English High Court in *National Navigation v Endesa* which was decided following the ECJ's decision in *West Tankers*.

CMA v Hyundai

In *CMA v Hyundai*, Hyundai entered into four shipbuilding contracts which provided for arbitration in London and also provided that the rights were not assignable without the prior written consent of either party, such consent not to be unreasonably withheld. CMA wished to take over the contracts, but Hyundai refused consent. CMA therefore issued proceedings in the French courts. CMA and Hyundai subsequently resolved the issue and concluded four novation agreements. However, CMA continued with the French proceedings and was awarded substantial damages which Hyundai paid. Following the French judgment, Hyundai brought London arbitration proceedings against CMA to recover the sums paid and contended that CMA was in breach of the arbitration agreement by continuing with the French proceedings. The arbitrators found in Hyundai's favour and held that the loss and damage caused by CMA's breach was the sum which Hyundai paid to CMA in the French proceedings. CMA appealed to the High Court on the grounds that the arbitration agreement did not apply to the French proceedings and, in the alternative, the arbitrators were bound by the French judgment pursuant to the Regulation.

The High Court dismissed the appeal and held that the only relevant question was what would have happened had the contract not been breached, applying the principle that a contract breaker should not be entitled to benefit from its own wrong (*New Zealand Shipping Co Ltd v Société des Ateliers et Chantiers de France*¹⁰). The Regulation was irrelevant to this question. The Court held that had the contract not been breached, the parties would have complied with their obligations to have the matter resolved by arbitration, and there would be no French judgment.

Since this case was decided before the ECJ's decision in *West Tankers*, it is not certain whether or not the *New Zealand Shipping* route is still good law. However, applying the case of *National Navigation v Endesa*, an innocent party may be able to reach the same conclusion on different grounds.

National Navigation v Endesa

Endesa entered into a supply contract for the purchase of coal which was to be delivered to Endesa in Spain on NNC's vessel. The vessel suffered damage and could not deliver the goods under the bill of lading to Endesa in Spain. The relevant charterparty included a London arbitration clause. Endesa issued an application in the Maritime Court in Spain for arrest of the vessel as security for its claim. This was granted, but the order required Endesa to file its main claim within 30 days. On the same date as Endesa's arrest application, NNC issued a claim form in the English High Court in view of the risk that Endesa might issue Spanish proceedings. Endesa subsequently issued Spanish proceedings in accordance with

9. *CMA CGM SA v Hyundai Mipo Dockyard Co Ltd* [2008] EWHC 2791 (Comm); [2009] 1 Lloyd's Rep. 213.

10. *New Zealand Shipping Co Ltd v Société des Ateliers et Chantiers de France* [1919] A.C. 1.

the Mercantile Court order. It was subsequently served with the English proceedings. NNC also commenced arbitration proceedings in London. The English court held that it had no jurisdiction under the Regulation to hear the claim and awarded indemnity costs to Endesa.

However, NNC had also applied for a declaration in the arbitration action that certain disputes between the parties were referable to London arbitration. The Spanish court had already held that the arbitration agreement had not been incorporated and that in any event NNC had repudiated or waived the arbitration agreement.

Proceedings not within the Regulation

The court in *CMA v Hyundai*, in obiter dicta, left open the possibility that, due to the wording of the Regulation, the Regulation did not apply to arbitration tribunals and that therefore they were not bound to recognise court judgments. However, in *National Navigation v Endesa*, the English court went further and held that they were not required to recognise the Spanish judgments in proceedings in another Member State which were not themselves proceedings within the Regulation because of the arbitration exception in art.1(2)(d).

Regulation 44/2001 article 34(1)—Public Policy Exception

As an alternative basis for its decision, the English court in *National Navigation v Endesa* applied art.34(1) of the Regulation which provides that a judgment shall not be recognised if such recognition is manifestly contrary to public policy in the Member State in which recognition is sought. The Court held that it would be manifestly contrary to public policy of the United Kingdom to recognise the Spanish court's judgment in relation to non-incorporation of the arbitration agreement and the alleged waiver of any agreement. The possibility of advancing an argument under art.34 had also been raised in obiter dicta in *CMA v Hyundai*.

Therefore, the English court held that it had to decide for itself whether the arbitration clause was validly incorporated and whether or not NNC had waived or repudiated the arbitration agreement in commencing the court proceedings. The English court held that there was a valid arbitration agreement and that NNC had not waived it.

The English court's decisions in these two cases provide the innocent party with additional options in the event of an anticipated or actual breach of an arbitration agreement. However, parties should be aware of the risk that these cases may be appealed.

Conclusion

The ECJ's decision in *West Tankers* has created a number of serious issues for parties wishing to have their disputes resolved by arbitration. One of the major concerns is the lack of certainty for parties subject to arbitration agreements. The consequence of all this may be that fewer businesses will choose European arbitration centres and will instead opt for jurisdictions which afford them more certainty. It has been suggested by some that the only possible solution to these problems is a reform of the law. However, unless the law is substantially amended and/or the ECJ is told that its approach is wrong, it is difficult to see how a reform of the law would fix this problem.

Nevertheless, in spite of the ECJ's approach, recent decisions from the English courts indicate a reluctance to allow parties to breach the terms of an arbitration agreement and a willingness to come up with alternative ways of getting around the *West Tankers* problem. However, parties will have to wait and see whether or not the current approach of the English courts will continue or whether they will be overturned in the future.

In the meantime, parties will need to reconsider the arbitration clauses in their agreements to ensure that they are prepared for the consequences of *West Tankers*. It is difficult to see why parties will not agree to the inclusion of additional provisions in the agreement to enforce the arbitration agreement, since these obligations will only be relevant if there is a breach of the arbitration agreement.