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BNA v BNB: CAPPUCCINO WITHOUT THE FOAM

[2020] SAL Prac 6

The Singapore Court of Appeal had reason to consider the law in relation to the selection of the *lex arbitri* and the seat of arbitration, in a situation where the obvious choice of the *lex arbitri* could render the entire arbitration agreement invalid. While the Singapore court was able to deftly avoid thorny issues of separability and the extent to which an express choice of the *lex arbitri* had to be "express" to reach its conclusion, in a case shortly thereafter, the Court of Appeal of England and Wales considered these very same issues.

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I. Introduction

1 "[F]or arbitration in Shanghai" – a seemingly innocuous phrase that caused parties in *BNA v BNB*[1] unexpected consternation. The majority of the tribunal (the "Majority") believed the phrase to be nothing more than a selection of the venue for hearings, while the sole dissenting arbitrator (the "Minority") took the view that the phrase amounted to an obvious reference to the seat of the arbitration. The High Court sided with the Majority. The Court of Appeal overruled this finding, agreeing with the Minority that the simple phrase "for arbitration in Shanghai" held only its

1 [2020] 1 SLR 456.

obvious and *ex facie* meaning, *ie*, that Shanghai was the seat of the arbitration, regardless of whether such a finding would mean that tribunal had no jurisdiction to determine the dispute between the parties.

2 As observed in *BCY v BCZ*[2] ("*BCY*"), Singapore law accepts a potential nexus between the *lex arbitri* and the seat of an arbitration. This results from the acceptance of the framework in *Sulamérica Cia Nacional de Seguros SA v Enesa Engelharia SA*[3] ("*Sulamérica*"):

> (a) What is the parties' express choice of law to govern the arbitration agreement?
>
> (b) If there is no express choice, then what is the implied choice of the parties – as gleaned from their intentions at the time of contracting?
>
> (c) If there is no implied choice, then what is the system of law that has the closest and most real connection with the arbitration agreement?

3 The seat of the arbitration is one of many factors that can be considered when determining the system of law that has the closest and most real connection with the arbitration agreement. However, where there is a dispute as to the seat of arbitration, determining the *lex arbitri* can become complicated if the *lex arbitri* cannot be determined in the first two stages of the *Sulamérica* framework. Incorrectly identifying the seat of arbitration could result in the invalidity of any arbitration award.[4]

4 In recent decisions, the Singapore Court of Appeal has emphasised that Singapore's pro-arbitration policy is subject to limits. In *BNA v BNB*, the Court of Appeal took pains to remind the arbitration community that:[5]

> ... it does not follow that the parties' manifest intention to arbitrate must always be given effect to come what may. Ultimately,

2 [2017] 3 SLR 357.
3 [2013] 1 WLR 102.
4 *ST Group Co Ltd v Sanum Investments Ltd* [2020] 1 SLR 1 at [102].
5 *BNA v BNB* [2020] 1 SLR 456 at [2].

> whether the parties' intention to arbitrate should be enforced invariably depends on the wording and proper construction of the arbitration agreement. What must not be overlooked is that arbitration agreements, despite the best of intentions of the parties, can at times be invalid for any one of a variety of reasons. After all, the [New York Convention] expressly contemplates that arbitration agreements can be 'null and void, inoperative or incapable of being performed'.

5 This article provides a case update and identifies further developments since the release of the Court of Appeal's judgment. From the authors' perspective, the Court of Appeal's judgment may be like a cappuccino without the foam, missing the opportunity to cap the case off by giving its indubitably valuable input on two issues:

(a) How express does an express selection of *lex arbitri* have to be?

(b) How narrow is the legal fiction of separability?

A. Factual matrix

6 In *BNA v BNB*, the plaintiff ("BNA") and the first respondent ("BNB") entered into an agreement ("Takeout Agreement"), under which BNA agreed to buy and BNB agreed to sell certain industrial gases. BNB subsequently assigned its rights under the Takeout Agreement to the second respondent ("BNC") – an assignment that was contemplated by the parties at the outset.

7 The critical provisions of the Takeout Agreement are the preamble and Art 14:

> This agreement (hereinafter called "Agreement") is made and entered into on Aug 7th, 2012 by and between [BNB] and [BNA] ...
>
> ...
>
> Article 14: Disputes
>
> 14.1 This Agreement shall be governed by the laws of the People's Republic of China.
>
> 14.2 With respect to any and all disputes arising out of or relating to this Agreement, the [p]arties shall initially attempt in good faith to resolve all disputes amicably between themselves. If such negotiations fail, it is agreed by both parties that such

> disputes shall be finally submitted to the Singapore International Arbitration Centre (SIAC) for arbitration in Shanghai, which will be conducted in accordance with its Arbitration Rules. The arbitration award shall be final and binding on both [p]arties.

8 A dispute arose as between BNA and BNC, which resulted in the respondents filing a notice of arbitration. BNA thereafter challenged the tribunal's jurisdiction on the following basis:

> (a) The *lex arbitri* has been, expressly or impliedly, chosen to be the law of the People's Republic of China ("PRC") as a result of Art 14.1 of the Takeout Agreement. However, PRC law did not allow domestic disputes to be administered by foreign arbitration institutions such as the Singapore International Arbitration Centre (the "SIAC").
>
> (b) The seat of arbitration was expressly chosen as Shanghai in Art 14.2 of the Takeout Agreement. However, foreign arbitration institutions are prohibited from administering arbitrations seated in the PRC under PRC law.

9 BNA maintained this approach before the tribunal, High Court and Court of Appeal.

10 The respondents argued that:

> (a) The tribunal should adopt a preliminary step of determining the seat of arbitration. Shanghai was no more than a choice of venue, and there were three indications that Singapore was the seat:
>
> (i) rule 18.1 of the SIAC Rules 2013;
>
> (ii) the reference to "*Singapore* International Arbitration Centre" in Art 14.2 of the Takeout Agreement;[6] and
>
> (iii) extrinsic evidence of pre-contractual negotiations showed that parties had always

6 This line of argument was not pursued by the respondents before the Court of Appeal.

intended for Singapore to be the seat of the arbitration, instead of Shanghai.[7]

(b) The implied choice of PRC law as the *lex arbitri* ought to be displaced in favour of Singapore law (as the law of the seat) given the risk that the arbitration agreement might be invalid under PRC law. However, even if the *lex arbitri* was PRC law, the arbitration agreement would not have been invalid under PRC law.

B. The tribunal's decision on the jurisdictional challenge

11 The tribunal could not come to a unanimous decision on whether it had jurisdiction to determine the dispute as between the parties. The Majority were concerned that the *lex arbitri* had to be a law that would not invalidate the arbitration, affirming the validation principle and the principle of effective interpretation. This forced the Majority to engage in reverse engineering the outcome:

(a) As the choice of Shanghai as the seat of arbitration *could* render the arbitration agreement invalid under PRC law, it was therefore ambiguous. Considering this ambiguity, parties could not have intended "for arbitration in Shanghai" to be a reference to the seat of arbitration. Accordingly, applying r 18.1 of the SIAC Rules 2013, the seat of arbitration was Singapore with Shanghai merely constituting the venue for meetings and/or hearings of the tribunal.

(b) Given a real risk that the arbitration would be invalid under PRC law, it similarly followed that parties could not have intended the *lex arbitri* to be PRC law. Instead, the law of the seat (*ie*, Singapore) would be the *lex arbitri*.

12 On the other hand, the Minority found that it was obvious that the seat of arbitration was Shanghai, and the *lex arbitri* was

7 Extrinsic evidence was only adduced before the High Court. The respondents did not rely on extrinsic evidence in arguments before the tribunal.

PRC law. She gave a pointed criticism of the Majority's decision, noting that:

(a) The Majority had simply worked backwards from a conclusion that the arbitration clause was valid, and therefore treated all arguments supporting the validity of the arbitration clause as arguments that had to be correct.

(b) It was impermissible for the Majority to determine that a clause is ambiguous simply because a clause might be invalid if the choice of law properly ascertained is applied to it.

C. The High Court's decision in BNA v BNB

13 BNA availed itself of its remedies under s 10 of the International Arbitration Act[8] and filed an appeal against the Majority's jurisdictional award. Vinodh Coomaraswamy J dismissed BNA's application, finding that:

(a) The legal fiction of separability could be used resuscitate an invalid arbitration agreement, in a situation where the invalidity was the result of the operation of a provision of the substantive contract, contrary to the statements made by Moore-Bick LJ in *Sulamérica* at [26] and Chong J in *BCY* at [60]–[61].

(b) By incorporating the SIAC Rules 2013 into their arbitration agreement, Art 14.2 referred to two geographical locations – Shanghai and Singapore – and in these circumstances, Singapore is the seat of the arbitration and Shanghai is merely the selection of the venue of hearings. Crucially, the reason that Shanghai was not the seat was because the arbitration clause referred to "Shanghai" which was not a law district but a city.

(c) Article 14.1 of the Takeout Agreement could not amount to an express choice of the *lex arbitri*. While PRC law would be the implied *lex arbitri*, it would be displaced

8 Cap 143A, 2002 Rev Ed.

in favour of the law of the seat (*ie*, Singapore law) at the second step of the *Sulamérica* framework.

14 However, Coomaraswamy J granted leave to BNA to appeal against his own decision.

D. The Court of Appeal's decision in BNA v BNB

15 The Court of Appeal allowed the appeal in part, holding that:

(a) Article 14.1 of the Takeout Agreement could not amount to an express choice of the *lex arbitri*, as that would be inconsistent with *BCY*. Instead, there was a clear implied choice of PRC law as the *lex arbitri*.

(b) The natural meaning of the phrase "for arbitration in Shanghai" is a designation of Shanghai as the seat of the arbitration, consistent with *PT Garuda Indonesia v Birgen Air*.[9] Contrary indicia would be necessary in order to displace this finding. No such contrary indicia were present the present case. In particular:

(i) The fact that PRC law might render the arbitration agreement invalid could not be taken into consideration when construing Art 14.2 of the Takeout Agreement, unless this invalidity itself was operating on parties' minds at the time of contracting.

(ii) The reference to a city as opposed to a law district in an arbitration agreement is not unusual as commercial parties often do only specify either the city or country.

(c) Singapore cannot be the default choice of seat under r 18.1 of the SIAC Rules 2013 because this provision only applies in the absence of agreement by parties. In the present case, parties had chosen Shanghai as the seat of arbitration in Art 14.2 of the Takeout Agreement.

9 [2002] 1 SLR(R) 401.

16 In view of the Court of Appeal's findings, and the complex issues of PRC law that the case raised, it was clearly more appropriate for the PRC court to decide whether the tribunal had jurisdiction to determine the disputes between the parties under the Takeout Agreement.

II. Analysis

17 The Court of Appeal has now articulated the position most practitioners have taken hitherto. Under Singapore law:

(a) The *lex arbitri* is to be determined in accordance with the framework set out in *Sulamérica* as opposed to *FirstLink Investments Corp Ltd v GT Payment Pte Ltd*[10] ("*FirstLink*").

(b) A reference to a geographical location in an arbitration agreement is generally construed to be a selection of the seat, in the absence of clear indication to the contrary.

18 The Court of Appeal's analysis of the foregoing issues comprises the shots of espresso and steamed milk. However, in omitting its full views on the two issues discussed below, the foam in the cappuccino was missing, and an opportunity for further clarity may have been passed over.

A. How express does an express choice of lex arbitri *have to be?*

19 BNA argued that Art 14.1 of the Takeout Agreement did not just constitute an express choice of law that governed the substantive contract, but also comprised an express choice of the *lex arbitri*. This was because Arts 14.1 and 14.2 of the Takeout Agreement, being sub-clauses of the dispute resolution mechanism, were meant to be construed together with the preamble. The words "This Agreement" in Art 14.1 of the Takeout Agreement was a reference to all clauses in the agreement, not all clauses but excluding the arbitration agreement. Such an

10 [2014] SGHCR 12.

interpretation is consistent with, *inter alia*, *Arsanovia Ltd v Cruz City 1 Mauritius Holdings*[11] ("*Arsanovia*").

20 The Court of Appeal disagreed and came to a finding which it considered consistent with the decisions of *BCY* and *Sulamérica* wherein the courts held that an express choice of the law that governed the substantive contract could only be used to *infer* the *lex arbitri*.

21 Ultimately, the issue of whether the *lex arbitri* had been expressly chosen was not canvassed before Chong J in *BCY* as the defendant argued only that there had been an implied choice of the *lex arbitri*; the focus in *BCY* was how to determine parties' implied choice of *lex arbitri* and whether the approach in *Sulamérica* or *FirstLink* represented the law of Singapore. As explained earlier, in *BCY*, the court determined that *lex arbitri* was to be determined in accordance with the approach in *Sulamérica*. It then becomes necessary to question why the governing law clause in *Sulamérica*, which referred to "this Policy", did not amount to an express selection of the *lex arbitri*. Again, the authors find the same answer, *ie*, the issue of whether there was an express selection of the *lex arbitri*, was not argued.

22 In *Arsanovia* at [22], Mr Justice Andrew Smith also sought to distinguish the clause in *Sulamérica* which referred to "this Policy" from clauses akin to Art 14.1 of the Takeout Agreement, which refer to "This Agreement":

> The governing law provisions in the agreements in the two Court of Appeal authorities referred to 'the policy' and 'this Policy' being governed by the internal laws of New York and Brazilian law respectively, and the word 'policy' might naturally be taken to connote to obligations and rights more directly relating to the insurance [than] the arbitration agreement.

23 Indeed, the following sentiments in *BCY* (at [59]) ought to apply with equal force in the context of determining whether there is an express selection of the *lex arbitri* as opposed to only at the second stage of the *Sulamérica* framework:

11 [2012] EWHC 3702 (Comm).

> To say that the word 'agreement' contemplates all the clauses in the main contract save for the arbitration clause would in fact be inconsistent with its ordinary meaning.

24 The theoretical possibility that parties can agree to have different systems of law govern different aspects of their relationship should not mean that governing law clauses ought to be interpreted in a manner that is arguably inconsistent with their ordinary meaning and/or the methodology generally adopted when construing terms in a contract, *ie*, if a particular term is defined in a contract (for example, "Agreement"), a commercial party would look for what that term meant. In the present case, parties agreed that the word "Agreement" referred to all clauses in the Takeout Agreement, as opposed to all clauses to the exclusion of the arbitration agreement. Hence, Art 14.1 should constitute an express choice of both the law governing the substantive contract and the *lex arbitri*.

25 The authors do not have reasons from the Court of Appeal for its rejection of such an approach – it only sought to broadly affirm the approaches in *BCY* and *Sulamérica*. As an aside, the Court of Appeal also did not justify its conclusion that there was no express choice of the *lex arbitri* on the basis of separability. The Court of Appeal did not consider it necessary to express any view as to the scope of separability. In the authors' view, for the reasons at paras 29 to 38 set out below, such justification would have been in any event erroneous. Separability ought to be irrelevant to the determination of the *lex arbitri*.

26 Less than a month after the Court of Appeal issued its judgment, the Court of Appeal of England and Wales (the "EWCA") released its grounds of decision in the case of *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)*[12] ("*Kabib-Ji*"), which involved similar issues. The contractual provisions in *Kabib-Ji* are materially similar to the Takeout Agreement. The following clauses are especially relevant:

12 [2020] EWCA Civ 6.

> Article 1: Content of the Agreement
>
> This Agreement consists of the foregoing paragraphs, the terms of agreement set forth herein below, the documents stated in it, and any effective Exhibit(s), Schedule(s) or Amendment(s) to the Agreement or to its attachments which shall be signed later on by both Parties. It shall be construed as a whole and each of the documents mentioned is to be regarded as an integral part of this Agreement and shall be interpreted as complementing the others.
>
> ...
>
> Article 15: Governing Law
>
> This Agreement shall be governed by and construed in accordance with the laws of England.

27 Significantly, the EWCA noted that there was no need for an express choice of the *lex arbitri* to be framed in a manner such as "This arbitration agreement shall be governed by English law". This appears to be different from the position expressed by the Singapore Court of Appeal. Indeed, Art 15 made clear that all terms of the agreement, including the arbitration agreement, were governed by English law. This does not necessarily render the first step of the *Sulamérica* framework otiose in that all governing law provisions would therefore amount to an express choice of the *lex arbitri*. Rather, on the correct construction of Arts 1 and 15 of the relevant agreement, the inclusion of the phrase "This Agreement" in Art 15 also amounted to an express selection of the *lex arbitri*.

28 It remains to be seen if Singapore's Court of Appeal will, having the benefit of *Kabib-Ji*, reconsider the question of how express an express choice of *lex arbitri* has to be. In particular, where a governing law clause is broad enough, no reason has been articulated to justify the governing law clause as only constituting an express choice of the law governing the substantive contract, when its natural and ordinary meaning would allow the governing law clause to also amount to an express choice of the *lex arbitri*. In the interim, parties who do wish to make an express selection of the *lex arbitri* should include a specific clause to this effect and cannot assume that an express choice of law to govern the entire agreement (including the arbitration agreement) would amount to an express choice of the *lex arbitri*.

B. How narrow is the legal fiction of separability?

29 In view of the findings of Coomaraswamy J in the High Court, which seemed to depart from positions taken in other common law jurisdictions, the authors believed it was critical that the Court of Appeal set out clear boundaries as to the scope of separability.

30 By way of background, before the tribunal and Coomaraswamy J, the respondents argued that separability provided an analytical reason not to apply a particular choice of law to the parties' arbitration agreement. BNA contested this position, noting that:

(a) Separability provides that an arbitration agreement is independent of the substantive contract and therefore can survive its invalidity or termination: *Sulamérica* at [9] and [26]).

(b) Separability does not mean that the governing law of the agreement is determined separately from the governing law of Art 14.2. It is irrelevant to such a determination.

(c) Separability was thus a very narrow doctrine.

31 Both the Majority and Coomaraswamy J agreed with the respondents. In particular, Coomaraswamy J determined that:

(a) The decision in *Sulamérica* at [9] and [26] was constrained by the application of s 7 of the English Arbitration Act 1996;[13] and

(b) Chong J was not seeking to define the limits of separability in *BCY* at [60] to [61].

32 BNA disagreed with Coomaraswamy J's reasoning and made the following arguments to the Court of Appeal.

33 First, separability was not a creation of statute in English law, but a creature of the common law.[14] Historically, separability

13 c 26.

14 *Heyman v Darwins Ltd* [1942] Lloyd's Rep 65; *Bremer Vulkan Schiffbau und Maschinenfabrik v South India Shipping Corp Ltd* [1981] 1 Lloyd's Rep 253; *(cont'd on the next page)*

had not generally been applied other than to insulate the arbitration agreement from the invalidity or unenforceability of the substantive contract, notwithstanding that s 7 of the Arbitration Act 1996 had not yet been enacted. The doctrine of separability merely received codification in s 7 of the Arbitration Act 1996.[15]

34 Second, the tenor of *BCY* at [59]–[61] did suggest that Chong J intended to articulate limits to separability, having held that:

> 61 Separability serves the *narrow though vital purpose* of ensuring that any challenge that the main contract is invalid does not, in itself, affect the validity of the arbitration agreement. This is necessary because the challenge to the validity of the arbitration agreement often takes the form of a challenge to the validity of the main contract. … [emphasis added]

35 A narrow doctrine of separability is also consistent with Art 16 of the UNCITRAL Model Law on International Commercial Arbitration, which formed part of Chong J's analysis in *BCY*, and case law from abroad.[16]

36 In *Kabib-Ji*, the EWCA also had reason to consider the issue of separability, particularly in the context of determining whether separability could be used to intellectually justify the fact that the express choice of law of the substantive contract could be different from an express choice of the *lex arbitri*. The EWCA rejected the notion that separability can be relied upon to divorce the arbitration agreement from the substantive contract for interpretative purposes, affirmed the findings of Moore-Bick LJ in *Sulamérica* (at [26]) and held that:[17]

> The rationale of separability is that it ensures that the dispute resolution procedure chosen by the parties survives the main

Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd [1993] Lloyd's Rep 455.

15 *Beijing Jianlong Heavy Industry Group v Golden Ocean Group Ltd* [2013] EWHC 1063 (Comm) at [24].

16 *Comandate Marine Corp v Pan Australia Shipping Pty Ltd* [2006] FCAFC 192; *Krutov v Vancouver Hockey Club Ltd* [1991] BCJ No 3464; *Prima Paint Corp v Flood & Conklin Manufacturing Co* 388 US 395 (1967).

17 *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6 at [66].

agreement becoming unenforceable for example because of fraud or misrepresentation.

37 It is the authors' view that separability, by reason of its origins and its function as a legal fiction to preserve the dispute resolution mechanism in the face of invalidity of the substantive contract, must be construed narrowly to preserve party autonomy, which, for better or for worse, includes the autonomy to draft an unworkable or invalid arbitration agreement. Respecting party autonomy requires recognising the problems and limitations in the parties' agreement to arbitrate, notwithstanding that there may otherwise be a general intention to arbitrate.

38 The issue of the scope of separability will undoubtedly be canvassed before the Court of Appeal again. Until then, it appears there is inconsistent authority in the Singapore High Court on how narrow or broad the scope of separability is. This issue potentially affects other areas of arbitration law, and a decision could result in having to revisit arbitration law on several issues.

III. Conclusion

39 The Court of Appeal reached the most commercially sound decision possible in its decision on *BNA v BNB*. It addressed the High Court decision head on, constraining the overly facilitative approach taken, bearing in mind that jurisdiction cannot be determined in a vacuum and has consequences when setting aside or enforcing substantive arbitration awards. In applying its wisdom to only the areas that were genuinely crucial to deciding the matter, the Court of Appeal avoided wading into uncharted territory, but also lost the first-mover advantage, which the EWCA in *Kabib-Ji* appears to have seized. While the Court of Appeal's approach resulted in a very robust and palatable flat white, it was not quite the cappuccino that the authors were hoping for, leaving room for learned friends at the Bar to argue these issues in future cases.