Court upholds tribunal's jurisdiction to determine remedies for breach of arbitration agreement and rejects claim for state immunity (London Steam-Ship v Spain, M/T 'Prestige')

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Arbitration analysis: A challenge by the Kingdom of Spain (Spain) to an order granting permission to serve an arbitration claim form out of the jurisdiction was rejected by Mr Justice Henshaw in the Commercial Court. London Steam-Ship Owners' Mutual Insurance Association Ltd (the Club) sought the appointment by the court of a sole arbitrator under section 18 of the Arbitration Act 1996 (AA 1996). The claims referred to arbitration were for remedies arising out of Spain's pursuit in its courts of claims against the Club, brought in breach of an arbitration agreement providing for arbitration in London. Spain argued that (i) it was immune from all suits brought by the Club under the State Immunity Act 1978 (SIA 1978), and/or, (ii) the court lacked jurisdiction to appoint an arbitrator, as the claims did not fall within the scope of the arbitration clause. The court held that (i) Spain did not have state immunity, and, (ii) the court did have jurisdiction to appoint a sole arbitrator in respect of all bar one of the Club's claims. Written by Paul Toms, barrister, at Quadrant Chambers.

London Steam-Ship Owners' Mutual Insurance Association Ltd v Kingdom of Spain, M/T 'Prestige' [2020] EWHC 1582 (Comm)

For our initial coverage of this judgment, see: Commercial Court concludes Spain has no immunity in respect of arbitration claim for appointment of arbitrator in oil spill insurance dispute (The London Steam-Ship Owners' Mutual Insurance Association v Spain, M/T 'Prestige').

What are the practical implications of this case?

It is established law that where a party, X, acquires or asserts rights under a contract between two other parties, B and C, X can only enforce those rights consistently with the terms of that contract. That means that where the contract contains an arbitration agreement, X can only permissibly pursue any substantive claim in arbitration and not in some other forum. This is the application of the so-called 'conditional benefit' principle.

The principle often arises in the context of claims by an assignee against the contractual counterpart of the assignor. Sometimes the assignee is an insurance company because some European legal systems provide that where an insurer indemnifies an assured under an insurance policy, there is an automatic assignment of the assured's rights against its contractual counterpart or a tortfeasor. By contrast, for insurance policies subject to English law, such a claim would be pursued by the insurer in the name of the assured pursuant to the insurer's rights of subrogation.

This case establishes that where the 'conditional benefit' principle applies, the jurisdiction of the arbitrator extends not only to determining X's substantive claim but also, in the event that X fails to pursue its substantive claim in arbitration, to determining what relief, if any, the other party is entitled to arising out of X's failure to comply with the arbitration agreement.

The case also explores in detail the scope and application of various exceptions to state immunity under SIA 1978 and provides a helpful summary for practitioners as to the approach to be applied by the courts in deciding whether to appoint a sole arbitrator under AA 1996, s 18.

What was the background?

In 2002, the MT 'Prestige' (the vessel) broke in two, discharging oil which caused significant pollution to parts of the shoreline of Spain. The Club provided protection and indemnity pollution insurance to the shipowners on terms which included an arbitration clause providing for ad hoc arbitration in London under the AA 1996.

Civil proceedings were instituted by Spain against the shipowners before the Spanish courts. The Club was added to those proceedings as a defendant pursuant to the Spanish Penal Code which provides for direct liability of liability insurers. In other words, Spanish law, unlike English law, permits a party (Spain) with a cause of action against a party that has liability insurance (the shipowners) to sue the insurer (the Club) direct.

The Club's position was that since Spain was, in effect, seeking to enforce the shipowners' rights under the contract of insurance, it could only pursue its claims in arbitration in London.

In 2013, the Club accordingly sought and obtained an award in London that Spain was bound by the arbitration clause such that its claims had to be referred to arbitration. The Club then obtained an order of the court under AA 1996, s 66 to enforce that award (and resisted an application by Spain disputing the jurisdiction of the arbitrator) *London Steam Ship Owners Mutual Insurance Association Ltd v Kingdom of Spain; The Prestige* [2013] EWHC 3188 (Comm), [2013] All ER (D) 299 (Oct). Those orders were upheld in 2015 by the Court of Appeal *London Steamship Owners' Mutual Insurance Association Ltd v Kingdom of Spain; The Prestige* [2015] EWCA Civ 333, [2015] All ER (D) 34 (Apr). The English courts' decisions were grounded in the 'conditional benefit' principle.

Undeterred, Spain continued to pursue its claims against the Club in the Spanish courts resulting in a judgment that the Club was liable up to the limit of the insurance cover of $US 1bn.

The Club commenced a fresh London arbitration in 2019 seeking—(i) a declaration that Spain was in breach of its obligation to pursue its claims in arbitration, (ii) equitable compensation for breach of that obligation, (iii) damages for breach of contract, (iv) an anti-suit injunction or damages in lieu, and (v) an order that Spain withdraw the claims brought in the Spanish proceedings and be enjoined from having the Spanish judgment recognised or enforced.

What did the court decide?

The court decided that Spain did not have immunity from suit.

The four exceptions in SIA 1978 which were said by the Club to apply such that Spain had no immunity from suit were:

- SIA 1978, s 9(1) which applies where a State has agreed in writing to submit a dispute to arbitration
- SIA 1978, s 3(1)(a) which applies where the proceedings relate to a 'commercial transaction' entered into by the state
- SIA 1978, s 3(1)(b) which applies where the proceedings relate to an obligation on the part of the State which by virtue of a contract falls to be performed in the UK, and
- SIA 1978, s 2 which applies where a State has submitted to the jurisdiction of the court

The court held that all of the exceptions to state immunity applied save for that under SIA 1978, s 2.

As to SIA 1978, s 9(1), the English courts had in the earlier proceedings determined that Spain ought to have pursued its claims against the Club in arbitration in London by reason of the 'conditional benefit' principle.

However, Spain contended that the principle did not apply to the proposed claims which the Club now sought to pursue because the principle did not extend to any claims made by the Club against Spain but applied only to claims made by Spain against the Club relying on the decision of the Supreme Court in *Aspen Underwriting Ltd v Credit Europe Bank NV* [2020] UKSC 11.

The court observed that the existing authorities did not directly govern the position and the *Aspen* case was not on point.

The court unsurprisingly rejected Spain's submission holding that 'it would be highly artificial to conclude that by pursuing its claim Spain had assumed the burden of the arbitration clause insofar as it relates to the substantive issues, but is free of the arbitration clause insofar as it covers disputes arising from a failure to observe the arbitration clause in relation to those same substantive claims[…]'.

The court, therefore, concluded that the effect of the 'conditional benefit' principle was that Spain had agreed in writing to submit any dispute relating to the contract of insurance to arbitration in London including the Club's claims against Spain.

The court did, however, hold that the claim for damages for breach of contract fell outwith the arbitration clause; that claim was said impliedly to arise out of Spain's participation in the previous English court proceedings under AA 1996, s 66 and not under the contract of insurance.

As to SIA 1978, s 3(1)(a), given that the wording of this section (and SIA 1978, s 3(3) which defines 'commercial transaction') is, and has been held by the courts, to be very broad, it is again unsurprising that the court reached the conclusion that this exception applied. The judge held that Spain's pursuit in the Spanish proceedings of a claim against the Club was 'the invocation and attempted enforcement of a contract of insurance relating to the liabilities of a business viz the Owners' shipping activities', i.e. the relevant transaction was commercial in nature. He also held that the motive that Spain might have had in pursuing the claims of seeking compensation for damage to its territory or citizens could not change the private law character of the transaction which was such that a private citizen might have entered into it.

The court also held that the exception in SIA 1978, s 3(1)(a) applied to the claim for damages for breach of contract and Spain did not have immunity from suit in respect of that claim either.

As to SIA 1978, s 3(1)(b), the court held that Spain's equitable obligation to exercise the rights under the insurance contract only in accordance with the arbitration agreement was an 'obligation of the State' within SIA 1978, s 3(1)(b). The question that then arose was whether the obligation fell to be performed in England. While it was clear that the obligation to pursue claims in London arbitration fell to be performed in England, the court considered it less clear whether the same was true of the negative obligation inherent in such a clause not to pursue claims in any forum other than London arbitration. That negative obligation was the basis of the claims referred to arbitration by the Club. The court concluded that the negative obligation could not be treated separately from the positive obligation since 'a claim to enforce the negative covenant is in a very real sense a claim to enforce the positive covenant[…]'.

As to SIA 1978, s 2, Spain had taken no step in the current court proceedings which constituted an unequivocal election to waive immunity and, as such, the Club's arguments on this section failed.

Having rejected Spain's claim for immunity, the court turned to consider whether it had jurisdiction to appoint an arbitrator and, in particular, whether the Club's claims fell within the scope of the arbitration clause.

The court summarised the approach to be taken to an application under AA 1996, s 18, namely:

- it was sufficient for the Club to show a good arguable case that the sole arbitrator would have jurisdiction to determine the claims referred to arbitration
- in relation to the merits of the claims referred to arbitration, the court should leave these to the arbitrator unless the claims were obviously ill-founded i.e. the merits of the claims were so obviously hopeless that there would be no point in appointing an arbitrator

Having already held that the Club's claims (with the exception of the claim for damages for breach of contract) were claims which Spain had agreed to submit to arbitration in writing within the meaning of SIA 1978, s 9(1), the court held that it necessarily followed that those claims fell within the scope of the arbitration clause.

The court also rejected Spain's submissions that the Club would not be entitled to the relief sought, saying that the merits of the claims were for the arbitrator to determine. The court did, however, consider in some detail the authorities on whether equitable compensation would be available for a failure to comply with an arbitration agreement, which will be of interest to practitioners.

Case details:

- Court: Queen's Bench Division, Commercial Court, Business and Property Courts of England and Wales, High Court of Justice
- Judge: Henshaw J
- Date of judgment: 18 June 2020

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