

Testing The Limits Of English Courts' Pro-Arbitration Stance

By **Declan Gallivan and Peter Morton** (September 13, 2024)

In a June decision in *Eternity Sky Investments Ltd. v. Xiaomin Zhang*, carrying potentially important implications for consumer-facing businesses, the Court of Appeal of England and Wales considered the U.K.'s public policy of protecting consumers and how it interacts with the public policy of enforcing international arbitration awards.

The Court of Appeal upheld the enforcement of a \$64 million Hong Kong-seated arbitration award against Xiaomin Zhang, rejecting her argument that she was protected by the U.K. Consumer Rights Act 2015, or CRA.[1]

Although the ultimate decision sounds rather unremarkable, the case should be a warning to all consumer-facing businesses. This is because of the substantive comments made by Lord Justice Stephen Males in the leading judgment.

Justice Males made clear that if the CRA applied and was infringed, consumer rights would prevail over an arbitration award on U.K. public policy grounds, and the court would have to refuse enforcement of the award.

This decision follows on from *Payward Inc. v. Chechetkin*,[2] a 2023 decision in which the Commercial Court, King's Bench Division of the High Court of Justice of England and Wales, refused to recognize a U.S. arbitration award on public policy grounds, partly on the basis of the CRA.

Both decisions are important because they provide rare examples of where the English courts' pro-arbitration and pro-enforcement stance would be outweighed by another competing policy interest.

Background

Let's look at the underlying facts in *Eternity Sky v. Zhang*, which Justice Males likened to "the facts of a students' moot."

Zhang, a Chinese businessman's widow, had commenced a Hong Kong arbitration to try to invalidate a personal guarantee. Zhang lost the Hong Kong arbitration and was held liable to pay Eternity Sky 500 million Hong Kong dollars (\$64 million), plus interest.

Zhang then took her fight to the English courts, arguing that, under the CRA, the personal guarantee she signed was nontransparent and unfair, thus making the arbitration award unenforceable on public policy grounds under Section 103(3) of the Arbitration Act 1996.



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The Commercial Court had found that Zhang was a "consumer" under the CRA (although not a typical one), but held that the CRA did not apply because the transaction was much more closely connected with Hong Kong than the U.K.

Court of Appeal Decision

Turning to the appeal, there were five issues before the court.

1. Was Zhang a consumer?

This was a key question, which required the court to consider if she acted wholly or mainly for business purposes when entering into the guarantee. On this issue, the Court of Appeal disagreed with the Commercial Court and found that Zhang was not a consumer.

According to Justice Males, whether Zhang was a consumer was to be decided objectively, taking into account the "sphere of activity" in which the guarantee took place.

Despite this finding, which meant the CRA did not apply, Justice Males nevertheless went on to consider the other requirements for the application of the CRA.

2. Did the personal guarantee have a close connection with the U.K.?

Because the guarantee was governed by foreign law, in this case Hong Kong law, it required a "close connection with the U.K." for the CRA to apply. Justice Males agreed with the Commercial Court that the guarantee lacked the necessary close connection. The key here was the connection of the contract with the U.K., rather than the consumer's connection with the U.K.

3. Was Clause 2 of the guarantee transparent and prominent?

The Court of Appeal upheld the Commercial Court's findings that Clause 2, the core term of the guarantee detailing Zhang's obligations, was transparent. Justice Males said this issue involved an analysis of "the average consumer" test under the CRA.

He said, "It may be that to distinguish between the average consumer who takes out membership of 'a gym club which is not a high end facility' and one who takes out membership of a more up-market gym involves unnecessary fine tuning, but the principle that the standard of the average consumer is variable and depends on the nature of the transaction and the context in which it is concluded is undoubtedly sound."

He added that in this case, "it was obvious on the face of the guarantee that the guarantor was undertaking personal liability in connection with a major bonds issue."

4. Was Clause 2 of the guarantee unfair?

On this issue, the Court of Appeal stated that the judge in the lower court was right to conclude that the core term of the guarantee was not unfair.

5. If the CRA applied, should the award nevertheless be enforced?

This is a particularly interesting part of the judgment.

The claimant, Eternity Sky, claimed that even if Zhang succeeded on all the issues, such that the CRA applied and was infringed, the court should still enforce the arbitration award.

Eternity Sky argued that Section 103(3) of the Arbitration Act afforded the court discretion, and in exercising that discretion, the court would need to balance two competing public policies, the policy of enforcing arbitration awards on the one hand and the policy of effective consumer protection on the other.

Zhang countered, insisting that the CRA created a special rule that should prevail over the general rule of enforcement of awards.

In obiter commentary, Justice Males rejected Eternity Sky's "balancing exercise" argument. He acknowledged that there is a competing public policy in favor of enforcing arbitral awards, but said that had the CRA applied and been infringed, the arbitration award would not be enforceable.

Justice Males stated that the CRA provided unequivocally that "an unfair term of a consumer contract is not binding on the consumer" and that this was a public policy principle found in primary legislation.

In what may provide some comfort to readers, Justice Males did reiterate the narrow public policy exception as grounds upon which to resist enforcement of arbitration awards and the importance of England's pro-arbitration stance.

The decision was unanimous, with Lord Justice James Dingemans and Lady Justice Sarah Falk agreeing with Justice Males.

Practical Takeaways

This judgment offers useful guidance on the requirements of the CRA and its application to business contracts. There is analysis of the meaning of "consumer" and the close connection, transparency and fairness tests.

The decision reiterates that an objective approach should be adopted when assessing whether an individual is a consumer. The key consideration is the contract itself, its terms, and the nature of the goods or services covered.

Further, this is the latest decision in a growing body of case law concerning the interaction of international arbitration and consumer protection, which makes clear that the enforceability of arbitration awards can be affected by consumer rights.

Importantly, Justice Males said that where consumer protections in legislation such as the CRA apply to render an unfair contract term nonbinding, the court has no choice but to refuse enforcement of an arbitration award giving effect to that term.

More broadly, this judgment, and that of *Payward v. Chechetkin*,^[3] should make businesses that deal directly with consumers stop and think about the following regarding their contracts.

Businesses should consider whether the contractual terms are clear and fair. If not, where the relevant tests are met, an individual may be able to avoid enforcement of an arbitration award on the basis of their personal status as a consumer.

It is also important to assess the connections of contracts (e.g., consumers' jurisdictions) and what local laws apply, particularly in multijurisdictional situations and where cross-border contracts are involved. For example, Justice Males suggested that the majority of consumer contracts entered into with U.K. residents will have a close connection with the U.K., and the CRA will likely apply.

Remember that individuals may be protected by U.K. consumer laws irrespective of what law governs the underlying contract. It cannot be assumed that choices of law and jurisdiction will necessarily be able to prevent or enjoin actions based on consumer protections in a consumer's local courts.

Also consider the choice of dispute resolution clauses and, when arbitration is chosen, the seat of arbitration. Wherever you are in the world, consumer rights may be relevant.

Take account of where you may want to enforce any resulting arbitration award. And finally, seek to navigate relevant consumer protection legislation and other public policy considerations in relevant jurisdictions.

In sum, the recent rulings make clear that the enforceability of arbitration awards can be affected by consumer rights. Companies should take that into careful consideration when drafting contracts.

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[1] Eternity Sky Investments Ltd v Xiaomin Zhang [2024] EWCA Civ 630, <https://www.bailii.org/ew/cases/EWCA/Civ/2024/630.html>.

[2] [2023] EWHC 1780 (Comm), <https://www.bailii.org/ew/cases/EWHC/Comm/2023/1780.html>.

[3] <https://www.bailii.org/ew/cases/EWHC/Comm/2023/1780.html>.