NAVIGATING ARBITRATION WITH CONSUMERS – INSIGHTS FROM RECENT CASES

UK based individuals are increasingly turning to consumer protection law to challenge the validity of arbitration agreements or to resist enforcement of arbitral awards, but appropriately drafted arbitration agreements remain an effective form of dispute resolution in many circumstances.

OVERVIEW

Businesses providing services, goods and financial products to individuals manage risk via a range of user agreements and standard terms and conditions. They may also enter into more bespoke agreements with high-net-worth individuals. Where they operate in global markets, and particularly online, governing law clauses and dispute resolution provisions (arbitration agreements in particular) are key tools for managing and allocating risk. However, these provisions must be sensitive to national laws designed to protect consumers, given the severe prejudice that in principle could be suffered by a consumer forced to litigate abroad. Such provisions must therefore be tailored carefully to ensure that they remain valid in all relevant jurisdictions. In three recent cases in the English High Court, individuals have asserted that they are consumers and have challenged arbitration agreements and arbitral awards under UK consumer protection legislation. This briefing considers those recent cases and highlights risks for users of arbitration agreements when dealing with UK-based individuals and explains how arbitration agreements can be designed to ensure fairness to all parties.

CONSUMER ARBITRATION

Arbitration is a form of alternative dispute resolution that can provide a robust and cost-effective forum in which to resolve consumer disputes outside of a national court system. However, consumer protection laws are typically designed thwart potential misuse of arbitration by businesses. This includes preventing businesses from erecting barriers to access to justice, whether practical or financial, or to cloak difficult issues in secrecy or (particularly in the US) to frustrate the pursuit of class action or group claims. Different jurisdictions strike different balances between being pro-arbitration and safeguarding consumer rights.

In the UK, consumer rights and arbitration legislation have long provided for certain limits to ensure that the two can coexist, aiming to protect UK

Key issues

- Consumer protection legislation in the UK (and in many other jurisdictions) places limits on the use of arbitration for consumer disputes and the enforceability of arbitral awards against consumers.
- The English courts have jurisdiction to hear claims made by English consumers against overseas businesses that direct their activities at the UK notwithstanding arbitration agreements or exclusive jurisdiction clauses in user agreements.
- The test for who is a consumer is very broad. It is linked to an individual's professional activities, rather than their financial status or level of expertise.
- There has been a recent spate of cases in which individuals have asserted their consumer rights to challenge arbitration agreements or resist enforcement of arbitral awards.
- UK public policy in favour of the enforcement of awards may not outweigh that relating to consumer protection.
- Employed appropriately, arbitration remains an efficient, effective and fair process for cross-border disputes.
- What kind of arbitration provision in a consumer agreement would be acceptable however requires careful consideration.

consumers without unduly hindering arbitration processes. The consumer rights legislation in the UK derived principally from EU law and no substantial modifications have been made post-Brexit. Historically, these protections have rarely been invoked and have featured in virtually no cases in the last two decades. So, what has changed?

One explanation for this shift is the rapid growth of global cryptoasset markets during the COVID pandemic. Crypto service providers such as exchanges have frequently required users to accept user agreements mandating arbitration of any disputes, often in the US where consumer arbitration is widespread, and without making any distinction for where the users are based.

A longer-term trend that has laid the groundwork for the English cases discussed below is a series of EU and English court judgments that have confirmed a very wide test for "*consumer*" under legislation. Relatively high-net-worth individuals, trading in risky assets or entering into sophisticated financial arrangements, have succeeding in establishing their status as consumers, and thus gain access to the court's extensive consumer protection powers.

Recent decisions of the English courts have provided the important clarification that arbitration agreements with consumers are not automatically unfair or unenforceable. However, the arbitration agreements must be fair to be valid (and there is a statutory presumption that such arbitration agreements may be unfair). This means that there is still a role for a carefully drafted arbitration process in consumer agreements, with the benefits that arbitration can bring in that context.

THE THREE RECENT CASES

- *Eternity Sky Investments Ltd v Mrs Xiaomin Zhang* [2023] EWHC 1964 (Comm) ("***Zhang***")[1] – Eternity Sky had obtained a HKIAC award in its favour confirming that Mrs Zhang was liable for a £64 million debt. The debt arose from a Personal Guarantee she had provided in relation to a Hong Kong bond issuance. Mrs Zhang applied to set aside an English court order that recognised and enforced the award. She argued that it would be contrary to English public policy, as the arbitration clause, applicable law clause and other terms of the Personal Guarantee were unfair terms pursuant to the Consumer Rights Act 2015 ("**CRA**"). The Court held that the CRA did not apply, as the "*Personal Guarantee's connections to Hong Kong were so great as to be overwhelming*" such that it did not have a close connection with the UK.[2]
- *Payward Inc v Chechetkin* [2023] EWHC 1780 (Comm) ("***Payward***") – Mr Chechetkin was a UK-based consumer who used Payward's online cryptocurrency trading platform. Payward's terms of service provided for disputes to be resolved by JAMS arbitration seated in San Francisco. Payward obtained a JAMS award. Mr Chechetkin sought to oppose recognition and enforcement on the grounds that it would be contrary to English public policy, including the CRA. The Court held that the contract had a close connection with the UK and that enforcing the award would be contrary to the public policy expressed in the CRA and the Financial Services and Markets Act 2000 ("**FSMA**"), due to the disadvantages faced

[1] Clifford Chance acted for Eternity Sky in these proceedings.
[2] *Zhang* [128].

by Mr Chechetkin in being forced to arbitrate in the US and under Californian law.

- *Amir Soleymani v Nifty Gateway LLC* [2022] EWCA Civ 1297 ("***Soleymani***") – Mr Soleymani won an auction for a non-fungible token ("**NFT**") on an online platform operated by Nifty. He later claimed that the auction was unfair and refused to pay, in response to which Nifty commenced a JAMS arbitration in New York (as provided for in its Terms and Conditions). Mr Soleymani commenced proceedings in England to challenge the arbitration agreement and the validity of the auction itself. Nifty applied to stay the English proceedings, which the High Court granted, but the Court of Appeal later overturned. In doing so, the Court of Appeal held that it was properly arguable that there was a consumer contract with a close connection with the UK and that the English courts would therefore be better placed to determine whether the arbitration agreement was null and void, inoperative or incapable of being performed. It ordered a trial on those issues.

FAIRNESS OF TERMS IN CONSUMER CONTRACTS

A consumer can invoke consumer rights in two ways when faced with an arbitration agreement (and foreign governing law clause) in a contract.

A consumer can launch claims in the English courts[3] in respect of disputes arising under the contract, including to seek declarations that certain terms are unfair under the CRA or compensation or declarations under other relevant UK statutes (e.g. FSMA). The consumer may then have to defend a stay application made by the business under the Arbitration Act 1996 ("**AA**").

Alternatively, the consumer may wait for arbitral proceedings to take their course and then seek resist the enforcement of any arbitral award by arguing that it would be contrary to UK public policy intended to safeguard consumer interests.

In both context, the three essential questions are the same:

- Is the individual seeking to enforce rights under the CRA a 'consumer' as defined by Section 2(3) of the CRA?
- If the contract in question is subject to a non-UK governing law clause, is there a 'close connection' between the contract and the UK? (Section 74 of the CRA);[4] and
- Is the relevant contract term 'unfair' within the meaning of section 62 of the CRA?

Where a consumer seeks to launch claims in England an important question for the purposes of establishing jurisdiction is whether the business "directs" its commercial or professional activities at the UK.

[3] Relying on the English court's jurisdiction in respect of consumer disputes pursuant to section 15B of the Civil Jurisdiction and Judgments Act 1982.

[4] Section 74 referred originally to non-EEA governing law but to cater for the effects of Brexit this was amended by the Consumer Protection (Amendment etc.) (EU Exit) Regulations 2018.

Who is a consumer?

Section 2(3) CRA defines consumer as "*an individual acting for purposes that are wholly or mainly outside that individual's trade, business, craft or profession.*" As the CRA was enacted in the UK to give effect to an EU Directive, the courts are informed by both English and European case law on the meaning of a consumer.

In *Payward*, the judge accepted that it was possible for Mr Chechetkin to open a trading account with the intention of generating an additional income stream, without doing so in the course of a trade, business, craft or profession. Mr Chechetkin's profession was a lawyer and he gave evidence that this was his full-time job and source of income when he opened his account. While Bright J agreed that Mr Chechetkin was knowledgeable, experienced and sophisticated in trading, crucially, he found that this experience post-dated the opening of his account.

In *Zhang*, the question of whether Mrs Zhang was acting as a consumer turned on whether she had a "*functional link*" with the company whose bonds she was guaranteeing. This was derived from what Bright J called the "*well-established*" test first formulated by the CJEU in *Tarcău Banca Comerciala Intesa Sanpaolo Romania SA* (Case C-74/14) of "*whether that person acted for purposes relating to his trade, business or profession or because of functional links he has with that company, such as a directorship or a non-negligible shareholding, or whether he acted for purposes of a private nature.*"[5] The judge rejected suggestions that Mrs Zhang had a real business interest in the company sufficient to negate her status as a consumer, either because Mrs Zhang had become extremely wealthy from her husband's business dealings in the company, or because she had her own shareholding. Bright J accepted Mrs Zhang's evidence that she acted predominantly out of love and entered into the contract for purposes of a private nature, namely her marriage. The judge also observed that Mrs Zhang's approximately 0.4% shareholding in the company was not one that could give rise to a functional link.

Is there a "close connection" between the contract and the UK?

Under section 74(1) CRA, the key provisions of the CRA will apply to contracts notwithstanding an agreement to subject them to some other governing law if the contract has a 'close connection' with the UK. This is a fact-sensitive question and courts will consider a wide range of factors, including connections with other countries.

The fact that the consumer is resident in the UK will not necessarily constitute a close connection. In *Zhang*, Bright J held that the "*Personal Guarantee's connections to Hong Kong were so great as to be overwhelming*".[6] As such, Mrs Zhang's residence in London, while treated as a connection to the UK, did not constitute a close connection.

In *Payward*, despite the user agreement being governed by Californian law, Bright J concluded that it had a close connection to the UK because the crypto

[5] *Zhang* [75].
[6] *Zhang* [128].

exchange operated via a UK company, the services were paid for in sterling and payments made to and from English bank accounts.

Another factor that may be considered where a business is wholly outside of the UK is where it directs its commercial activities. In *Soleymani*, the High Court found that the defendant's activities were directed at the UK based on its various marketing efforts and in-person promotional events. The Court of Appeal subsequently adopted this as one of the reasons for finding that there was a close connection for the purposes of section 74 CRA, and notwithstanding the user agreement being governed by New York law.

Was the term unfair?

Section 62 CRA provides a general requirement of fairness for consumer contracts. For core terms, under section 64 CRA, these fall to be assessed for fairness only if the term itself was not transparent and prominent. Non-core terms are assessed for fairness at the outset.

Schedule 2 to the Consumer Rights Act 2015 sets out sample consumer contract terms that may be regarded as unfair (the Grey List), which includes arbitration. The AA makes arbitration with consumers unfair automatically if the amounts in issue are less than £5,000.

In *Zhang,* both core and non-core terms (as defined by the CRA) of the Personal Guarantee were challenged as unfair in support of the overarching challenge that it would be contract to public policy to enforce the award.

In respect of the core term (i.e. the guarantee itself), Mrs Zhang did not get past the first hurdle in section 64(2) as Bright J found the term was transparent and prominent, notwithstanding the fact that Mrs Zhang herself had not read it. The applicable test is the "*average consumer who might enter into a consumer contract of this particular type*".[7] Here there was a very narrow class of consumer that would enter into a personal guarantee for a substantial bond issue. Bright J also held that the average consumer should be well-informed, observant and circumspect, suggesting someone who is not negligent. In that regard, he considered relevant the representations in the Personal Guarantee as to Mrs Zhang having taken legal advice.

The fairness of a governing law clause requires a factual analysis of its actual impact on the case. In *Payward*, Bright J considered the Californian governing law clause unfair because it precluded (when applied by the arbitrator) the claimant from bringing substantive claims under FSMA against the exchange. In *Zhang*, Bright J considered the choice of Hong Kong law fair because it made no difference to the outcome of the case, even if the CRA had applied.

The fairness of the arbitration agreement also received contrasting treatment in *Payward* and *Zhang*. Mrs Zhang argued that choice of arbitration seated in Hong Kong was intended to deprive her of consumer rights in England. Bright J reiterated that "*The mere fact that a consumer contract provides for disputes to be resolved in arbitration does not make it unfair*." [8] The factual circumstances in the case were highly relevant and, in Mrs Zhang's case, meant that provision for Hong Kong arbitration was not unfair.

[7] *Zhang* [145].
[8] *Zhang* [182].

When are commercial or professional activities "directed" at the UK?

This question is relevant when a consumer seeks to make a substantive claim in the English courts, notwithstanding that the contract itself contains an arbitration agreement or exclusive jurisdiction clause in favour of other courts.

The English court has jurisdiction in respect of consumer disputes pursuant to section 15B of the Civil Jurisdiction and Judgments Act 1982 ("CJJA"), which replicates part 4 of the EU Recast Brussels Regulation and retains those elements of EU law post-Brexit.

- The subject-matter of proceedings must relate to a "consumer contract" where the "consumer" is domiciled in the UK. Parties may depart from these rules by an agreement but only by one entered into after the dispute has arisen.
- A "Consumer Contract" for the purposes of the CJJA includes

  (c) a contract which has been concluded with a person who—

(i) pursues commercial or professional activities in the part of the United Kingdom in which the consumer is domiciled, or

(ii) by any means, directs such activities to that part or to other parts of the United Kingdom including that part.

The question of what "*directs such activities*" means was considered by the High Court in *Bitar v Banque Libano-Française SAL* [2021] EWHC 2787 (QB) and in *Soleymani*. It is an objective test; what would the "*fair minded*" observer think? Neither of the businesses in *Bitar* or *Soleymani* had any establishment in the UK itself but UK-based customers were able to access services (banking and NFT trading respectively) via websites. In both cases the court considered in some detail the defendants' websites, internal strategy materials and marketing efforts. In *Bitar* the court held that the website was clearly targeting banking activities at the Lebanese diaspora. In *Soleymani*, the judge found the NFT marketplace's physical marketing activities in the UK highly persuasive that it was directing its erstwhile global business there.

DOES PUBLIC POLICY IN FAVOUR OF ENFORCEMENT OF AWARDS OUTWEIGH CONSUMER PROTECTION PUBLIC POLICY?

Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 ("**New York Convention**"), an arbitral award made in the territory of one convention state – such as the UK and the US – shall be enforceable in another. That principle is reflected in section 101 AA.

The English courts display a pro-enforcement and pragmatic approach to the enforcement of arbitral awards. Section 103(1) AA sets out the limited grounds on which the courts may refuse to enforce a New York Convention award. Those grounds include where it would be contrary to public policy to recognise or enforce an award.[9] *Payward* was a very rare example of a successful challenge to enforcement based on public policy.

[9] Section 103(3) AA.

In *Zhang*, as in *Payward*, Bright J rejected arguments that the pro-enforcement public policy enshrined in section 101 AA should prevail over the public policy imperatives underlying the CRA. Bright J held that only infrequently will there be cases in which a New York Convention award should be enforced, notwithstanding a conflict between the award and CRA rights; for example, where the breach is purely technical and would result in minor unfairness to the consumer.[10]

TAKE AWAYS

Recent judgments highlight the complexity of enforcing governing law and dispute resolution provisions in what the court finds to be consumer contracts. Each case will turn on its facts. If the court finds that a party is a 'consumer' for the purposes of the CRA, it will consider what a reasonable consumer in the position of the relevant party might reasonably be expected to agree to.

The judgment in *Zhang* has confirmed that arbitration awards can indeed be enforced in England against a party that is classified as a 'consumer'.

However, the use of 'one size fits all' arbitration agreements and governing law clauses in the user agreements of online service providers and other businesses remains widespread. Recent decisions demonstrate why that is not a viable approach and there is a risk that such agreements will be held to be ineffective in significant markets.

Similarly, online global businesses cannot evade national regulations by trying to avoid the jurisdiction of national courts or selecting different governing laws. Mandatory provisions of domestic law, such as consumer protection legislation, will continue to apply and users in the relevant jurisdictions will be able to invoke them before their own courts.

To assess potential risk, businesses should consider the following issues:

- What is the profile of their user or customer base and do they fit the definition of consumer?
- Do they direct business at the UK or the EU, for example through online or live marketing events or promotions or particular territory-specific features (such as customer service telephone numbers or ability to pay in a local currency) on their website?
- Where else do they direct business or have users and do any of those jurisdictions have applicable consumer protection rules?
- What dispute resolution procedures best suits their business, taking account of where it is based, its geographic reach, the nature of the goods, assets or services involved and the characteristics and locations of the user or customer base?

What kind of arbitration agreement would be acceptable?

There is still a role for a carefully drafted arbitration process in consumer agreements, with the benefits that arbitration can bring in that context. What kind of arbitration agreement would be acceptable however would require careful consideration. For UK consumers, a UK-seated arbitration that provides for the appointment of consumer rights or financial regulation specialist arbitrators could be acceptable to the courts. Arbitration in other

[10] *Zhang* [200]-[203].

seats may also be justifiable on the basis that it causes no injustice to the consumer. As held by Bright J in *Zhang* arbitration in Hong Kong was not unfair because arbitrators in Hong Kong are "*very adept*" at applying English law and do so regularly. In contrast, in *Payward*, he did not accept that the preservation of mandatory consumer rights in the JAMS rules was sufficient to protect UK consumers given its combination with the US governing law clause. The practicalities and costs of arbitrating abroad was a relevant factor but, while it made arbitration unfair for Mr Chechetkin in *Payward,* it did not for Mrs Zhang.

To the extent that attempts are made to design dispute resolution clauses that would be enforceable in England, building in sufficient protections will be essential.

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