

Arbitration - United Kingdom

Severability has limits: arbitration clause cannot exist without underlying agreement

Contributed by **Clifford Chance LLP**

June 20 2013

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Introduction

The principle of severability of arbitration clauses from the rest of the contract of which they form part is well established under English law and enshrined in Section 7 of the Arbitration Act 1996. The arbitration clause is a distinct agreement that will not necessarily be invalid because the underlying agreement is invalid (eg, due to misrepresentation). An arbitration agreement can be impugned only due to independent vitiating factors that relate directly to the arbitration agreement (*Fiona Trust & Holding Corporation v Privalov* [2008] 1 Lloyd's Rep 254). If the arbitration clause has been agreed, the parties will be presumed to have intended the question of whether there was a concluded main agreement to be decided by arbitration.

In the recent High Court case of *Hyundai Merchant Marine Company Limited v Americas Bulk Transport Ltd* ([2013] EWHC 470 (Comm)), this point was argued in reverse. The issue was whether the parties had entered into a contract at all; if they had, it contained an arbitration clause.

The arbitral tribunal found that there was a contract, and accordingly an arbitration agreement allowing them to decide that there was a contract. On hearing a challenge to the substantive jurisdiction of the tribunal under Section 67 of the Arbitration Act, the court set aside the arbitrators' award and found that the questions of whether there was a binding main contract and a binding arbitration agreement incorporated into the main contract stood or fell together. A complete lack of consensus not only prevented the main contract from coming into existence, but also the arbitration agreement.

Facts

The claimant was the charterer of a vessel. The defendant intended to charter the vessel through the Orinoco River in Venezuela.

The parties' pre-contractual negotiations were central to the case. The defendant sent the claimant emails confirming terms discussed during a prior telephone conversation. The emails referred between the parties to "English law and arbitration to apply". They also provided that the charterparty should be "back-to-back" with the claimant's head charterparty and included a number of conditions precedent.

The claimant then informed the defendant that its head charterparty forbade trading through the Orinoco River.

The defendant contended that the emails constituted a binding contract. It initiated arbitration proceedings alleging that the claimant was in repudiatory breach and brought a claim for damages.

The claimant objected to the jurisdiction of the tribunal on the basis that no binding contract existed between the parties and, accordingly, no binding arbitration agreement existed either.

The tribunal held that the claimant and the defendant had entered into a binding contract – and a binding arbitration agreement.

Proceedings

The claimant challenged the tribunal's award pursuant to Section 67 of the Arbitration Act. The claimant sought a declaration that the parties had not entered into a binding

contract – or a binding arbitration agreement – with the effect that the tribunal had no jurisdiction to hear the defendant's claims.

The court considered whether the existence of a binding contract and an arbitration agreement were separate questions, or whether these two issues were indivisible.

The defendant relied on the *Fiona Trust* decision to argue that an arbitration agreement was separate and divisible from any underlying main agreement. The defendant argued that any rehearing by the court need only concern the specific issue of whether the parties had agreed to arbitrate. The court rejected this argument on the following grounds:

- It found no evidence that the parties had intended any alleged arbitration agreement to have effect independently of the proposed contract.
- If there were no consensus between the parties on the terms of the contract, the lack of consensus would not only prevent the contract from coming into existence, but also any agreement to arbitrate from coming into existence.
- It held that the alleged arbitration clause was subject to the same condition precedents as the main contract. The reference to arbitration was conditional on the 'back-to-back' with the head charterparty condition precedent and, as the condition was not satisfied, there could be no operative arbitration agreement.

The court therefore held that the questions of whether there was a binding contract and/or a binding arbitration agreement stood or fell together. It found that the parties had not entered into a binding contract, with the result that they had similarly not entered into an arbitration agreement. In consequence, the tribunal had lacked jurisdiction and its award had to be set aside. A full re-hearing would be required, not limited to the specific terms concerned with the agreement to arbitrate.

Comment

The House of Lords indicated in *Fiona Trust* that there may be cases in which the grounds on which the underlying agreement is invalid are identical to the grounds on which the arbitration clause is invalid. *Hyundai* is consistent with this reasoning, finding that a complete lack of consensus will prevent the arbitration clause from coming into existence, just as it will prevent the main agreement from coming into existence. *Hyundai* clarifies the limits of the doctrine of severability of an arbitration agreement. It also reassures parties that they will not be bound to arbitrate merely by engaging in commercial negotiations for the conclusion of a contract containing an arbitration clause.

However, *Hyundai* may be seen as undermining the arbitration process as, on the basis of the Section 67 challenge on substantive jurisdiction, the court effectively reversed the findings of the arbitral tribunal that had already considered evidence from the parties, and found on the basis of that evidence that the parties had reached a consensus on both the charterparty and the arbitration clause.

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