ARBITRATION CLAUSE: AN AGREEMENT OF ITS KIND

*Name: AKHILA

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Abstract

The agreement to arbitrate is the foundation of an international commercial arbitration. Consent of the parties to enter into a form of dispute resolution outside the domestic courts is indispensible. An arbitration proceeding, generally, takes place pursuant to an arbitration clause in an international commercial contract. A Model clause is adopted which comprises of a set of rules that are self- sufficient in guiding the arbitral tribunal and the parties in an arbitral proceedings. Such a clause should meet the following requirements: firstly, it should be in writing; secondly, it should deal with existing or future disputes; thirdly, the dispute should arise in respect of a defined legal relationship and fourthly, it should concern of a subject matter capable of settlement by arbitration.

This essay seeks to cull out the essential elements of an arbitration agreement. It discusses the doctrine of competence-competence and the importance of a well drafted clause which helps to ascertain the jurisdiction of the arbitrator. It also elaborates on the validity of the clause in cases where the main contract is invalidated by the arbitrator by virtue of the doctrine of separability. It also emphasizes on the concept of party autonomy and the bilateral rights of parties to elect arbitration.

Keywords: arbitration, arbitration agreement, arbitration clause, competence competence, party autonomy, separability.

Introduction

An arbitration clause is a special kind of contract; and parties' intention to settle disputes through arbitration shall always first be verified and judged as regards its range.[2] An arbitration clause constitutes the foundation of any arbitration.

Course/ Department: Student, 4th year BA. LLB (Hons.)University: School of Law, Christ University.

Corresponding E-mail address: akhila.subramanya@yahoo.co.in

Arbitration clause is basically viewed as "the parties' expression of their intent to arbitrate disagreements arising within the scope of the agreement and with limited exceptions".[3] Arbitration is a "matter of contract," therefore, it is to be given the same respect as to any other clause in a contract and major laws and principles concerning the validity of the contract should be applied to arbitration clause. As it is specified in section 2 of the American Federal Arbitration Act (FAA), arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract".[4] The use of arbitration clause in commercial contracts as well as other types of contracts is based on two basic principles: firstly, the autonomy of parties' will and secondly, consensual nature of agreement.[5] In other words, the agreement to arbitrate the case needs to be mutual and voluntary in its nature. In addition, the basic arbitration rules require arbitration agreement to be expressed in writing and the dispute itself should be capable of being settled by means of arbitration.[6]

Essential Elements of an Arbitration Agreement

Essential to a binding arbitration clause is, of course, an unambiguous and unequivocal reference to arbitration, preferably under the rules of a reputable and experienced institution.[7]

The second indispensable element in an arbitration clause is the circumscription of the arbitrator's authority, the scope of the dispute to be arbitrated. The best approach for international business contracts is to grant the arbitrator broad authority to decide disputes arising "in connection with" a contract.[8]

In May 1981, the Prime Minister of France promulgated a decree providing special rules applicable to international commercial arbitration. An important element to understanding the decree is the *Gotaverken* case[9]."[10] An ICC award had been rendered in favour of a Swedish shipyard that had built three petroleum tankers for an agency of the Libyan government. The Libyans sought to have the award set aside in France by direct appeal. Under the existing law such a procedure was available only for French, as opposed to International arbitral awards.[11] The Paris Court of Appeal held that the award was not a French award. Therefore the court considered itself to lack jurisdiction to hear the challenge.[12]

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[2] *Xiaohong Liu*, Achieving Effectiveness of Arbitration Clauses-A Practical Survey from a Chinese Legal Perspective 33, US-China Law Review, Jun. 2006, Volume 3, No.6 (Serial No.19), available at https://www.copyright.com/ccc/basicSearch.do?&operation=go&searchType=0&lastSearch=simple&all=on&titleOrStdNo=1548-6605 _ (last accessed 29 Nov. 2014).

[3] Ingrida Paskauskaite, Is arbitration clause in a commercial contract enforceable, if it has no provision of the apportionment of arbitration costs between the parties? 27 3 int'l j. Baltic l. 21 2007, available at http://heinonline.org _ (last accessed 29 Nov 2014).

[4] *Ibid.*

[5] *Ibid.*

[6] *Ibid.*

[7] *William W. Park*, Arbitration of International Contract Disputes at 1785, 39 Bus. Law. 1783 1983-1984, available at http://heinonline.org _ (last accessed 29 Nov 2014).

[8] *Ibid.*

[9] Libyan Gen. Nat'l Maritime Transp. Co.v. Gotaverken Arendal, Judgment of 21 February 1980, Cour d'Appel, Paris, (1980).

[10] William W. Park, *supra* note 6 at 1792.

[11] *Ibid.*

[12] *Ibid.*

Separability of the Arbitration Clause

The arbitration clause in a contract is considered to be separate from the main contract of which it forms a part and survives the termination of that contract. It would be entirely self-defeating if a breach of contract or a claim that the contract was voidable was sufficient to terminate the arbitration clause as well. The advantage of this principle is that it constitutes a serious bar, for a party who desires delay or wishes to repudiate his arbitration agreement, to subvert the arbitration clause by questioning in court the existence or validity of the arbitration agreement [by questioning the validity of the main contract].[13] It survives for determining the mode of their settlement. The purposes of the contract have failed, but the arbitration clause is not one of the purposes of the contract.[14] An arbitration clause which forms part of a contract and which provides for arbitration under the Rules shall be treated as an agreement independent of the other terms of the contract.[15] A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* the invalidity of the arbitration clause.[16] In international arbitration, the agreement to arbitrate, whether concluded separately or included in the contract to which it relates, is always save in exceptional circumstances….completely autonomous in law, which excludes the possibility of it being affected by the possible invalidity of the main contract.[17] The validity of an arbitration agreement cannot be contested on the ground that the main contract may not be valid.[18] In France, French courts will not stay court proceedings in circumstances in which the arbitration agreement is "*manifestement nul*" (manifestly void), although in practice it is very rare for French courts to deny an arbitral tribunal the opportunity to rule on its own jurisdiction.[19] In England, the Arbitration Act 1996 provides that an arbitration agreement contained in another agreement "shall not be regarded as invalid, non- existent or ineffective because that other agreement did not come into existence", although recent case law suggests that for some English judges the fate of an arbitration agreement remains inextricably linked to the initial existence of the main contract.[20]

The principle of separability is generally adopted in national laws and accepted by national courts, the manner in which they have been implemented and are applied by the courts may vary considerably.[21]

In Peterson Farms Inc.[22], the English Commercial Court set aside an arbitral award rendered in London in which the "group of companies" doctrine had been applied to grant damages to

[13] ALAN REDFERN, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 163 (Sweet&Maxwell, London, 4th ed., 2004).
[14] Heyman v. Darwins Ltd [1942] AC 356 at 374.
[15] UNCITRAL Arbitration Rules, Art. 21.2.
[16] Model Law, Art. 16(1).
[17] Gosset Case, Cour de Cassation, 1st Civil Chamber (1963) p.545; Prima Paint Co. v. Food and Conklin Manufacturing Corp., 388 US 395 at 402 (1967).
[18] *Ibid.*
[19] Gillard, "The negative effect of competence-competence", International Arbitration Report, No. 1, January 1, 2002.
[20] S. 7 of English Arbitration Act, 1996; Shackleton "Arbitration without Contract", Mealey's Int. Arb. Rep. Vol. 17 No.9, Sep 2002.
[21] Pacificare Health Systems, Inc. v. Book, 538 US 401 (2003).

entities of C&M Faming Ltd. Group which were not named as parties to the sale agreement which contained an ICC arbitration clause.[23] The law applicable to the sales agreement were the laws of Arkansas, USA and the place of arbitration was London.[24] The court held that a challenge to jurisdiction under Section 67 of the Arbitration Act 1996 was by way of a full hearing and that the relevant question was not whether the arbitral tribunal had been entitled to reach the decision to which it came, but whether it was correct in doing so. The ultimate arbiter of jurisdiction is not the arbitral tribunal itself.[25] The arbitral tribunal held as follows: Under the doctrine of separability, an arbitration agreement is separable and autonomous from the underlying contract in which it appears. The autonomy of arbitration agreements has become a universal principle in the realm of international commercial arbitration. A corollary of the doctrine is that the law applicable to the arbitration agreement may differ from the law applicable to both the substance of the contract underlying the dispute and to the arbitral proceedings themselves. The right of C&M to make claims from C&M group is a question of an interpretation of arbitration agreement contained in the Agreement, including the intention of the parties. In the absence of any choice of law made by the parties with regard to the arbitration agreement itself, the tribunal will determine this question in accordance with the common intent of the parties.[26] The Court, on the other hand, found the tribunal's approach to be flawed. The Court held that there was no basis for the arbitral tribunal to apply any other law and that no other law can be derived from "the common intent of the parties". The common intention of the parties was expressed in the agreement: both Arkansas and English law. The "law" the tribunal derived from its approach was neither the proper law of the agreement nor the law of the place of arbitration. It went on to find that the group of companies' doctrine was not recognised in English law.[27]

The Paris Court of Appeals has held, " An arbitration clause in an international contract has a validity and an effectiveness of its own, such that the clause must be extended to parties directly implicated in the performance of the contract and in any disputes arising out of the contract, provided it has been established that their respective situations and activities raise the presumption that they were aware of the existence and scope of the arbitration clause, and irrespective of the fact that they did not sign the contract containing the arbitration agreement."[28] While there is general agreement that the question should be determined by the arbitral tribunal in the first instance, there is a wide variety of approaches taken by national courts reviewing such jurisdictional decisions.[29]

Validity of Arbitration Clause and the Doctrine of Competence-Competence

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[22] Peterson Farms Inc. v. C&M Farming Ltd., [2004] All ER (D) 50; (2004) EWHC 121 (Comm).
[23] LOUKAS A. MISTELIS, PERVASIVE PROBLEMS IN INTERNATIONAL ARBITRATION 133 (Kluwer Law International, 2006).
[24] *Ibid.*
[25] *Ibid.*
[26] *Ibid.*
[27] *Ibid.*
[28] Fouchard Gaillard Goldman on International Commercial Arbitration, Emmanuel Gaillard and John Savage eds., (Kluwer Law International 1999) at pp. 288-289.
[29] LOUKAS A. MISTELIS, *supra* note 22 at 138.

A valid and, as far as this is feasible, perfect arbitration clause is a primary pre-condition and safeguard for parties to start lawful and effective arbitration proceedings.[30]

Even if the validity of a contract in dispute is challenged (e.g. on account of fraud), a *broad* arbitration clause, which is *independent of* the contract, may enable the arbitral tribunal in question to determine its jurisdiction. In contrast, a *narrow* arbitration clause may probably bear a negative influence on its effectiveness due to the conditions and restrictions arising from it.[31] For instance, in a dispute tried by an American federal district court, the court found that the challenged arbitration clause, which related to *disputes arising out of the following text*, narrowed the scope of matters that could be submitted to arbitration, while the court held that only disputes related to the interpretation and enforcement of the contract under consideration were arbitrable. In terms of such interpretation, disputes relating to accusation of fraud committed during the conclusion of the contract in question could not be resolved by arbitration.[32] There are four essential functions of an arbitration clause, translated into English from the original French: The first, which is common to all agreements, is to produce mandatory consequences for the parties; The second is to exclude the intervention of state courts in the settlement of the disputes, at least before the issuance of the award; The third is to give powers to the arbitrators to resolve the disputes likely to arise between the parties; The fourth is to permit the putting in place of a procedure leading under the best conditions of efficiency and rapidity to the rendering of an award that is susceptible of judicial enforcement.[33] The 1958 New York Convention offers a comparatively universal criterion for identifying indispensable substantial elements of a valid arbitration agreement. According to the Convention, an arbitration agreement, which satisfies the following substantive conditions, in addition to formal requirements, can be recognized as valid and enforceable. The dispute must arise out of a legal relationship entered into by the parties, the subject matter of the dispute is eligible to arbitration, the parties are legally capable of concluding an arbitration agreement, and the agreement is valid under applicable law, i.e. the contents of the agreement must be lawful.[34]

Party Autonomy and the Bilateral Rights to Elect Arbitration

A clause which confers on both parties the right to elect arbitration as the means for settlement of disputes is an arbitration agreement.[35] The Court at Singapore decided on the question of whether a clause providing that disputes arising under or in connection with the contract shall be determined either by curial adjudication or arbitration is an arbitration agreement requiring the parties to refer disputes to arbitration in *Turner Corporation Ltd v Austotel Pty Ltd*[36]. *In the case*, clause 2 of the bill of lading provided that "All disputes arising under or in connection with this bill of lading shall be determined by Chinese law in the courts of, or by arbitration, in the People's Republic of China." The plaintiffs who were the holders of the relevant bill of lading

[30] *Xiaohong Liu, supra* note 1 at 33.
[31] *Ibid.*
[32] *Ibid.*
[33] *Id.* at 38.
[34] *Ibid.*
[35] Agreements To Refer Disputes To Arbitration 267, 1993 Sing. J. Legal Stud. 261 1993, available at http://heinonline.org/ _ (last accessed 29 Nov 2014).
[36] (1992) 27 NSWLR 592 at 599.

caused the defendants' vessel to be arrested in Singapore. The defendants took out an application to stay the action *in rem* on the ground that by clause 2 of the bill of lading, both parties had agreed to arbitrate and/or litigate the dispute in the People's Republic of China. The defendants succeeded in their application before the Senior Assistant Registrar and the plaintiffs appealed against the order of the Senior Assistant Registrar. The plaintiffs' appeal came before Goh Joon Seng J who held that the dispute between the parties was not one which was required to be referred to arbitration. Therefore the Arbitration (Foreign Awards) Act does not apply. It may be contended that clause 2 is an arbitration agreement. The point is that one does not speak of a matter that is required to be referred to arbitration "in pursuance of the *agreement"* unless one accepts that there is an arbitration agreement.[37]

In *"The Amazona"*[38], the English Court of Appeal described the relevant clause as providing for an option to arbitrate and confirmed that until and unless a valid election is made by a party to the agreement, the contract provides for High Court jurisdiction rather than arbitration.[39]

Giles J. in *Pittalis & Ors* v *Sherefettin*[40], has held that it is the agreement conferring the right to elect to proceed by arbitration which is the agreement by which the parties have agreed to refer their disputes to arbitration. In the words, the dispute proceeded to arbitration "because the parties agreed by the contract that [the exercise of the right to elect under the contract to proceed by arbitration] would have that effect; to that extent there was an agreement to refer disputes to arbitration.[41]

Conclusion

International commercial arbitration has been the victim of its own success.[42] Arbitration is often the only dispute resolution process acceptable in business contexts where parties from different countries have rejected recourse to each other's legal system at the outset of the contractual relationship.[43] Thus, the presence of a valid arbitration clause excludes exhaustion of local remedies in the national courts although the parties have the right to enforce the award through these courts. Hence, the parties' conferment of jurisdiction on the arbitration tribunal may be confined to declaring a breach of contract and to contractual remedies. As discussed, the arbitration clause is an agreement of a unique nature.

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[37] Supra note 34 at 268.
[38] [1989] 2 Lloyd's Rep 130.
[39] Supra note 34 at 268.
[40] [1986] 1 QB 868.
[41] Supra note 34 at 272.
[42] William W. Park, *supra* note at 1783.
[43] *Ibid.*

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