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DREW & NAPIER LLC

LEGAL UPDATE

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CASE UPDATE

HOUSE OF LORDS SIGNALS THAT COURTS SHOULD BE SLOW TO INTERFERE WITH ARBITRATION AGREEMENTS

Premium Nafta Products Limited & Ors v Fili Shipping Company Limited & Ors [2007] UKHL 40

Executive Summary

The UK House of Lords has, in what has been described as a “big win for the arbitration process”, unequivocally endorsed the approach that the courts should be slow to interfere when parties include in their contracts clauses submitting disputes for resolution by way of arbitration. England’s highest court also affirmed and reiterated that an arbitration clause must be treated as a “distinct agreement” and can only be void or voidable on grounds which relate directly to the arbitration agreement itself.

This judgment concerned an appeal from the UK Court of Appeal’s decision in *Fiona Trust & Holding Corporation & Ors v Yuri Privalov & Ors* [2007] EWCA Civ 20 (the “**Fiona Trust case**”). The *Fiona Trust* case was previously examined in Drew & Napier LLC’s Legal Update dated 2 February 2007. To view our earlier case note, please click on the following link:

[UK Court of Appeal Decides that Arbitrators Should Decide on Validity of Contract](#)

Background

The House of Lords’ decision was centered on the scope and effect of arbitration clauses set out in eight charterparties (the “**Charters**”) made between eight shipowners (the “**Owners**”) and eight charterers (the “**Charterers**”). The Owners alleged that the Charters had been procured by bribery.

Each of the Charters contained an arbitration clause giving the parties the right to elect to have “any dispute arising under [the] Charter” or “out of [the] charter” referred to arbitration.

The Owners purported to rescind the Charters on the ground of bribery and commenced court proceedings to enforce their rights. The Charterers responded by applying for a stay of proceedings under Section 9 of the UK Arbitration Act 1996 (the “**UK Arbitration Act**”).

The court at first instance declined to stay the Owners’ court action, and the Charterers appealed. The Court of Appeal, in the *Fiona Trust* case, allowed the appeal and granted the stay.

Dissatisfied with the Court of Appeal’s decision, the Owners appealed to the House of Lords.

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Decision of the House of Lords

Before the House of Lords, the Owners argued that the arbitration clause did not apply because first, as a matter of construction, the question of whether the Charters had been procured by bribery was not technically a dispute “*arising under*” the Charter and secondly, the arbitration clause was liable to be rescinded on account of bribery and therefore not binding on the parties.

The House of Lords unanimously rejected the Owners’ arguments and dismissed their appeal. In the written judgments, important issues concerning the approach to be taken in the interpretation of arbitration clauses and the separability of the arbitration agreement from the main contract were addressed.

Approach to the interpretation of arbitration clauses

Businessmen are assumed to have entered into agreements to achieve “*some rational commercial purpose*”. Accordingly, the purpose of an arbitration clause must be ascertained where the question of its construction is concerned. In the judgment of Lord Hoffman, this purpose is patently obvious:

“[t]he parties have entered into a relationship, an agreement or what is alleged to be an agreement ... which may give rise to disputes. They want those disputes decided by a tribunal which they have chosen, commonly on the grounds of such matters as its neutrality, expertise and privacy, the availability of legal services at the seat of arbitration and the unobtrusive efficiency of its supervisory law. Particularly in the case of international contracts, they want a quick and efficient adjudication and do not want to take the risks of delay and, in too many cases, partiality, in proceedings before a national jurisdiction.”

The House of Lords concurred with the opinion of Longmore LJ in the *Fiona Trust* case that a “*fresh start*” to the construction of arbitration clauses was needed. The previous judicial pronouncements on the myriad distinctions among terminology such as “*arising under*”, “*arising out of*”, “*arising in relation to*” and “*arising in connection with*” reflect “*no credit upon English commercial law*” and should be consigned to history.

An arbitration clause (or arbitration agreement) should be construed in accordance with the presumption that parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered (or purported to enter) to be decided by the same tribunal. Courts should therefore proceed on this assumption unless the language in the arbitration agreement makes it abundantly clear that certain questions were intended to be excluded from the arbitrator’s jurisdiction. In this connection, Lord Hoffman endorsed the views of Longmore LJ in the *Fiona Trust* case: “*if any businessman did want to exclude disputes about the validity of a contract, it would be comparatively easy to say so*”.

Support for this position also comes in the form of Section 7 of the UK Arbitration Act which enables the courts to give effect to the reasonable commercial expectations of the parties about the questions which they intend to be decided by arbitration.

Section 7 of the UK Arbitration Act provides as follows:

“[u]nless otherwise agreed between the parties, an arbitration agreement which forms part of another agreement (whether or not in writing) shall not be regarded as invalid, non-existent or ineffective because the other agreement is invalid, or did not come into existence or has become ineffective, and it shall for that purpose be treated as a distinct agreement.”

[**Note:** In Singapore, the independence of the arbitration clause is dealt with in Section 21 of the Arbitration Act and Article 16(1) of the UNCITRAL Model Law on International Commercial Arbitration, which has the force of law in Singapore pursuant to section 3 of our International Arbitration Act.]

Separability of the arbitration agreement

In light of the principle of separability embodied in Section 7 of the UK Arbitration Act, the arbitration agreement must be treated as a “distinct agreement” and would be void or voidable only on grounds which relate *directly* to the arbitration agreement. In the words of Lord Hope, this is an “*exacting test ... [a]llegations that are parasitical to a challenge to the validity to the main agreement will not do*”.

Forgery, for instance, could constitute a ground of challenge. So if, for example, it is alleged that the signature to the document containing the main agreement and the arbitration agreement is forged, the premise of attack is not that the main agreement is invalid, but that the signature to the *arbitration agreement* is invalid.

Similarly, an allegation that the agreement had been signed by an “agent” who in fact had no authority to do so would be an attack on the arbitration agreement (and not just the main agreement). In such situations where the challenge is mounted directly against the arbitration agreement, a party may succeed in his attempt to rescind the whole contract, including the arbitration clause.

On the facts of the present case, however, the Owners’ complaint was that the main agreement was couched in uncommercial terms which, together with other surrounding circumstances, gave rise to the inference that an agent acting for the Owners had been bribed to consent to it. In the court’s view, this did not demonstrate that the agent had been bribed to enter into the arbitration agreement. As observed by Lord Hoffman, “*[i]t would have been remarkable for [the agent] to enter into any charter without an arbitration agreement, whatever [the main agreement’s] other terms had been*”.

Accordingly, in the present case, the operation of Section 7 of the UK Arbitration Act meant that the agreement to go to arbitration must be given effect.

Comments

Over the years, judicial sentiment has changed from one of vague suspicion of the arbitration process to a full-fledged recognition of arbitration as a consensual and viable alternative mode of

dispute resolution. This case is the strongest signal yet of judicial authority giving effect to parties' intentions to have arbitration as their chosen mode of dispute resolution, and not to let technicalities or legal niceties stand in the way.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the litigation and dispute resolution lawyers in Drew & Napier LLC (please refer to the Directors' Profiles on our website), or:

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