DREW & NAPIER

LEGAL UPDATE

CASE UPDATE

13 September 2016

PROMISSORY NOTE HOLDERS NOT BOUND BY ARBITRATION CLAUSE IN UNDERLYING CONTRACT

***Rals International Pte Ltd v Cassa di Risparmio di Parma e Piacenza SpA* [2016] SGCA 53**

INTRODUCTION

Where a promissory note is issued under a contract containing an arbitration agreement and the assignee of the note wishes to commence a claim under the note, is the assignee bound by the obligation to arbitrate? Or can he simply sue on the promissory note through a court action?

Recently, the Singapore Court of Appeal in *Rals International Pte Ltd v Cassa di Risparmio di Parma e Piacenza SpA* [2016] SGCA 53 upheld the decision of the High Court that the assignee's claim based on a number of promissory notes did not fall within the scope of the arbitration agreement in the Supply Agreement. Hence the assignee of such notes was free to litigate in the courts.

The decision is of significance given the widespread use of promissory notes and other negotiable instruments, especially for entities engaging in international commercial and shipping transactions.

BACKGROUND

The appellant, Rals International Pte Ltd ("**Rals**"), had entered into two agreements with an Italian supplier for the supply of equipment to shell and process raw cashew nuts ("**Supply Agreement**") and for the assembly and commissioning of the equipment at Rals' factory. In particular, the Supply Agreement was governed by Singapore law and contained an arbitration clause which provided for disputes to be ultimately settled in accordance with "*the rules of Conciliation and Arbitration Rules of the International Chamber of Commerce in Singapore*".

Under the Supply Agreement, the purchase price for the equipment was to be paid in ten instalments, with the last eight instalments to be paid by way of eight promissory notes issued by Rals ("**Notes**").

The Notes were subsequently indorsed and delivered by the Italian supplier to the respondent bank, Cassa di Risparmio di Parma e Piacenza SpA ("**Cariparma**") pursuant to a discounting arrangement whereby the bank bought the Notes at a discount from their face value.

The first four Notes were subsequently presented for payment by Cariparma, but dishonoured by Rals. Cariparma subsequently commenced litigation proceedings against Rals for the face value of the dishonoured Notes and various declarations concerning the remaining Notes. In response, Rals applied for a stay of the litigation proceedings in favour of arbitration under Section 6 of the International Arbitration Act.

DECISION OF THE HIGH COURT

Whilst the High Court held that Cariparma, as the assignee of the contractual right against Rals, was contractually bound to arbitrate disputes falling within the scope of the arbitration agreement, the High Court did not order a stay of the litigation proceedings. This is because Cariparma had advanced its claim entirely on the promissory notes and, accordingly, the High Court held that Cariparma's claim and Rals' defences were wholly distinct from the Supply Agreement which contained the arbitration agreement. The Supply Agreement, and the rights and obligations under it,

were separate and independent from the statutory contract represented by the Notes.

The High Court reasoned that the choice of promissory notes as parties' payment mode was a considered one and not a mere formality or mere coincidence. The High Court held that unless the parties' arbitration agreement makes an express provision bringing a claim on a bill of exchange within the scope of that arbitration agreement, a bill of exchange is ordinarily outside the scope of the arbitration agreement even though the bill of exchange was issued pursuant to the contract containing the arbitration agreement. In this regard, the High Court appears to have based its decision on the cash equivalence principle – that the commercial purpose of stipulating a bill of exchange as a payment mechanism is to function as a substitute for cash.

DECISION OF THE COURT OF APPEAL

The Court of Appeal upheld the decision of the High Court, holding that the cause of action in Cariparma's action in respect of the Notes did not fall within the scope of the arbitration agreement in the Supply Agreement.

In coming to its decision, the Court of Appeal held that in the absence of express stipulation or incorporation, an arbitration clause in the underlying contract generally does not cover disputes arising under an accompanying bill of exchange, endorsing the view that "*as a matter of commercial common sense, it is difficult to see why any right-thinking merchant would choose to give up his rights in respect of bills of exchange*".

The Court of Appeal also clarified that notwithstanding its departure from the "strict rule" in relation to incorporation of arbitration agreements in the seminal case of *International Research Corp PLC v Lufthansa Systems Asia Pacific Pte Ltd and another* [2014] 1 SLR 130 (under which a "*clear and express reference*" to an arbitration clause contained in one contract was required for the court to find that it had been incorporated in another contract), the "strict rule" continued to apply in the context of negotiable instruments.

Accordingly, given that the obligations under the Notes were "*separate and autonomous*" from those under the Supply Agreement and in the absence of an express term incorporating the arbitration clause into the Notes, claims under the Notes were not subject to the arbitration agreement in the Supply Agreement.

COMMENTS

This was the first Court of Appeal decision to consider the interplay between promissory notes and the arbitration agreement contained in the underlying contract. The Court of Appeal's decision preserves the utility of negotiable instruments as a means of obtaining quick payment. In the usual course, a suit based on such instruments results in summary judgment.

In some cases, the assignees of promissory notes and negotiable instruments generally may not have had sight of the terms of the underlying contract and/or the relevant arbitration clause – from the point of fairness, this is yet another justification for reinstating the "strict rule" in the specific context of negotiable instruments.

Should negotiable instruments expressly incorporate arbitration clauses? We note the Court of Appeal's observations on the on-going controversy in England regarding the availability of summary judgment procedures in international arbitration and the fact that most major institutional arbitration rules apart from the SIAC Rules 2016 do not expressly provide for such procedures. Hence, at least until summary procedures in international arbitration are more widely accepted, it would be prudent for parties to hold off on introducing arbitration clauses into negotiable instruments.

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