préparatoires of the UNCITRAL Model Law and concluded that the contractual documents did not need to make an explicit reference to the arbitration clause and that general words of incorporation suffice under Article 7 of the UNCITRAL Model Law.[35]

4.21 In contrast, however, the Federal Court of Appeal in Canada, in *Nanisivik Mines Ltd v Canarctic Shipping Co Ltd*,[36] held that an arbitration clause within a charter party, incorporated in the bill of lading by general reference to the terms and conditions of the charter party, would not bind the parties to the bill of lading. The court stated that in order to incorporate the arbitration clause a specific reference to the arbitration clause was required. Similarly, the Supreme Court of India has recently considered this issue in *Owners of the Baltic Confidence v State Trading Company of India*.[37] The Supreme Court held that it was the intention of the parties which was paramount. The fact that the parties had made a specific reference to the arbitration clause within the bills of lading showed that they intended that it should be incorporated into their agreement.

Variations to the arbitration clause

4.22 An arbitration agreement, like any other contract, may be varied by the agreement of the parties. However, modern arbitration legislation fails to address whether the variation to the arbitration agreement needs to be in writing. Under the English Arbitration Act 1996 any other agreement as to any matter relevant to the arbitration is only effective if it is in writing. It follows that only a written variation to the arbitration clause would be effective. An issue arose in the case of *JSC Zestafoni G Nikoladze Ferroalloy Plant v Ronly Holdings Ltd*[38] as to whether a variation clause within a contract containing an arbitration clause was effective to allow a party to vary the terms of the arbitration clause. It was argued by one of the parties that the variation clause, which permitted a variation 'of any Clause of this Agreement' was not drafted in sufficiently broad enough terms to permit a variation of the arbitration provision. The party argued that as the arbitration clause was separate to the underlying contract it was not covered by the variation clause which referred to *this* agreement. The Commercial Court disagreed. Colman J acknowledged that the arbitration agreement was a 'free-standing agreement capable of conferring rights and imposing obligations in

[35] The court made reference to UNCITRAL's Fifth Working Group Report A/CN.9/246 (6 March 1984) in which 'The Working Group was agreed that the last part of the last sentence of paragraph (2) should not be understood as requiring an explicit reference to the arbitration clause contained in a document referred to.'

[36] Clout Case 70, (1995) XX Ybk Comm Arbn 276, 10 February 1994, Federal Court of Appeal of Canada.

[37] (2001) 7 Supreme Court Cases 473–87, (2002) XXVII Ybk Comm Arbn 478–81.

[38] EWHC [2004] 245 (Comm).

circumstances where the underlying agreement may be said to be voidable, illegal or no longer of continuing effect'.[39] However, he stated that terms within the contract would apply equally to the arbitration agreement as they would do to other terms within the agreement. Colman J concluded that the fact that the arbitration agreement was separable did not stop it from being just another clause of the agreement.

C. Arbitrability

4.23 There is no internationally accepted opinion as to what matters are arbitrable. Arbitrability relates to the issues in dispute and whether they are capable of settlement by arbitration. A dispute relating to matrimonial proceedings may not be arbitrable in England but may be arbitrable in Libya.[40] Where parties have chosen arbitration to resolve conflicts then there is a heavy presumption in favour of arbitrability.[41] Mustill and Boyd[42] succinctly make the point that there is unlikely ever to be a consensus of opinion as to what matters are arbitrable.

> As rightly stated in a work of authority,[43] there is a balance between the policy of reserving matters of public interest to the courts and the public interest of encouraging arbitration in commercial matters. Since different states have their own traditions and precepts, differing radically from state to state, on matters of politics, economics, morality and the like, it is not surprising that equally radical divergences can be found when each state identifies the matters which are regarded as too important to be left to private dispute resolution. The attempt to draw up a list containing the common factors which determine inarbitrability was bound to fail, and has failed.[44] Thus, in the majority of instruments where one might expect to find a definition there is none.

4.24 The issue of arbitrability may be determined in three different ways. First, it may be determined by the arbitral tribunal as a preliminary point. A party who

[39] Paragraph 30 of the judgment.

[40] Articles 740 and 772 et seq of Document IV, Libya 2.a (Code of Civil Procedure) permit arbitrators to be appointed to affect a conciliation between husbands and wives. However, under Libyan law disputes relating to the civil status of persons including matters relating to divorce are not arbitrable.

[41] Craig, Park, Paulsson, *International Chamber of Commerce Arbitration* (2000), 62; and see generally Bernard Hanotiau, *Larbitrabilité et la favor arbitrandum: un réexamen* (1994) 121 JDI 899; and see *Moses H Cone Memorial Hospital v Mercury Construction Corp* 460 US 1, 24, 103 S Ct 927, 74 L Ed 2d 765 (1983).

[42] Mustill and Boyd, *Commercial Arbitration—2001 Companion* (2001), at 71.

[43] A Redfern and M Hunter, *Law and Practice of International Commercial Arbitration* (3rd edn) para 3.21.

[44] For an illustration of the difficulties which would face the formulation of such a list, see C Alfaro and F Guimarey, '*Who Should Determine Arbitrability? Arbitration in a Changing Economic and Political Environment*' (1996) 12 Arbitration International (No 4) 415–28.

raises an issue of arbitrability may frame its case as one of jurisdiction. That party will allege that if the matter is not arbitrable then the arbitral tribunal has no jurisdiction to proceed. Secondly, a party may apply to the courts of the seat of the arbitration for an injunction or declaration to the effect that the subject matter of the dispute is not capable of settlement by arbitration. Thirdly, a party may commence legal proceedings on the merits of the dispute. In the event that the opposing party seeks to have the litigation stayed to arbitration then the court will have to decide whether the dispute is arbitrable and whether the arbitration agreement is null and void, inoperative, or incapable of being performed.

4.25 There is a presumption in favour of the validity of arbitration agreements.[45] This also translates into a presumption that disputes are arbitrable. In *Moses H Cone Memorial Hospital v Mercury Construction Corp,*[46] the court held that 'any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability'. Where there is an international relationship between the parties then this presumption may be greater.[47] In considering whether a dispute was arbitrable a Second Circuit court of the United States stated that it ought to undertake a two-part enquiry. The court stated that first it must decide whether the parties agreed to arbitrate, and if so, then whether the scope of that agreement encompasses the asserted claims.[48] This is also referred to as jurisdictional and subject matter arbitrability.[49]

The work of UNCITRAL

4.26 The issue of arbitrability was raised and considered when the UNCITRAL Model Law was being drafted. The drafters could not reach any consensus as to a definition of arbitrability. In the end it was decided to ignore the issue within the UNCITRAL Model Law. However, the issue has not gone away and UNCITRAL's recent paper on 'Possible future work in the area of international commercial arbitration'[50] still refers to the need to reach some worldwide consensus on this issue. The UNCITRAL Working Group has suggested that it should call on each country to list the issues which that country considers are not arbitrable. In this way parties to an international contract will know

[45] *Oldroyd v Elmira Savings Bank FSB,* 134 F 3d 72, 76 (2d Cir 1998).
[46] 460 US 1, 24–25 (1983).
[47] *Deloitte Noraudit A/S v Deloitte Haskins & Sells US,* 9 F 3d 1060, 1063 (2d Cir 1993).
[48] *Imports Ltd v Saporiti Italia SpA* 117 F 3d 655, 666 (2d Cir 1997).
[49] *PaineWebber Inc v Mohamad S Elahi* 87 F 3d 1996 (1st Cir).
[50] A/CN.9/460 paras 32–34.

whether their disputes are capable of settlement by arbitration at the seat of the arbitration and if their awards are likely to be enforced.

The law applicable to arbitrability

4.27 Issues of arbitrability, if raised during the arbitration proceedings, are usually determined by reference to the law of the seat of the arbitration or the law of the arbitration agreement if this is different.[51] It is common to find that some disputes are not capable of settlement by arbitration. For example, matters which affect a third party are generally not capable of settlement by arbitration nor are disputes which involve the State imposing a sanction on one of the parties, such as criminal proceedings. Where an issue of arbitrability is raised in the proceedings then the arbitral tribunal may either address that issue immediately or proceed with the arbitration. An arbitral tribunal which proceeds with the arbitration may justify its stance on the basis that this reflects the intention of the parties to resolve disputes by arbitration. However, such a stance is not necessarily helpful to the parties especially if the award is subsequently held to be unenforceable.

New York Convention, Article II(1)

4.28 Article II(1) of the New York Convention obliges each of the contracting States to the convention to 'recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration'. It is this requirement within the New York Convention that creates a presumption in favour of arbitration.[52] There are three essential elements to this article of the New York Convention. First, there must be an agreement in writing;[53] secondly there must be a defined legal relationship; and thirdly the subject matter of the dispute must be capable of settlement by arbitration.

A defined legal relationship

4.29 The phrase 'defined legal relationship' is one which is found within numerous statutes[54] and arbitration rules.[55] What constitutes a defined legal relationship

[51] See paras 7.21 et seq.
[52] This presumption in favour of arbitration does not necessarily amount to a presumption in favour of arbitrability and in *ACD Tridon Inc v Tridon Australia Pty Ltd* New South Wales Supreme Court, IntADR, a presumption in favour of arbitrability was rejected by the court.
[53] Agreements in writing are considered at paras 4.05 et seq above.
[54] See, for example, the UNCITRAL Model Law, art 7; Zimbabwe Arbitration Act 1996, art 7; New Zealand Arbitration Act 1996, s 2; German Arbitration Law 1998, s 1029: and Indian Arbitration and Conciliation Act 1996, s 7.
[55] See, for example, the Indian Council of Arbitration, rules of arbitration, r I(ii); and Netherlands Arbitration Institute, 1998 arbitration rules, art 1.

will differ from country to country. It is common to find that the words 'defined legal relationship' are interpreted broadly.[56] In *Hi-Fert Pty Ltd and Cargill Fertilizer Inc v Kiukiang Maritime Carriers and Western Bulk Carriers (Australia) Ltd*[57] the Federal Court of New South Wales had to consider whether an arbitral tribunal had jurisdiction to hear claims arising from a breach of the Trade Practices Act. The court considered whether a claim for breach of statutory duty arose from a breach of a 'defined legal relationship'. The court stated that as the expression 'defined legal relationship' was followed by the words 'whether contractual or not' these words indicated that the type of dispute that could be referred to arbitration reached beyond the contractual relationship established within the underlying contract. The court also held that the expression 'in respect of' also indicates that a broad approach should be taken to the nature and extent of the relationship. The 'legal relationship' can, on this approach, be defined by statute. Therefore, the scope of the arbitration agreement may also include claims in negligence or other torts.[58]

4.30 In contrast, in *O'Callaghan v Coral Racing Ltd*[59] the English Court of Appeal held that an arbitration clause in a gaming agreement, which referred disputes to the editor of *The Sporting Life*, was void as under English law gaming agreements are unenforceable and the arbitration agreement could not survive independently. The Court of Appeal held that this was not a valid arbitration agreement as English law did not recognize any legal relationship between the parties. Hirst LJ stated: 'To my mind the hallmark of the arbitration process is that it is a procedure to determine the legal rights and obligations of the parties judicially, with binding effect, which is enforceable in law, thus reflecting in private proceedings the role of a civil court of law.'[60] Similarly, an arbitration that had as its object the payment of monies for a bribe was held not to be arbitrable.[61]

Disputes capable of settlement by arbitration

4.31 The dispute between the parties must be capable of settlement by arbitration. In this regard there will be some forms of dispute which will be seen as falling within the exclusive jurisdiction of the national courts. The rationale for this is that certain matters are considered to be so important to the operation of justice or the running of business that they are reserved exclusively to the control of the courts.[62] In *Zimmerman v Continental Airlines Inc*,[63] for example, the court held that bankruptcy proceedings were not capable of settlement by arbitration because of their importance to the smooth functioning of the nation's commercial activities. The court held that such proceedings were one of the few areas where Congress has expressly pre-empted state court jurisdiction.[64]

International arbitrability and domestic arbitrability

4.32 The issue of whether a dispute is domestic or international is also relevant to the question of arbitrability. In *Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc*[65] the United States' Supreme Court held that the issues of arbitrability would be interpreted more broadly in an international context than in a domestic context. The court stated 'that concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes require that we enforce the parties' agreement, even assuming that a contrary result would be forthcoming in a domestic context'. Referring to the case *of Fritz Scherk v Alberto-Culver Co*,[66] the court stated that 'it will be necessary for national courts to subordinate domestic notions of arbitrability to the international policy favoring commercial arbitration'. These statements of principle have been cited and approved by the courts of a number of different countries.[67]

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[56] See, for example, *German Party v Austrian GmbH*, Note by P Schlosser in Entscheidungen zum Wirtschaftsrecht (December 1995) 1245–6, (1996) XXI Ybk Comm Arbn 845–50; and *Silkworm Screen Printers, Inc v Robert Abrams* 1992 US App LEXIS 28843; 32 Federal Reporter, Third Series, 563 et seq, (1995) XX Ybk Comm Arbn 830–7.

[57] (1997) 12 Mealey's International Arbitration Report (No 7) C-1–C-9; (1998) XXIII Ybk Comm Arbn 606–18.

[58] See *Kaverit Steel & Crane Ltd v Kone Corp* (1992) 87 DLR 4th 129; 40 CPR 3d 161 et seq, 30 ACWS (3d) 1105 et seq, (1994) XIX Ybk Comm Arbn 643–52; and *Canada Packers Inc v Terra Nova Tankers Inc* 1992 Ont CJ LEXIS 1776, (1997) XXII Ybk Comm Arbn 669–72.

[59] The Times, 26 November 1998.

[60] Page 7 of the case transcript.

[61] *Hub Power Co Ltd (HUBCO) through Chief Executive v Pakistan WAPDA through Chairman* PLP 2000 SC 841.

[62] In this regard there are certain fundamental rights guaranteed by international covenants; see, for example, the International Covenant on Economic, Social and Cultural Rights. Disputes which affect such rights may not be arbitrable unless the arbitration agreement permits affected parties to have effective and appropriate remedies: see further paras 11.41–11.42.

[63] 712 F 2d 55 (3d Cir, 1983), cert. denied, 464 US 1038, 79 L Ed 2d 165, 104 S Ct 699 (1984).

[64] However, see *Stawski Distributing Co Inc v Browary Zywiec SA* IntADR, (US Ct of Appeals for the seventh circuit) where the court held that an agreement which was contrary to the Illinois Beer Industry Fair Dealing Act could be arbitrated even if the choice of law clause was void.

[65] 473 US 614, 105 S Ct Reports (1985) 3346, (1986) XI Ybk Comm Arbn 555–65.

[66] 417 US 506, 515–20 (1974).

[67] See, for example, *Government of New Zealand v Mobil Oil New Zealand Ltd* International Arbitration Report, 1987, 725–74, (1998) XIII Ybk Comm Arbn 638–54; *Renusagar Power Co Ltd v General Electric Co* 1993(4) SCALE Vol IV, Part No 1 (11–24 Oct 1993) 44–99; (1993) 8 International Arbitration Report (No 12) A-1–A-81; (1995) XX Ybk Comm Arbn 681–738; *Hebei Import & Export Corp v Polytek Engineering Co Ltd* (1999) 14 Mealey's International Arbitration Report (No 2) G-1–G-15, (1999) XXIVa Ybk Comm Arbn 652–77.

Disputes which are null and void, inoperative, or incapable of being performed

4.33 Article II(3) of the New York Convention provides that the courts of a Contracting State must stay legal proceedings to arbitration unless the arbitration agreement is 'null and void, inoperative, or incapable of being performed'. This provision is one which is found in many statutes and appears in the UNCITRAL Model Law.[68] This provision of the New York Convention covers situations where the law deems the arbitration agreement to be invalid and also where the arbitration agreement is defective.[69]

Arbitration agreements which are null and void

4.34 An arbitration agreement may be held to be null and void where it promotes an illegal act or enterprise or where the arbitration agreement is considered to be unconscionable. In *Alexander v Anthony International*[70] the United States' Third Circuit Court of Appeals held that an arbitration clause was unconscionable because it prevented an employee from recovering not only his own attorney's fees but also prevented him from claiming punitive damages. The court stated that as the arbitration clause precluded the employee from claiming complete compensation and the company was able to evade full responsibility for its actions the arbitration agreement was therefore void.

4.35 Arbitration agreements have also been held to be null and void where the subject matter of the dispute may affect the rights of third parties. In *A Best Floor Sanding Pty Ltd v Skyer Australia Pty Ltd*[71] the parties entered into a joint venture agreement and agreed to arbitrate any dispute, difference or question touching, inter alia, the dissolution or winding up of the 'association' which was their joint venture entity. Warren J declined an application for an order staying a winding-up proceeding, under the Victorian commercial arbitration legislation, on the ground that the arbitration clause was null and void because it had the effect of 'obviating the statutory regime for the winding up of a company'.[72] Her Honour's decision was partly based on public policy considerations surrounding the process of winding-up a company and partly based on the fact that a winding-up order operates to affect the rights of third parties, not merely the rights of the parties to the arbitration clause.[73]

[68] Article 8(1) of the UNCITRAL Model Law. See also English Arbitration Act 1996, s 9(4); Singapore International Arbitration Act 2002, s 6(2); and New Zealand Arbitration Act 1996, art 8(1).

[69] See Schmitthoff, 'Defective Arbitration Clauses' [1975] JBL 9.

[70] IntADR, 19 August 2003—Federal Court of Appeals for the Third Circuit.

[71] [1999] VSC 170.

[72] ibid at para 18 of the case transcript: http://www.austlii.edu.au/au/cases/vic/VSC/1999/170.html.

[73] See also *ACD Tridon Inc v Tridon Australia Pty Ltd* (2002) New South Wales Supreme Court; Digest by: D Meltz, *Selborne Chambers*, ITA Board of Reporters, IntADR.

Public policy and contracts *contra bonos mores* An arbitration agreement **4.36** which seeks to promote an illegal or immoral agreement or is contrary to the public policy of the law of the seat of the arbitration will be null and void.[74] The term 'public policy' under English law is open textured and encompasses a broad spectrum of different acts. A contract may be contrary to public policy because it is entered into with the object of committing a criminal act, or to evade a statute, or to commit a tort. It may involve bribery and corruption or trading with an enemy in wartime. Alternatively, it may involve a practice which has no criminal element but which is unenforceable under English common law. In *Holman v Johnson*[75] the court stated that 'no court will lend its aid to a man who founds his cause of action upon an immoral or illegal act'. The very open textured nature of public policy has prompted fears about its unpredictable scope: 'It is a very unruly horse, and when you get astride it you never know where it will carry you.'[76]

There is a distinction between domestic public policy issues that arise during the **4.37** course of the arbitration and public policy issues which arise at the enforcement stage of an international arbitration award. During the course of the arbitration public policy defences will be interpreted broadly. In *Soleimany v Soleimany*[77] Waller LJ in the English Court of Appeal stated that 'It is clear that it is contrary to public policy for an English award (ie an award following an arbitration conducted in accordance with English law) to be enforced if it is based on an English contract which was illegal when made. That follows from the decision of this court in *David Taylor & Sons Ltd v Barnett Trading Company* [1953] 1 WLR 562 . . .' In relation to the enforcement of an international arbitration award the principle that the English courts will not aid in the enforcement of an award which is contrary to its public policy rules is not so rigidly observed.[78] However, there are certain breaches of public policy which are considered so fundamental that the courts will never lend their aid to the enforcement of an award where a breach of those principles is alleged.[79]

[74] See, for example, *Rosgoscirc v Circus Show Corp* (1995) XX Ybk Comm Arbn 891–8, United States District Court, Southern District of New York, 16 July 1993, where the court referred to *Meadows Indem Co v Baccala & Shoop Ins Svcs*, 760 F Supp 1036, 1043 (EDNY 1991) and held that reference to a non-existent forum should be classified as a mistake, which was a proper exception under the New York Convention, art II(3). The court reasoned that the arbitration agreement was null and void where there were recognized grounds for challenging the agreement. These grounds included claims of fraud, duress, mistake, and waiver.

[75] (1775) 1 Cowp 341, 343.

[76] *Richardson v Mellish* (1824) 2 Bing 229, 252.

[77] [1999] QB 785, [1998] 3 WLR 811, [1999] 3 All ER 847, [1998] CLC 779.

[78] *Westacre Investments Inc v Jugoimport-SDPR Holding Co Ltd* [2000] QB 288, [1999] 3 WLR 811, [1999] 3 All ER 864, [1999] 1 All ER (Comm) 865, [1999] 2 Lloyd's Rep 65, [1999] CLC 1176, [1999] BLR 279 and *Omnium de Traitement et de Valorisation SA v Hilmarton Ltd* [1999] 2 All ER (Comm) 146, [1999] 2 Lloyd's Rep 222.

[79] See paras 13.43 et seq.

4.38 The difference between public policy defences in international arbitrations and domestic arbitrations was considered by the English Court of Appeal in *Westacre Investments Inc v Jugoimport-SDPR Holding Co Ltd.*[80] Referring to *Lemenda Trading Co Ltd v African Middle East Petroleum Co Ltd*[81] the English Court of Appeal held that there were certain universally condemned activities such as terrorism, drug trafficking, prostitution, paedophilia, corruption, or fraud in international commerce which would 'invite the attention of English public policy in relation to contracts which are not performed within the jurisdiction of the English courts'. Even if an award was made outside of England, which was subject to a foreign law and had no connection with England whatsoever, the English courts would still not permit enforcement of such an award in England because it would violate the most basic notions of English justice. Waller LJ expressed this principle as follows:

> '(1) there are some rules of public policy which if infringed will lead to non-enforcement by the English court whatever their proper law and wherever their place of performance but others are based on considerations which are purely domestic; (2) contracts for the purchase of influence are not of the former category; thus (3) contracts for the purchase of personal influence if to be performed in England would not be enforced as contrary to English domestic public policy; and (4) where such a contract is to be performed abroad, it is only if performance would be contrary to the domestic public policy of that country also that the English court would not enforce it.'

Arbitration agreements which are inoperative[82]

4.39 Inoperability applies where the arbitration agreement has ceased to have effect.[83] An arbitration agreement may be inoperative because the arbitral institution no longer exists or the rules which are referred to are incorrectly cited. It will be a question of fact and degree in each case whether the deficiency in the arbitration agreement renders the agreement inoperative.[84] An arbitration agreement may also be inoperative where the underlying contract, which contains the arbitration clause, never came into existence. The courts in deciding this issue will need to determine whether the parties intended the arbitration agreement to have validity separately to the underlying agreement. The arbitration agreement

[80] [2000] QB 288, [1999] 3 WLR 811, [1999] 3 All ER 864, [1999] 1 All ER (Comm) 865, [1999] 2 Lloyd's Rep 65, [1999] CLC 1176, [1999] BLR 279.

[81] [1988] 1 FTLR 123.

[82] See further para 4.45 which illustrates how pathological arbitration clauses have been dealt with by the courts.

[83] See P Sanders (ed), '*New York Convention 1958 Commentary Cases*' (1984) IX Ybk Comm Arbn 357.

[84] In *The Levant Shipping Company v Romanian Air Transport Tarom* 2003 JDI 139 the French Cour de cassation held that the arbitration clause was not inoperative even though the arbitral tribunal had concluded that it was.

is a separate contract, discrete from the underlying contract, and therefore it may have validity even if the underlying contract was never concluded.[85] The arbitration agreement may also become inoperable because the parties waive their rights to arbitrate under the agreement.

Waiver and repudiation Where a party waives its right to arbitrate the dispute then the arbitration agreement will become inoperative. In each case this will be a question of fact and degree as to whether the actions of the party amount to a waiver. The waiver can arise by delay or inaction by a party. Alternatively a party may repudiate the arbitration agreement by an express statement or by conduct that indicates that it does not intend to be bound by the terms of the arbitration clause. **4.40**

In *ACD Tridon Inc v Tridon Australia Pty Ltd*[86] the Supreme Court of New South Wales held that the right to apply for a stay was a private right and therefore it could be waived.[87] The court stated that Parliament could not have intended that the parties should be allowed to litigate a claim and then, near the end of that process, one of the parties be permitted to stay the litigation to arbitration. In such circumstances a party which proceeded with litigation without making an application to stay to arbitration would be held to have waived its right and the arbitration agreement would be deemed to be inoperable. **4.41**

Where there is delay in making an application to stay litigation to arbitration then it will be a question of fact as to whether that party has waived its right to refer matters to arbitration. In *Thyssen Inc v Calypso Shipping Corp SA*[88] the United States Court of Appeals for the Second Circuit was asked to consider whether Calypso had waived its right to seek to stay litigation to arbitration. The court held that it had not. The court stated that the delay by Calypso in raising its right to arbitration did not prejudice Thyssen. The court further stated that there was a strong presumption in favour of arbitration and that the court would not lightly infer that there had been a waiver of a party's right to arbitrate. If a party was to establish that there had been a waiver, which rendered the arbitration clause inoperable, then it would need to show that it had been substantially prejudiced or had suffered prejudice due to excessive cost and time delay. **4.42**

[85] *Cecrop Co v Kinetic Sciences Inc* 2001 BCSC 532, 16 BLR (3d) 15 (Supreme Court of British Columbia).

[86] (2002) Supreme Court of New South Wales; Digest by: *D Meltz, Selborne Chambers*, ITA Board of Reporters, IntADR.

[87] Citing *Australian Granites Ltd v Eisenwerk Hensel Bayreuth GmbH* [2001] 1 Qd R 461 in support of its contention.

[88] IntADR, 9 August 2002—United States Court of Appeals for the Second Circuit.

4.43 Repudiation will occur where one party, by words or conduct, demonstrates an intention no longer to be bound by the contract. It is then open to the other party to accept the repudiation and to bring the contract to an end.[89] The repudiation of the arbitration agreement renders the agreement inoperable. In *Downing v Al Tameer Establishment*[90] the English Court of Appeal had to consider when an arbitration agreement had been repudiated. Al Tameer denied that there was any contractual relationship between the parties. Downing then commenced court proceedings against Al Tameer. Al Tameer sought to stay those proceedings to arbitration. The Court of Appeal stated that it should approach the question of whether or not a party has lost the right to arbitrate by applying the traditional principles of the law of contract. In particular, the court should consider whether the arbitration agreement has been repudiated. The Court of Appeal stated that, 'in appropriate circumstances, the court may hold that it is clear that the arbitration agreement sought to be relied on for the purposes of a stay has in fact come to an end prior to the application for a stay being made or heard, and hence is "inoperative" for the purposes of s. 9(4) of the 1996 Act'.[91]

Arbitration agreements which are incapable of being performed

4.44 An arbitration agreement is incapable of being performed where, for example, the arbitration process in incapable of being commenced.[92] This may occur where the arbitration agreement is too vaguely worded[93] or where it is no longer possible for the parties to arbitrate their dispute. In *CLOUT Case 404*[94] the German Federal Supreme Court had to consider an application that the arbitration agreement was incapable of being performed. The claimant alleged that it was not able to afford the arbitral proceedings and that if the matter were to proceed before the courts then it would be entitled to legal aid. The German Federal Supreme Court held that the arbitration agreement had proven impracticable under the circumstances. The court stated that under section 1032(1) ZPO, a court is not required to dismiss a claim brought before it, if 'the arbitration agreement is null and void, inoperative or incapable of being

[89] *The Splendid Sun* [1981] QB 694; *The Hannah Blumenthal* [1983] 1 AC 854; and *The Leonidas D* [1985] 2 Lloyd's Rep 18.

[90] [2002] EWCA Civ 721.

[91] See also *Société Générale de Surveillance v Pakistan* (2002) 19 Arbitration International (No 2) where it was held that a party's actions in contesting a claim before the courts amounted to a waiver of its right to arbitrate.

[92] See P Sanders (ed), 'New York Convention 1958 Commentary Cases' (1984) IX Ybk Comm Arbn 357.

[93] See below 'Pathological arbitration clauses' at para 4.45.

[94] Bundesgerichtshof; III ZR 33/00, 14 September 2000, Betriebs-Berater 2000, 2330; Betriebs-Berater, Beilage 6 zu Heft 31, 12 (with commentary Risse, 11), (2002) XXVII Ybk Comm Arbn 265.

performed'. On the facts the court found that the arbitration agreement was incapable of being performed because claimant was unable to afford the costs of arbitration.

Pathological arbitration clauses A 'pathological arbitration clause'[95] is one that contains deficiencies within its drafting. Not every arbitration agreement which contains a deficiency in its drafting will be 'inoperative or incapable of being performed'. However, where a national court concludes that the deficiency is so severe as to render the agreement inoperative or incapable of being performed, the arbitration agreement will not be enforced. The problems with most pathological arbitration clauses stem from either an ambiguity in the arbitration agreement or a reference to something which does not exist. Each country has addressed the issue differently and approached pathological arbitration clauses on a case by case basis. **4.45**

Imprecision in drafting The courts in the United States[96] and in Hong Kong[97] have both considered an arbitration agreement which stated that 'either party *may* refer a dispute to arbitration'. In *Cravat Coal Export Co*[98] the claimant argued that the word 'may' in the arbitration agreement meant that arbitration was permissive and not mandatory and that arbitration was only mandatory if both parties then agreed to arbitrate. In essence, Cravat argued that there needed to be a 'submission to arbitration' in its historic sense in addition to the arbitration clause. The court rejected this argument referring to the case of *Block 175 Corp v Fairmont Hotel Management Co*[99] where the court stated: 'Plaintiff contends the presence of the word "may" in the arbitration clause renders arbitration permissive and not mandatory. A commonsense reading of the clause belies this contention. When either party elects to arbitrate and serves the proper notice, as was done here, arbitration must ensue.'[100] Similarly, in *Nemitz v Norfolk and Western Railway Co*[101] the court concluded that where there was a valid arbitration agreement and arbitration was invoked by one of **4.46**

[95] The phrase was coined by Frédéric Eisemann, *La clause d'arbitrage pathologique*, Arbitrage Commercial: Essais in Memoriam Eugenio Minoli (1974) 129.

[96] *Cravat Coal Export Co Inc v Taiwan Power Co* (5 March 1990, USDC Eastern District of Columbia, Civil Action No 90–11) referred to by Benjamin Davis, *Pathological Clauses: Frédéric Eisemann's Still Vital Criteria*, (1991) 17 Arbitration International (No 4) 365–388.

[97] *China State Construction Engineering Corp Guangdong Branch v Madiford Ltd* (1991, A6563 judgment delivered on 2 March 1992).

[98] ibid.

[99] 648 F Supp 450, 452 (1986).

[100] *Canadian National Railway Co v Lovat Tunnel Equipment* 174 DLR (4th) 385 (1999); *Lobb Partnership Ltd v Aintree Racecourse Co Ltd* [2000] BLR 65; *WSG Nimbus Ote Ltd v Board of Control for Cricket in Sri Lanka* [2002] SLR LEXIS 109.

[101] 436 P 2d 841 (1971).

the parties then at the time of such election the arbitration clause became mandatory.[102]

4.47 Imprecision in drafting can arise because of a simple technical error in wording or a 'disastrous compromise'.[103] An example of a disastrous compromise is as follows: 'Disputes hereunder shall be referred to arbitration, to be carried out by arbitrators named by the International Chamber of Commerce in Geneva in accordance with the arbitration procedure set forth in the Civil Code of Venezuela and in the Civil Code of France, with due regard for the law of the place of arbitration.' Even if such a clause were workable and even if the ICC were prepared to appoint an arbitral tribunal any resulting award would be open to challenge. Further examples of arbitration agreements which contain disastrous compromises include agreements referring to different and inconsistent forms of dispute resolution procedures, and agreements referring to both courts and arbitration.[104] In *Rederi Aktiebolaget Sally v srl Termarea*[105] the arbitration clause was found to be defective in that the express provisions of the arbitration clause conflicted with mandatory requirements of the law of the place of the arbitration. The result was that an award was issued by the arbitral tribunal which the courts in Florence refused to enforce.

4.48 A further example of a defective arbitration agreement is where the reference to the place of the arbitration or the rules is uncertain. The courts of the seat of the arbitration will endeavour to remedy the defect but this may not always be possible. In *Star Shipping SA v China National Foreign Trading Transportation Corp (the 'Star Texas')*[106] the arbitration agreement provided that: 'Any dispute arising under the charter is to be referred to arbitration in Beijing or London in defendant's option.' The claimants contended that the arbitration agreement was null and void, inoperative, or incapable of being performed. The English Court of Appeal held that the arbitration agreement was valid and that the claimant's submission that the arbitration contained a floating curial law, either Chinese or English was rejected. The court stated that there was no doctrinal reason why the law governing the arbitration had to be fixed at the time of making the arbitration agreement. Policy reasons strongly supported the validity

[102] See also Kaplan J, 'The Model Law in Hong Kong—Two Years On', (1992) 18 Arbitration International (No 3) 223–36 and *Mitsubishi Motors Corp v Soler Chrysler-Plymouth Inc* 473 US 614 (1985); and *Scherk v Alberto-Culver Co* 417 US 506 (1974); (1976) I Ybk Comm Arbn 203.

[103] Craig, Park and Paulsson, *International Chamber of Commerce* (2000) at 132.

[104] See further, B Davis, 'Pathological Clauses: Frédéric Eisemann's Still Vital Criteria', (1991) 17 Arbitration International (No 4), 372–6.

[105] (1979) IV Ybk Comm Arbn (IV) 294.

[106] [1993] 2 Lloyd's Rep 445.

of an arbitration clause containing a floating curial law; a contract without a proper law could not exist but an arbitration agreement could perfectly exist without it being known at the time the agreement was entered into what law would govern the arbitration procedure.[107]

Similarly, in *Mangistaumunaigaz Oil Production Association v United World Trade Inc*[108] the arbitration agreement stated 'Other terms:—FOB incoterms latest issue.—Arbitration, if any, by ICC rules in London.—English law to apply.' Potter J held that the words 'Arbitration, if any, by ICC rules in London' amounted to a valid and binding arbitration clause. The clause as a whole, read in the context of an international contract for the sale of oil demonstrated that the parties intended to settle any dispute which might arise between them by arbitration according to ICC rules in London with English law to apply and the words 'if any' were to be treated as 'surplusage or as an abbreviation for the words "if any dispute arises" '. **4.49**

Incorrect nominating bodies or rules A further type of pathological arbitration clause is where the arbitration agreement refers to a non-existent nominating body or is ambiguous in its reference. In domestic arbitrations this may not be a major problem as the national courts at the seat of the arbitration are usually empowered to appoint an arbitrator in default of agreement.[109] However, in the international arena such a defect may be fatal to the arbitration process. In *Republic of Nicaragua v Standard Fruit Co*[110] the 9th Circuit Court of the United States had to consider a pathological arbitration clause. The arbitration clause stated: 'Any and all disputes arising under the arrangements contemplated hereunder . . . will be referred to mutually agreed mechanisms or procedures of international arbitration, such as the rules of the London Arbitration Association.' At first instance the district court found that the 'lack of specificity' within the clause militated against its enforcement. On appeal the court disagreed and stated that even the parties' most minimal indication of intent to arbitrate must be given full effect, especially in international disputes.[111] The court therefore granted the motion to compel arbitration. **4.5**

[107] See also *Sonatrach Petroleum Corp (BVI) v Ferrell International Ltd* [2002] 1 All ER (Comm) 627.

[108] [1995] 1 Lloyd's Rep 617.

[109] See, for example, the English Arbitration Act 1996, ss 16–18.

[110] 937 F 2d 469 (9th Cir, 1991).

[111] See also *Bauhinia Corp v China National Machinery and Equipment Co* 819 F 2d 247 (9th Cir, 1987). A similar decision was reached by the Swiss Federal Court, 1st Civil Chamber in *A v B*, Case (No 4P 162/2003, 21 November 2003). The Swiss Federal Court stated that where there was inconsistency in the arbitration agreement then the part of the clause that could not be performed should be either construed in the light of the principle of *favour valididatis*, in order to sustain the entire clause, or struck off, or substituted for the *lex arbitri*.

4.51 In *Danish firm v Egyptian firm*[112] the arbitral tribunal held that an arbitration clause that provided for disputes to be resolved by: 'the International Chamber of Commerce, Zurich, Switzerland, in accordance with the Swiss law of the Canton of Zurich' was valid even though there was no International Chamber of Commerce based in Zurich. The arbitral tribunal concluded that the reference must mean 'arbitration in Zurich under the ICC Rules with Swiss/Zurich law applicable to the substance of the case'.[113] In contrast, the case of *Nokia Maillefer SA v Mazzer*[114] illustrates that a national court will not always rectify a pathological arbitration clause. In this case the forum selection clause simply referred to 'International Chamber of Commerce, Paris'. There was no reference to arbitration. The court stated that an arbitration clause can only be validly concluded where the common intention of the parties was to refer the dispute to arbitration. The court stated that because of the important consequences attached to arbitration the court would not too easily find that such an agreement had been concluded.[115] The court concluded that: 'The jurisdiction of the International Chamber of Commerce in Paris cannot be deemed to be tantamount to the appointment of an arbitrator, as the word arbitrator or arbitration does not appear and the International Chamber of Commerce itself does not act as arbitrator.' The court therefore concluded that the parties had not entered into a valid and binding arbitration agreement.[116]

4.52 Where a pathological arbitration clause in an international arbitration agreement is considered by an arbitral tribunal then often its validity will be determined by international standards. In *Distributor (Spain) v Manufacturer (Italy)*[117] the arbitral tribunal did not feel compelled to consider the question of

[112] Final award in Case No 5294, (1989) XIV Ybk Comm Arbn at 137.

[113] See also *Seller (Europe) v Buyer (Canada/China)* (Preliminary Award of 25 November 1994) (1997) XXII Ybk Comm Arbn at 211; CLOUT Case 373 [2000/2] Recht und Praxis der Schiedsgerichtsbarkeit 13, 15 October 1999; and G Born, *International Commercial Arbitration*, (2nd edn, Deventer, 2001) ch 3, B 1 notes at 19; and Benjamin Davis, 'Pathological Clauses: Frédéric Eisemann's Still Vital Criteria', (1991) 17 Arbitration International (No 4) 365–88.

[114] Ybk Comm Arbn XXI (1996) at 687.

[115] Cf *David Wilson Homes v Survey Services Ltd (in liquidation)* [2001] 1 All ER (Comm) 449 where the dispute resolution clause of the contract stated 'any dispute or difference arising hereunder between the Assured and the Insurer shall be referred to Queen's Counsel of the English Bar . . .'. The Court of Appeal held that this was an arbitration clause although the word arbitration appeared nowhere in the contract.

[116] See also *Slovenian Co v Agent (Germany)* (Oberlandesgericht [Court of Appeal], Hamm, 15 November 1994) (1997) XXII Ybk Comm Arbn at 707 where the court held that the relevant arbitration clause was null and void because it failed to indicate a competent arbitral tribunal. The arbitration clause referred to 'the arbitral tribunal of the International Chamber of Commerce in Paris, seat in Zurich'. The Court of Appeal stated that 'this had more than one meaning, since not only the International Chamber of Commerce in Paris, but also the Zurich Chamber of Commerce have a permanent arbitration tribunal and their own Rules'.

[117] Partial Award in Case No 7920 of 1993, (1998) XXIII Ybk Comm Arbn at 80.

the validity of the arbitration agreement by reference to the national law of any particular country. However, this approach may be criticized in that any subsequent award may be unenforceable. The facts of the case were that the parties entered into a distribution agreement that contained a purported arbitration clause. The clause stated that: 'In case of litigation, parties hereby agree to appeal to International Chamber of Commerce of Geneva (Switzerland) according to international rules of arbitration.' When a dispute arose the Spanish party referred the matter to ICC arbitration. The Italian party refused to take part in the arbitration maintaining that the clause referred to arbitration before the Geneva Chamber of Commerce. The arbitral tribunal held that although the arbitration clause was ambiguous an ICC arbitration held in Geneva complied with the parties intentions to have the dispute settled by international arbitration in Geneva. The arbitral tribunal concluded that the parties undoubtedly intended to submit disputes between them to arbitration and the parties intended the arbitration to be conducted in accordance with 'international procedural rules'. The arbitral tribunal concluded that in arriving at its decision it should not lose sight of the parties' wish that the matter be settled by international arbitration. The arbitral tribunal noted that there was no 'International Chamber of Commerce of Geneva'. The choice was therefore between arbitration conducted by the ICC or the Chamber of Commerce and Industry in Geneva.

4.53 The arbitral tribunal held that if it had no jurisdiction, and the proceedings should be recommenced *de novo* before the Chamber of Commerce and Industry in Geneva, then this would delay in an unjustifiable manner the resolution of the dispute. The arbitral tribunal accepted that: 'It is impossible, on the basis of a literal analysis of the "pathological" clause, to determine with absolute certainty which arbitral institution the parties intended. Hence, we must define principles for the interpretation of international contracts, with reference to arbitral awards of the International Chamber of Commerce.' The arbitral tribunal then proceeded to consider 'the principle of effectiveness' (*effet utile*). The arbitral tribunal stated that:

> The principle of effectiveness is a principle for the interpretation of international contracts which embodies a universal truth: it requires that when two different interpretations of the terms of a contract are possible, the interpretation to be preferred is that which gives some effect to the terms (Phillipe Hahn, L'interprétation des contrats internationaux, Clunet 1981, p. 5 et seq).

Referring to ICC award no 1434,[118] the arbitral tribunal stated: 'The interpretation of contract is one of the fields in which international commercial

[118] Clunet 1976, 982.

arbitrators are most inclined to free themselves of national laws and refer to general principles of law.' The arbitral tribunal held that it could depart from general conflict of law principles, which it would otherwise have to apply, where the principles of national law that would be chosen conflicted with the principle of effectiveness. Having elected to apply the principles of effectiveness the arbitral tribunal then had to consider what was the intention of the parties. In this regard the arbitral tribunal looked at pre-contractual negotiations. The arbitral tribunal further concluded that the reference to the 'International Chamber of Commerce' was in fact a reference to the International Chamber of Commerce in Paris and that the words 'of Geneva' meant 'in Geneva' and therefore the parties intended ICC arbitration with the seat of the arbitration in Geneva.

Arbitrability and the burden of proof

4.54 A party which alleges that the arbitration agreement is null and void must prove the facts on which the allegation is made. In the event that a party alleges that there has been fraud in the inducement of the arbitration agreement or any claim of fraud which goes to the making of the agreement to arbitrate then it is for that party to prove its case.[119] The laws of the seat of arbitration will need to be examined in order to determine whether issues of arbitrability should be dealt with by the courts or by the arbitral tribunal.[120] Under English law if an applicant alleges that the arbitration agreement is null and void, inoperative, or incapable of being performed and the respondent raises an arguable case in favour of validity, a stay of the litigation should be granted and the matter resolved by the arbitral tribunal.[121]

D. Separability of the Arbitration Agreement

4.55 Nearly every jurisdiction now recognizes the concept of separability or autonomy of the arbitration agreement.[122] It is recognized by the UNCITRAL Model

[119] *Quasem Group Ltd v WD Mask Cotton Co* 967 Federal Supplement (WD Tenn 1997) 288–95, (1998) XXIII Ybk Comm Arbn 977–83; and *CBS Employees Fed Crédit Union v Donaldson, Lufkin & Jenrette Sec Corp*, 912 F 2d 1563, 1567 (6th Cir, 1990).

[120] See paras 5.72–5.87.

[121] *Hume v AA Mutual International Insurance* [1996] LRLR 19; and *Downing v Al Tameer Establishment* [2002] EWCA Civ 721. However, see *Azov Shipping Co v Baltic Shipping Co (No 1)* [1999] 1 All ER 476, [1999] 1 Lloyd's Rep 68.

[122] See Fouchard, Gaillard, Goldman, *International Commercial Arbitration* paras 400–406 for illustrations of where the autonomy principle is recognized in arbitration statutes and arbitral case law.

Law,[123] in the United States,[124] in England,[125] in most countries in Europe,[126] and in a number of Commonwealth countries.[127] However, the extent of the separability doctrine differs between each jurisdiction. The concept of separability of the arbitration agreement exists as a matter of law and not fact. The arbitration agreement, if part of the underlying contract, will derive its existence from the underlying contract. The offer, acceptance, consideration and the capacity of the parties to make the underlying contract are used to justify the validity of the arbitration agreement. However, no separate consideration is needed nor is a specific offer or acceptance relating to the arbitration agreement required. The principle of separability means that the underlying contract containing the arbitration clause may be void but the arbitration agreement may survive.

The doctrine of separability

4.56 The principles underlying the concept of separability of the arbitration agreement were recently considered by the Court of Appeal of Bermuda in *Sojuznefteexport (SNE) v JOC Oil Ltd.*[128] The court stated that the doctrine of separability was often referred to a 'severability' in the United States and 'autonomy' in France and Germany. However, irrespective of the different names the effect of the doctrine was that the invalidity of the main contract does not, in principle, entail the invalidity of the arbitral clause. An effect of this doctrine is that an arbitral tribunal may 'declare a contract invalid and yet retain its jurisdiction to decide a dispute as to the consequences of such invalidity provided that the arbitration clause is valid as a separate entity'.[129] It follows therefore that

[123] UNCITRAL Model Law, art 16(1).

[124] *Robert Lawrence Co Inc v Devonshire Fabrics Inc* 271 F 2d 402 (1959); *Prima Paint Corp v Flood & Conklin Manufacturing Co* 388 US 395 (1967); *Information Sciences Inc v Mohawk Data Science Corp* 43 NY 2d 198 (1978); and *Peoples Security Life Insurance Co v Monumental Life Insurance Co* 867 F 2d 809 (1989). However, in *Pollux Agencies Inc v Louis Dreyfus Corp* 455 F Supp 211 at 218 (SDNY 1978) the court questioned whether the doctrine of severability could exist where it was alleged that the underlying contract never existed. Similar dicta are given in *Three Valleys Mun Water Dist v E F Hutton and Co Ltd* 925 F 2d 1136; and *Continental Group v NPS Communications Inc* 873 F 2d 613, 617 (2nd Cir, 1989).

[125] Arbitration Act 1996, s 7 and see further paras 20.02–20.07.

[126] In Sweden, *Sonatrach v KCA* (1991) 2 World Arbitration and Mediation Report 297; *AB Norrköpings Trikefabrik AB Per Persson*, NJA 1936, 521; and *Hermansson v AB Asfaltsbeläggningar, NJA 1976, 125*. In France, *Société Gosset v Société Carapelli*, [1963] D Jur 545 Cour de cassation; and *Hecht v Société Buisman's*, 1974 Rev Arb 89, Cour de cassation.

[127] *QH Tours Ltd v Ship Design & Management (Australia) Pty Ltd* (1991) 105 ALR 371. However see *IBM Australia Ltd v National Distribution Services Ltd* (1991) 22 NSWLR 466 where the Court of Appeal in New South Wales stated that an arbitrator had no jurisdiction to decide whether the contract under which he derived his jurisdiction was void *ab initio*.

[128] (1989) 4 International Arbitration Report (July) B1–86, (1990) XV Ybk Comm Arbn 384–435, Court of Appeal of Bermuda, 7 July 1989.

[129] (1990) XV Ybk Comm Arbn 384, 406.