English High Court addresses separability of arbitration clauses

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By: James Carter | Hannah Kennedy

The English High Court in *Beijing Jianlong Heavy Industry Group v Golden Ocean Group Limited & Ors* recently addressed the issue of the separability of arbitration agreements and the circumstances in which public policy factors invalidating the underlying contract may also impeach an arbitration clause.

In its pro-arbitration conclusion, the court reinforced the strength of "powerful commercial factors" which weigh in favour of upholding an agreement to arbitrate.

The doctrine of separability

Separability is a legal doctrine that allows an arbitration agreement to be considered entirely separately from the underlying contract in which it is contained. This is important where there are questions about the enforceability of the underlying agreement.

The rule stems from the case of *Harbour Assurance* and was subsequently enshrined in section 7 of the Arbitration Act 1996. The practical effect of the rule is that unenforceability of the underlying agreement does not automatically render an arbitration agreement contained within it unenforceable. Without the rule, an arbitral tribunal would always be precluded from hearing any dispute which raised a question about the validity or existence of the contract containing the arbitration agreement.

It follows that, in order to render an agreement to arbitrate unenforceable, the arbitration agreement itself must be directly impeached. In other words, there must be independent factors that specifically invalidate or render void the arbitration clause.

Under English law, an arbitration agreement may be directly impeached on public policy grounds. The question which arises is whether or not the arbitration agreement can stand independently of the void contract or whether enforcement of the arbitration agreement assists in the furtherance or concealment of an illegal scheme, or the evasion of a foreign law which it causes to be broken.

*Beijing Jianlong* illustrates the principle that whether or not the agreement will be struck down depends on the nature of the public policy rule that invalidates the underlying contract.

Background to *Beijing Jianlong*

*Beijing Jianlong* concerned various letters of guarantee that had been entered into by the claimant in relation to the performance of certain charterparties by a third party (HXS). The claim arose because the defendant alleged that
HXS had repudiated its obligations under the charterparties, thereby rendering Beijing Jianlong liable under the guarantees.

The defendants commenced arbitration proceedings. The claimant's principal defence was that the parties knew that the giving of such guarantees is illegal in China without prior state authorisation. This rendered the guarantees unenforceable as a matter of English public policy. However, the tribunal held that the arbitration agreements would not be void or unenforceable. It was this finding that the claimant sought to challenge.

For the purposes of the court proceedings, it was assumed that the claimant's allegations were correct and that the underlying guarantees were illegal under Chinese law and therefore unenforceable. The question then became whether the arbitration agreements within the guarantees were also unenforceable.

**Basis of unenforceability**

The claimants relied on the public policy rule in *Foster v Driscoll* that in English law a contract will not be enforceable if the common intention of the parties was to perform, in a foreign country, an act that is illegal under the law of that country. The claimants argued that since the arbitration agreements formed part of the overall transaction to provide and conceal unlawful guarantees they were tainted by this illegality and should similarly be deemed unenforceable, as various ancillary contracts were in *Foster v Driscoll*.

The defendants submitted that this was going too far, and that *Foster v Driscoll* did not lay down a general rule to this effect. Instead they argued the court should apply the separability principle established in *Harbour Assurance* and ask whether the policy of the rule invalidating the main contract also invalidated the arbitration agreement.

Thus, the question for the court in *Beijing Jianlong* was whether the arbitration agreements were directly and distinctly impeached by the illegality of the underlying guarantees, such that by allowing the parties to arbitrate the policy of the rule rendering the contract unenforceable would be defeated.

**The decision - arbitration agreement upheld**

The court held that the arbitration agreements were enforceable and that the rule in *Foster v Driscoll* did not apply for the following reasons:

- *Foster v Driscoll* did not concern an arbitration clause. This was material as the "nature and function of an arbitration clause is distinct and different from that of other contractual provisions". The effect of *Foster v Driscoll* was not simply to sweep away the arbitration agreements. Rather, on the basis of *Harbour Assurance* the arbitration clauses must be individually evaluated to see whether they are impeached by the relevant public policy rule.
- In *Beijing Jianlong*, the arbitration provisions did not themselves require that anything be done in China, illegal or otherwise. They could not therefore fall within the scope of the public policy rule in *Foster v Driscoll*.
- The finding that the arbitration agreements were enforceable would not furnish any foreign government with just cause for complaint, nor would it breach obligations of international comity.
- The fact that the claimants may fare potentially less favourably as a result of the choice of forum and law was deemed irrelevant and "certainly not a reason for seeing the arbitrations (sic.) provisions as impeached".

The court also emphasised that the "powerful commercial factors in favour of upholding arbitration provisions", as well as a desire to respect the parties' choice and provide a one-stop process for resolving disputes, applied to this case as they would any other arbitration dispute. The court went so far as to say that even if a public policy rule might be liable to be defeated by allowing the parties to arbitrate, this must be balanced against the powerful commercial reasons for upholding arbitration clauses, unless it is clear that this would defeat the policy of the specific illegality rule.

**The English court will look at each case on its facts**

*Beijing Jianlong* illustrates that the English court will not only enforce an arbitration agreement where the underlying contract is found to be unenforceable, but that it may also be prepared to do so even where there is a public policy rule rendering the underlying contract void for illegality.

The court will look at each case on its facts to determine if the specific public policy rule would be defeated by
allowing the parties to arbitrate, but this appears to be a high test, and the courts will bear in mind the factors weighing in favour of upholding arbitration agreements.

The decision reinforces the pro-arbitration stance of the English courts, who will not lightly allow parties to avoid an agreement to arbitrate their disputes.

To learn more about this decision and its meaning for your business, please contact Hannah Kennedy and James Carter.

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1 [2013] EWHC 1063 (Comm)
2 Harbour Assurance v Kansa General International Insurance [1993] 1 Lloyd’s Rep 455
3 Fiona Shipping v Privalov [2007] EWCA Civ 20
5 Soleimany v Soleimany [1999] QB 785
6 [1929] 1 KB 470