What Law Governs the Separability of an Arbitration Agreement?

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Introduction

It is a key principle in many jurisdictions across the world that arbitration clauses should be separable from the underlying contract in which they are contained. This prevents arbitration clauses from being denuded of their effect, particularly where the contract is void for fraud.

However, not all jurisdictions uphold the separability principle. Therefore, in circumstances where the validity of an arbitration clause is challenged, it becomes necessary to identify the law (or laws) that should govern the question of separability.[fn]As discussed in this article, in some jurisdictions the question of separability can be governed by any one of a number of relevant laws.[/fn] This article explores the absence of an international consensus on this issue, with reference to the recent English case *NIOC v Crescent Petroleum* [2016] EWHC 510 (Comm) – an application under sections 67 and 68 of the Arbitration Act 1996 ("the Act") to set aside an arbitral tribunal's decision, including its finding that it had jurisdiction.

NIOC v Crescent Petroleum

In *NIOC v Crescent Petroleum* the contract was governed by Iranian law and provided for ad hoc arbitration. The parties had not stipulated the seat of arbitration, but when Crescent commenced proceedings against the National Iranian Oil Company ("NIOC") for breach of contract, both parties agreed to seat the arbitration in London.

In the arbitration proceedings, NIOC challenged the jurisdiction of the arbitrators, arguing that: (1) the contract had been procured by corruption and was therefore void; (2) in the absence of an express choice of law governing the arbitration agreement, the arbitration agreement was governed by Iranian law; (3) the separability presumption is not recognized under Iranian law and therefore the arbitration agreement was necessarily void along with the contract; and (4) as a consequence, the arbitrators had no jurisdiction.

The tribunal rejected NIOC's challenge to jurisdiction and found against NIOC on the merits. NIOC applied to the courts of the seat – to the commercial division of the English High Court – to set the award aside.

In the application to set aside the award, NIOC relied on Sections 2(5) and 4(5) of the English Arbitration Act to argue as follows: (1) applying Section 2(5) where an arbitration is seated outside

England & Wales but the law of the arbitration agreement is English, that law governs separability, therefore, separability is implicitly a matter of the substantive law of the arbitration agreement, not of the *lex fori*[fn]Section 2(5) of the Act provides that where English law governs the arbitration agreement and where an arbitration is seated outside England & Wales, the separability presumption under Section 7 of the Act applies. Although, by contrast, the arbitration in this instance was seated in England, NIOC submitted that this provision meant that, as a matter of English law, the law of the arbitration agreement governs the question of separability.[/fn]; (2) applying Section 4(5) of the Act the substantive law of the arbitration agreement was the same as that under the contract, namely Iranian law; the law of the seat was not applicable because the seat was only chosen after the arbitration agreement was entered (and the law governing the arbitration agreement should not change); (3) Iranian law does not recognize the separability principle and therefore both the contract and the arbitration agreement were void.

The judge in the case, Justice Burton, rejected these arguments and instead held that Section 2(5) was not applicable since the arbitration was seated in England. Rather, applying Sections 2(1) and 7 of the Act, he held that the arbitration agreement was valid.

Section 2(1) provides that where an arbitration is seated in England, Section 7 of the Act applies. Section 7 articulates the English law position on separability and reads:

> "Unless otherwise agreed by the parties, an arbitration agreement which forms or was intended to form part of another agreement (whether or not in writing) **shall not be regarded as invalid, non-existent or ineffective because that 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."

This judgment supports the presumption of separability and is consistent with the pro-arbitration position adopted by English courts, as well as that of numerous other jurisdictions.

The judgment does, however, leave unanswered the issue of the legal basis of the separability presumption, which NIOC sought to exploit. Its arguments raise interesting conflict of laws and/or comity questions regarding the governing law of separability: specifically, it remains unclear whether the law of the main contract, the law of the arbitration agreement, the *lex fori*, or (where different) the relevant procedural law applies. This is a question for which there is no international consensus.

In certain jurisdictions it may not matter: arbitrators can employ the "validation principle" to give effect to the separability of an arbitration agreement. This principle encourages arbitrators to apply **a** law connected to the dispute that will give effect to separability and the parties' agreement to arbitrate.[fn]Born, Gary. *International Commercial Arbitration: Commentary and Materials.* Second Edition. Kluwer Law International. 2001, at p.112. See also: Born, Gary. *International Arbitration: Law and Practice.* Kluwer Law International. 2012, at p. 56; Article 178(2) of the Swiss Law on Private International Law; Santiago de Compostela Resolution of the Institut de Droit International, Article 4, in 4 ICSID Rev. 139, 141 (1989); *Award in ICC Case No. 7920 of 1993*, XXIII Y.B. Comm. Arb. 80 (1998).[/fn] A number of legal systems adopt the principle, including Switzerland, Spain and Algeria, as well as the *Institut de Droit International.*[fn]Born, Gary. *International Commercial Arbitration.* Second Edition. Kluwer Law International, at §4.04[A][3] and §19.04[A][d]; See also for instance, *Hamlyn & Co v Talisker Distillery* [1894] AC 202, 215 (House of Lords): "[i]t is more reasonable to hold that the parties contracted with the common intention of giving entire effect to every clause, rather than of mutilating or destroying one of the most important provisions [-] the arbitration clause becomes mere waste paper if it is held that the parties were contracting on the basis of the

application of the law of Scotland."; see also Judgment of 26 August 2008, XXXIV Y.B. Comm. Arb. 404, 405 (Austrian Oberster Gerichtshof) (2009); *Award in ICC Case No. 11869*, XXXVI Y.B. Comm. Arb. 47, 57 (2011); and *Collection of ICC Arbitral Awards 1991-1995* 75, 84 (1997).[/fn]

The English Arbitration Act implicitly adopts a similar, although slightly different, approach: the Act has no provision that permits arbitrators to choose whichever law would give effect to separability. Instead, the Act provides for English law as the governing law for separability in scenarios where: (1) the arbitration is seated in England & Wales irrespective of the law of the contract and/or arbitration agreement[fn]If the arbitration is seated in England & Wales, the separability presumption applies, unless the parties have expressly stipulated that separability is to be governed by a different law (see Section 7 of the Act).[/fn]; and (2) where the arbitration is seated outside England and Wales but the law governing the arbitration agreement is English. In this regard the Act is more prescriptive than the validation principle but similarly expansive in its reach.

From a pure conflict of laws perspective, there is a clear tension between holding that: (1) the *lex fori* governs separability for arbitrations seated in England & Wales, but that (2) for arbitrations seated outside England & Wales, the law of the arbitration agreement (if English), governs separability, rather than the *lex fori*. Nonetheless, both achieve the effect of engaging Section 7 of the Act, which upholds the separability presumption. In this regard, the Act upholds the separability presumption whenever there is a connection to England & Wales or English law.

This might be seen as an implicit adoption of something similar to the validation principle. Both the validation principle and the English Arbitration Act prioritize expanding the reach of the separability presumption, over legislating for a single law that should govern the question. This is despite the fact that the latter would be more consistent with normal conflict of laws principles. However, arguably, when weighing up these competing concerns, given the centrality of party choice to the arbitration process, the absence of clarity over conflict of laws is a sacrifice worth making to maintain the validity of arbitration agreements: without Section 2(5) of the Act, it is quite possible that NIOC's application would have succeeded and the tribunal's jurisdiction may have been successfully challenged. That result would have undermined the parties' express choice to resolve their dispute by arbitration and forced them to litigate, which, in turn, would have damaged the perception of arbitration as an effective, binding mechanism.

Taken in this light, the Act maintains the progressive approach to arbitration that has been a central tenet of English law since the early 2000s. At a time when arbitration is coming under increasing scrutiny, the Act remains a welcome legislative framework to uphold party autonomy and keep the parties to their agreement to arbitrate. In doing so it helps to ensure arbitration's continued effectiveness as a dispute resolution tool.