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Trouble in the Caspian Sea: Clarification of the Breadth of the Word ‘hereunder’ in Arbitration Clauses

Francis Hornyold-Strickland (Wilmer Cutler Pickering Hale and Dorr LLP) · Monday, August 17th, 2015

In the recent case ***Integral Petroleum SA v Melars Group Ltd*** [2015] EWHC 1893 (Comm) arbitrator Mr W Laurence Craig was asked to decide a dispute involving three companies: Integral Petroleum SA (“Integral” or “Claimant”), Melars Group Ltd (“Melars” or “Respondent”) and Dartex Trade Ltd (“Dartex”).

By a contract signed on 14 December 2011 (the “***December Agreement***”) the buyer, Melars, agreed to purchase 300mt of gasoil from Integral for US$264,300. Integral was required to deliver its gasoil on FOB Incoterms at the Russian port of Makhachkala on the Western side of the Caspian Sea. That contract contained a “Law and Jurisdiction” clause stating:

“The contract shall be governed by and construed in accordance with English law. The parties hereby agree to submit all disputes ***hereunder*** to the exclusive jurisdiction of the arbitration court in London.”[1]

It is the ambit of the word “hereunder” in the above clause that subsequently became the crux of the dispute.

Due to delay in delivery of a separate quantity of gasoil purchased by Melars (that was due to be mixed with Integral’s gasoil), Melars’ third-party buyers cancelled their contract on 17 January 2012 and Melars found a new buyer, Dartex Trade Ltd (“Dartex”). Dartex agreed to purchase 2,420mt of gasoil for US$2,170,432.53. On 15 April 2012 Melars and Dartex signed an agreement (the “***Dartex Agreement***”).

Due to Melars’ additional purchase of gasoil described above, it did not need Integral’s 300mt of gasoil to meet its obligation to Dartex and preferred to be repaid the advance they had made to Integral and return Integral’s gasoil. As such two days later Integral and Melars entered into an agreement headed “Agreement on Cancellation of [the December Agreement]” (the “***Cancellation Agreement***”). The Cancellation Agreement contained a broadly-worded release of liability and indemnification clause (the “***Cancellation Agreement Settlement Clause***”); the parties confirmed that, once Melars was once again in receipt of US$237,024.22 (which it had paid in advance to Integral):

“all claims and demands of [Melars] against [Integral]…which [Melars] may have on any of them

and/or as a result of the [December agreement] and/or in tort, will become full and finally settled. ***The Parties have agreed as well not to make any claims or demands of any nature of kind whatsoever against each other and indemnify each other if any such cases will arise out in connection with [sic] the [December Agreement***]"[2]

Assuming the Dartex agreement had been performed presumably any further problems would have been avoided.

Unfortunately, Melars alleged that it only received US$200,000 from Dartex, leaving an outstanding balance of US$2,170,432.53. It further alleged that Integral and Dartex were in fact related via Integral's managing director, a Mr Seitnepesov. Melars alleged that Dartex was actually a shell company of Integral's managing director who, Melars suggested, was using Dartex to defraud Melars for the benefit of Integral (and himself). Therefore on 9 August 2012 Melars began Swiss litigation against Dartex, Integral and Mr Seitneposov in relation to the unpaid price under the ***Dartex agreement*** [not the ***December Agreement***].

In response to these proceedings Integral brought an LCIA reference pursuant to the ***December Agreement*** arbitration clause, between itself and Melars, seeking an injunction against Melars proceeding against it and a declaration that the Swiss litigation was brought in breach of the ***Cancellation Agreement Settlement Clause***. It stated that Melars' claim in Switzerland was really a dispute arising "hereunder" the ***December Agreement*** between Melars and Integral.

The arbitrator for the LCIA reference, Mr Craig, was first required to determine whether he had jurisdiction to resolve whether or not the terms of the ***Cancellation Agreement Settlement Clause*** had been broken by Melars issuing proceedings against Dartex, Integral and their shared Managing Director. Finding against Integral, Mr Craig noted that the alleged breach of the ***Cancellation Agreement Settlement Clause*** related to a dispute primarily concerning (a) different parties from the ***December and Cancellation Agreements***, (2) a different contract and (3) a much larger amount of gasoil than that in the December Agreement. Most importantly, the arbitration clause in the December Agreement only covered 'disputes hereunder' which, Mr Craig determined, the ***Dartex Agreement*** was not.

Finding against an expansive reading of the ***December Agreement***, Mr Craig remarked:

"It would not be a reasonable interpretation to find the general language of the settlement was intended to cover future claims related to a contract for different amounts of fuel entered into between different parties…[-]…it is not sustainable that the claimants [sic] made by [Melars] in Switzerland…are claims arising in connection with the [December Agreement]."

Integral challenged the award under s.67 of the Arbitration Act 1996.

In his judgment, Andrew Smith J – disagreeing with Mr Craig – noted that the parties agreed that the ***December Agreement*** applied equally to the ***Cancellation Agreement***. He further noted that the ***December Agreement*** necessarily covered a dispute about the ambit of the ***Cancellation Agreement Settlement Clause*** (including any allegation that the Swiss proceedings were in breach of that clause). It followed therefore that the tribunal did have jurisdiction to determine what relief should be awarded, in the case of breach of that clause. Indeed, taken together the ***December Agreement and Cancellation Agreement*** did cover any disputes in the Swiss proceedings that "*depend on the application to* [the Swiss proceedings] *of the settlement clause* [in the Cancellation

Agreement]" but ***not*** to any "other disputes about them." Mr Craig was therefore in error to decline jurisdiction on this point.

However, when considering whether to exercise the court's discretion to award relief under s.67 of the Arbitration Act, Andrew Smith J noted that Mr Craig had made it clear in his award that whilst he may have been wrong to decline jurisdiction on the matter, he would in any case have rejected Integral's contention that the Swiss litigation was brought in breach of the ***Cancellation Agreement Settlement Clause***. Furthermore since s.69 appeals under the Arbitration Act are excluded under the LCIA Rules, Integral would not have been able to appeal that determination. Andrew Smith J therefore held that the arbitrator's error concerning his jurisdiction was inconsequential and rejected Integral's request for relief.

The decision in ***Integral v Melars*** is instructive on two points: first, the scope of the word "hereunder" in the context of arbitration clauses specifically, and contractual interpretation more generally; secondly, the case illustrates the different levels of deference American and English law give to an arbitrator's determination on the scope of his/her own jurisdiction under institutional arbitration rules, like the LCIA Rules.

In relation to the scope of the word "hereunder", as Andrew Smith J remarked:

"[counsel's] submission demands an interpretation that goes way beyond any permissible interpretation of the expression "hereunder". I conclude that the arbitration agreement covers any disputes relating to the Swiss proceedings ***that depend on the application to them of the settlement clause, but no other disputes about them."***

This was a relatively narrow interpretation of the word "hereunder," confining it specifically to the underlying contractual instrument in question.

The construction adopted in ***Integral v Melars*** is consistent with that in a U.S. decision, ***Mediterranean Enterprises, Inc v Ssangyong Corp*** **708 F.2d 1458 (9th Cir. 1983),** where Nelson J remarked:

"MEI argues that the phrase 'arising hereunder' means 'arising under the contract itself' and was not intended to cover "matters or claims independent of the contract or collateral thereto…We are persuaded by a line of cases from the Second Circuit that MEI's interpretation is the more reasonable one…We interpret 'arising hereunder' as synonymous with 'arising under the Agreement.' The phrase 'arising under' has been called 'relatively narrow as arbitration clauses go'[3]

This is echoed by an earlier U.S. decision in ***Old Republic Insurance Co., v Lanier,*** **644 So.2d 1258, 1262 (Ala. 1994).**

Taken together, all three cases demonstrate a tentative alignment between English and U.S. law on the breadth of the word "hereunder" that offers helpful guidance for the interpretation of the word in future disputes over arbitration clauses, particularly where more than one contract, and potentially different parties, are concerned.

Despite the assistance the cases cited above give on construing the word "hereunder", the decisions are not easily reconciled with the avowedly "pro-arbitration" approach to interpretation of

international arbitration agreements adopted in ***Mitsubishi Motors v. Soler Chrysler-Plymouth* 473 U.S. 614 (1985**), which parallels the English case ***Fiona Trust* [2007] UKHL**. For instance, whilst Andrew Smith J echoed the English courts' pro-arbitration stance by finding Mr Craig did have jurisdiction, he was fairly conservative in construing the ambit of that jurisdiction. It remains to be seen how this understanding will be subsequently applied in the light of pro-arbitration rules of interpretation like those in ***Fiona Trust*** and ***Mitsubishi Motors*.**

Turning to the second point outlined above, ***Integral v Melars*** is a useful example of the differences between English and U.S. law in relation to the deference accorded to arbitrators' determinations on the scope of their own jurisdiction in arbitrations conducted under institutional arbitration rules, like the LCIA Rules, which contain broad grants of jurisdictional competence to the arbitral tribunal.

In line with the English courts' approach to s.67 appeals, in ***Integral v Melars***, Andrew Smith J made clear that his review of Mr. Craig's jurisdictional ruling was *de novo*. Andrew Smith J remarked:

"On an application under section 67, the court conducts a re-hearing of the issue(s) about the tribunal's jurisdiction, and does not merely review the decision."[4]

This is consistent with the general approach to jurisdictional rulings under the English Arbitration Act: "a party who participates in arbitral proceedings (under protest) may challenge any resulting award on jurisdictional grounds with *de novo* judicial review."[5]

By contrast, U.S. courts have adopted a substantially more deferential approach towards review of jurisdictional rulings by arbitral tribunals, at least in cases involving institutional arbitration rules that grant the arbitrators broad authority to determine their own jurisdiction. Thus, under the US Supreme Court decision in ***First Options of Chicago, Inc. v . Kaplan* 514 U.S. 938 (U.S. S.C.t.1995)**:

"…if an arbitration agreement granted arbitrators the power to consider and finally decide their own jurisdiction, then ***the arbitrators' resulting jurisdictional award would be subject to the same highly deferential standard of judicial review*** that is applicable under the [Federal Arbitration Act] to the merits of other awards."[6]

Consistent with this, a number of US appellate (and trial) courts have held that jurisdictional rulings by arbitrators will be subject to only very limited judicial review where the parties have agreed to institutional arbitration rules that grant the arbitral tribunal authority to determine their own competence.[7] Although some commentators have criticized this approach, it remains the predominant rule in US lower courts.

The two approaches – English and U.S. – offer markedly different alternatives to the review/appeal procedure of arbitral awards on jurisdiction. English courts prefer to retain a high threshold before meeting a statutory appeal 'gateway'; but once met, they apply the same scrutiny as they would to an appeal from a lower court. By contrast, U.S. law prescribes greater deference to arbitrators' decisions on jurisdiction where the parties have adopted institutional arbitration rules granting the arbitrators broad competence-competence.

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[1] Emphasis added

[2] Emphasis added

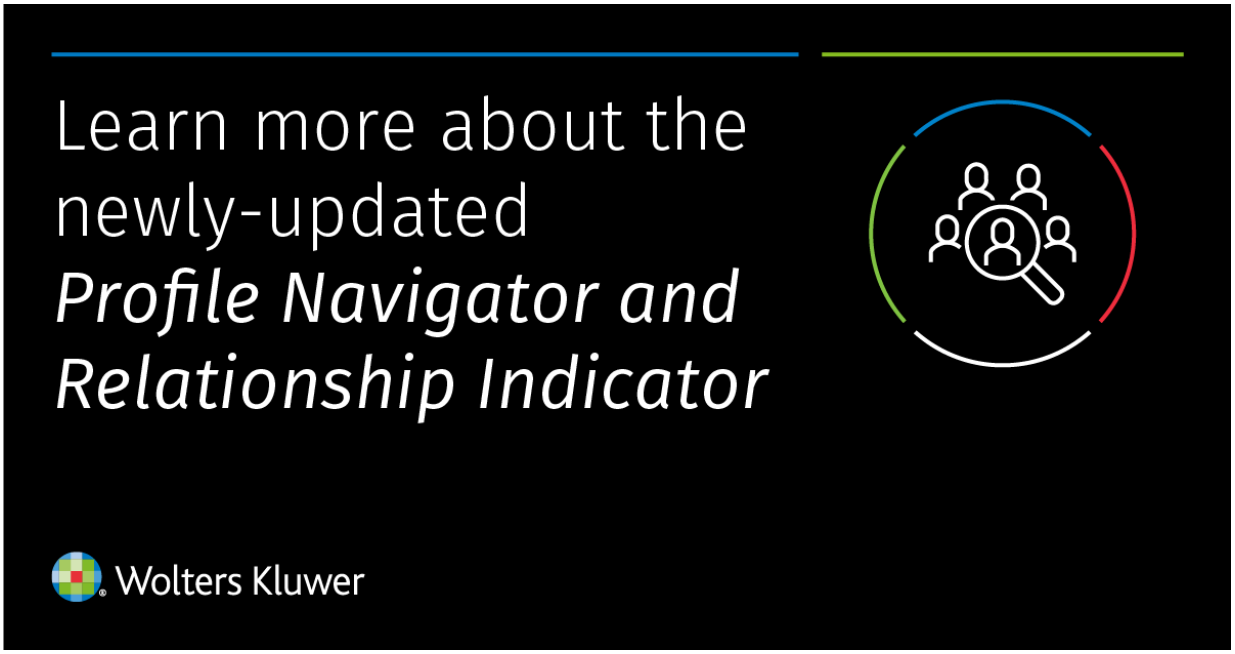
[3] For further discussion see: Born., Gary. International Commercial Arbitration: Commentary and Materials. Second Edition, pp.307-308.

[4] Emphasis added.

[5] Born, Gary., International Commercial Arbitration, Second Edition. Volume I, p.1209.

[6] Born, Gary., International Commercial Arbitration, Second Edition. Volume I, p.1133.

[7] See, e.g., *Howsam v Dean Witter Reynolds, Inc.*, 547 U.S. 79 (U.S. S.C.t 2002) and *Stolt-Nielsen SA v AnimalFeeds International Corp.*, 130 S.Ct 1758, 1762 (U.S. S.Ct 2010).



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