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Lessons for referring disputes to arbitration involving negotiable instruments

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In *Rals International Pte Ltd v Cassa di Risparmio di Parma e Piacenza SpA* [2016] SGCA 53 (***Rals International***), the Singapore Court of Appeal was asked to consider the application of an arbitration agreement in a supply agreement to a dispute arising out of promissory notes provided as payment under the supply agreement. The Court of Appeal held that the dispute in connection with the promissory notes was *not* governed by the arbitration agreement in the supply agreement. The case provides useful guidance as to the circumstances in which disputes arising out of negotiable instruments are governed by an arbitration agreement in an underlying contract.

In light of the Court of Appeal's decision in *Rals International*, parties should not assume that an arbitration agreement in an underlying agreement applies to disputes arising out of negotiable instruments issued in connection with the underlying agreement. If parties want disputes arising out of negotiable instruments to be submitted to arbitration in accordance with the underlying agreement, they must do so through express language or the express incorporation of the arbitration agreement into the negotiable instrument. However, depending on the arbitral rules agreed, doing so may result in a lengthier process for the payee under the negotiable instrument to receive payment. We provide a brief background of the decision along with our analysis.

Background

Rals International Pte Ltd (**Rals**) entered into a supply agreement with Oltremare SRL (**Oltremare**) for the purchase of equipment to shell and process raw cashew nuts (**Supply Agreement**). The Supply Agreement was governed by Singapore law and provided that disputes arising in connection with the Supply Agreement be settled in accordance with ICC Rules arbitration in Singapore:

"*All disputes arising in connection with this Agreement shall be settled by a direct conciliation between the parties. Failing this conciliation, the dispute will be settled in accordance with the rules of Conciliation and Arbitration Rules of the International Chamber of Commerce in Singapore.*"

(the **Arbitration Agreement**)

Rals' payments to Oltremare under the Supply Agreement were made through a mix of cash and promissory notes. In accordance with the Supply Agreement, the notes were sent to Oltremare's

bank, Cassa di Risparmio di Parma e Piacenza SpA (**Cariparma**) with instructions that the notes be released to Oltremare upon presentation of certain documents evidencing shipment of the goods under the Supply Agreement.

Oltremare and Cariparma then entered into an agreement by which the notes and the underlying credit owed to Oltremare by Rals were assigned to Cariparma. The notes were later negotiated to Cariparma.

When Cariparma presented the first four of the notes for payment, each was dishonoured by Rals on the basis of Oltremare's performance under the Supply Agreement. As a result, Cariparma commenced proceedings against Rals in the Singapore High Court for the total face value of the four notes, plus interest and costs (**Court Proceeding**).

In response, Rals filed an application for a stay of the Court Proceeding under section 6 of the Singapore International Arbitration Act (**IAA**), arguing that disputes were to be submitted to arbitration accordance with the Arbitration Agreement.

Stay Application

In order to be granted a stay under section 6 of the IAA, Rals had to establish that it was arguable that:

1. Cariparma was a party to the Arbitration Agreement or was claiming "through or under" Oltremare; and
2. Rals' obligation to pay under the promissory notes was a subject matter of the Arbitration Agreement.

The case first came before the Assistant Registrar of the Singapore High Court who granted the stay, holding that:

- due to Cariparma's knowledge of the Arbitration Agreement, there was at least an arguable case that the assignment of the credit under the Supply Agreement by Oltremare to Cariparma would bind Cariparma to the Arbitration Agreement;
- in the alternative, it was arguable that Cariparma was a party claiming "*through or under*" Oltremare for the purposes of section 6(5)(a) of the IAA, with Oltremare being a party to the Arbitration Agreement; and
- Cariparma's claim as the holder of the promissory notes fell within the scope of the Arbitration Agreement, because the notes were the mode of payment expressly stipulated in the Supply Agreement and Rals' intended defences to Cariparma's claim all related to Oltremare's performance of the Supply Agreement.

On appeal, a Judge of the Singapore High Court disagreed with the Assistant Registrar. The Singapore High Court held that Cariparma had to be a party to the Arbitration Agreement, in the contractual sense, for it to be bound. However, it went on to hold that Cariparma was a "party" for the purposes of section 6(5)(a) of the IAA as it was claiming "through or under" Oltremare. This was so held because Cariparma received not only the right to receive the purchase price under the Supply Agreement, but also the burden of the Arbitration Agreement. Accordingly, the Judge held that Cariparma was bound to submit its dispute to arbitration.

Despite this finding, the Singapore High Court went on to hold that that Cariparma's claim in the

Court Proceedings was not a dispute arising in connection with the Supply Agreement, as the rights and obligations under the promissory notes were separate from the Supply Agreement. His Honour was of the view that as Oltremare and Rals had expressly provided for payment by way of promissory notes, they must have contemplated that the notes would be negotiated and that the holder of the notes could claim outside of arbitration.

Court of Appeal

Rals appealed to the Court of Appeal, primarily arguing that the Arbitration Agreement should be construed broadly, such that it included disputes arising from the promissory notes. The consequence of such construction was that the Court Proceedings should be stayed pursuant to section 6(2) of the IAA. In considering the issue, the Court of Appeal recognised the presumption in *Fiona Trust & Holding Corporation and others v Privalov and others* [2007] 2 All ER (Comm) 1053 ("Fiona Trust") that arbitration agreements should be construed generously, and the principle's adoption into Singapore law in *Larsen Oil and Gas Pte Ltd v Petroprod Ltd* [2011] 3 SLR 414 ("Larsen Oil"). The Court of Appeal, however, stated that such presumption should not be applied irrespective of the context in which the underlying agreement was entered into or the plain meaning of the words used.

Further, the Court stated that, "[w]*here there are compelling reasons, commercial or otherwise, that may displace any assumed intention of the parties that claims of a particular kind are to fall within the scope of an arbitration clause, the court should be slow to conduct the exercise of contractual construction from that starting point*".[1] In this respect, the Court of Appeal departed from the High Court's decision in *Piallo GmbH v Yafriro International Pte Ltd* [2014] 1 SLR 1028 ("Piallo"), which held that the modern approach to the construction of arbitration clauses (i.e. the approach set out in *Fiona Trust*) meant that there could be no presumption against taking bills of exchange into arbitration. Instead, the High Court in *Piallo* held that it would have to be expressly stated if a cause of action under a bill of exchange were to be excluded from the arbitration agreement in the underlying distributorship agreement in that case.

Following its analysis, the Court of Appeal held that, in the absence of express language or express incorporation, an arbitration clause in an underlying contract will generally not be treated as covering disputes arising under an accompanying bill of exchange. That is, in this case, the fact that the obligations under the promissory notes were "separate and autonomous" from the obligations arising under the Supply Agreement supported the Arbitration Agreement not extending to cover the dispute in the Court Proceeding. Accordingly, the appeal was dismissed.

Analysis

The House of Lords' decision in *Fiona Trust* was a significant milestone for the interpretation of arbitration agreements. Specifically, it established a presumption in favour of a broad interpretation of the scope of arbitration agreements. This principle has since been incorporated into Singapore law in *Larsen Oil* and in fact confirmed in *Rals International* as the correct general approach. However, the Court of Appeal goes a step further in *Rals International* by clarifying that the presumption in *Fiona Trust* is not to be applied in all situations as there are other considerations that need to be taken into account.

Particularly, regard must be had to the commercial context and relationship of the parties before determining whether the presumption in *Fiona Trust* should be applied. The application of an

underlying arbitration agreement to disputes arising under related negotiable instruments is one such situation, as clarified by *Rals International*, where these considerations are significant and the court should be slow to apply the presumption in *Fiona Trust.* This is a notable shift from the position the Singapore High Court had adopted in *Piallo*, which used the presumption in *Fiona Trust* as a starting point in determining whether a dispute under a bill of exchange fell within an arbitration agreement in an underlying agreement.

Finally, it should be noted that the Court of Appeal's decision in *Rals International* aligns the Singapore position with that under English law and in Hong Kong. The English law position is set out in *Nova (Jersey) Knit Ltd v Kammgarn Spinnerei GmbH* [1977] 1 WLR 713 ("Nova"), in which the House of Lords held that the arbitration clause of an underlying main agreement did not apply to disputes arising out of a negotiable instrument. This decision in *Nova* was adopted by the Hong Kong Court of Appeal in *C.A. Pacific Forex Limited v. Lei Kuan Ieong* [1999] HKCA 364.

The *Rals International* decision is also helpful to reinforce the role negotiable instruments play in commercial transactions. Importantly, negotiable instruments give rise to independent rights and obligations, and are freely transferrable by indorsement and delivery. What is more, negotiable instruments often confer rights and obligations upon persons not party to the underlying agreement in connection with which the instruments were first issued. Accordingly, if disputes under negotiable instruments were ordinarily subject to an arbitration agreement in the underlying agreement, it may give rise to situations where the assignee of a negotiable instrument is obliged to submit disputes to arbitration in accordance with an arbitration agreement they have not previously seen or to which they were not privy.

Further, negotiable instruments provide the payee a right to be paid immediately, usually by way of summary judgment, on default under the instrument or the underlying contract. Summary judgment procedures have not been fully endorsed in international arbitration proceedings yet (the new 2016 SIAC Rules being one of the few rules which provides summary procedure). If the courts generally start construing that arbitration (arising from an arbitration clause in the underlying agreement) would be the natural remedy for a dispute arising under the negotiable instrument, a payee of a negotiable instrument would be left with a comparatively protracted mode of resolving disputes (arbitration) than what he would have originally agreed for (summary judgment).

Although, *Rals International* provides much needed clarity in Singapore law for applying the presumption in *Fiona Trust* to disputes arising from negotiable instruments, whether a dispute will be ultimately referred to arbitration will be adjudged on a case by case basis depending on the language of the arbitration clause.

[1] [2016] SGCA 53 at [34]

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