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Doctrine of separability in International Commercial Arbitration

Summary
Arbitration clause is phenomenon based on essential principles. The application and development of these principles ensures the functioning of the whole system of international commercial arbitration. One of cornerstone principles is the principle or doctrine of separability of arbitration clause. Without this principle no academicians in law, no judges or lawyers will be able to see "agreement" within the agreement. Without this principle the evolution of arbitration itself will be under question. The article tries to show the essence and importance of this principle.

Annotasiya
Arbitraj müddəası mühüm prinsiplər üzərində qurulan hadisədir. Bu prinsiplərin tətbiqi və inkişafı beynəlxalq kommersiya arbitrajı sisteminin tamamilə fəaliyyətini təmin edir. Əsas prinsiplərdən biri də arbitraj müddəasının ayrılığı doktrinasıdır. Bu prinsip olmadan heç bir akademik, hakim və yaxud hüquqşünas razılaşma içində yaranan "razılaşma"nı görə bilməz. Bu prinsip olmadan həmçinin arbitrajın qiymətləndirilməsi sual altına düşəcək. Bu məqalə adı çəkilən prinsipin vacibliyini və əhəmiyyətini göstərməyə yönəlmişdir.

Introduction

Arbitration is an alternative dispute resolution method. In order to refer their disputes to arbitration, parties shall have an arbitration agreement. International commercial arbitration is almost always consensual.[1] This is followed in the most definitions of arbitration agreement. For instance, article 7 of Model Law on International Commercial Arbitration 1985 characterizing the main elements of arbitration agreement states:
"Arbitration agreement" is an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not".
It arises from the definition and the essence of arbitration that the disputes are in connection with the legal relationship, which could be reflected in a contract.
The fact that the basis of arbitration is contractual is not disputed: "an arbitrator's power to resolve a dispute is founded upon the common intention of the parties to that dispute". [2] Arbitration clauses are generally considered "separable" or "severable" from the main contract, concluded by the parties. [3] Moreover, the term "separable" is used together with such terminology as independence" or "detachment" of the arbitration. Simply all of these wordings are focused to impress "that the arbitration clause in a contract is considered to

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[1] G.A. Born, International Commercial Arbitration, p. 5 (2nd ed. Wolters Kluwer 2001)
[2] Fouchard Gaillard. Goldman on International Commercial Arbitration. John Savage, Emmanuel Gaillard (editors) (hereinafter Goldman International Commercial Arbitration), § 2.44 (1999 Kluwer Law International)
[3] Born, p. 50

be separate from the main contract of which it forms part and, as such, survives the termination of that contract". [4] The principle of severability is essential when the party claims that the contract is void, and arguing that the arbitration clause is null. Then every time the sense and the purpose of the arbitration agreement will be in risk of non-enforcement.[5]

I. Doctrine of separability in International Commercial Arbitration

The accepted doctrine of separability has been reflected in most international documents: UNICTRAL Rules and UNCITRAL Model Law on International Commercial Arbitration.

The Model Law defines the doctrine in the following manner:
"Arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause."

It can be concluded that there are always two significant issues:

1. the validity of the main contract; and
2. the validity of the arbitration clause.

If the contact is void, and the arbitration clause is valid, logically the arbitration clause is still the legal basis for the award.

Notwithstanding, some reasons which affect the validity of the main contract could easily result in invalidating of the arbitration clause. Accordingly, the parties have to be capable to enter into contact. The incapacity of parties or one party to enter into the contract will invalidate it. Moreover, article V (1) (a) of the New York Conventionon the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Conventionon 1958) says that the recognition and enforcement of award can be refused where the parties were, under the law applicable to them, under some incapacity. However, the New York Convention 1958 has no clear and direct statement of the principle of separability. And above mentioned article V (1) (a) stating that recognition and enforcement of the award may be refused if the party against whom such measures are sought can establish that the arbitration agreement "is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made" is the only possible way to refer to this doctrine."[6] Therefore, it is an implied reference to the doctrine of separability, as the article does not refer to the validity of the whole contract, but the validity of the arbitration agreement. Moreover, article II (3) of the New York Convention 1958 provides that court should "at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed". The heart of this and correct approach is a *prima facie* finding an arbitration agreement which is not null and void, inoperative or incapable of being performed.[7] The wording of article II (3) sets

[4] Goldman on International Commercial Arbitration, section I, 389.
[5] Steven C. Bennett, Arbitration: Essential Concepts, p. 60 (ALM Publishing 2002)
[6] Goldman International Commercial Arbitration, p. 159
[7] Emmanuel Gaillard Prima Facie Review of Existence, Validity of Arbitration Agreement, NEW YORK LAW JOURNAL, p. 7 (December 1, 2005)

grounds to come to decision that the process of verifying an arbitration agreement is separate from the checking the validity of main contract. Thus, the invalidity of the main contract would not prevent from referring the parties to arbitration as the court accepts the severability principle.[8]

(a) "Null and void"

Article II (3) of the Convention is silent with regards to the legal standard for determining whether an arbitration agreement is null and void. For this purpose categories including fraud or fraudulent inducement, unconscionability, illegality or mistake and incapacity or lack of power can be the ones which forms null and void arbitration agreement.[9] For example, United States courts have ruled upon the "null and void" ground pursuant to "standard breach-of-contract defenses that can be applied neutrally on an international scale, such as fraud, mistake, duress, and waiver."[10]

(b) ''Inoperative''

The understanding of the term "inoperative" in light of article II (3) is an arbitration agreement that "was at one time valid but that has ceased to have effect". For instance, Indian courts applied Section 45 of the Indian Arbitration Act of 1996 which is the same as article II (3) of New York Convention and held that the arbitration agreement was inoperative because the parties had submitted numerous civil and criminal suits before Indian courts.[11]

(c) "Incapable of being performed"

This situation includes cases where the arbitration proceedings cannot be held due to physical or legal impediments. In Russia, the Highest Arbitrazh Court of the Russian Federation ruled that the agreement had to contain clear language from which the true intentions of the parties to refer the dispute to an arbitration body could be ascertained. [12] Thus, arbitration clauses may be so badly drafted and result in legal difficulties to commence arbitration proceedings. In contrast to New York Convention 1958, the UNCITRAL Arbitration Rule (as revised in 2010) includes article 23 which states the "a decision by the arbitral tribunal that the contract is null shall not entail automatically the invalidity of the arbitration clause". Thus it is separate and has the autonomy from the main contract. All these documents provides for the importance of the doctrine which is not arguable. Today, the principle of autonomy of the arbitration agreement is one of the general principles of arbitration. [13] The life of the principle can be examined through the most significant cases where the doctrine of separability was applied.

[8] ICCA's Guide to the Interpretation Of the 1958 New York Convention: A Handbook for Judges Published by the International Council for Commercial Arbitration, p. 52 (2011)
[9] *Ibid*. p 52.
[10] Allen v. Royal Caribbean Cruise, Ltd., District Court, Southern District of Florida, United States of America, 29 September 2008, 08-22014
[11] http://newyorkconvention1958.org/index.php?lvl=cmspage&pageid=11&provision=175#navig_art_201
[12] ZAO UralEnergoGaz (Russia) v OOO ABB Electro engineering (Russia), Ninth Arbitrazh Court of Appeal, Russia, 24 June 2009, No. A40-27854/09-61-247
[13] Goldman International Commercial Arbitration, p. 157.

II. Separability in case law

The most famous example of doctrine of separability was in Sojuznefteexport case. One of the subjects matters discussed was the autonomy (i.e. separability) of arbitration clause. The contract was concluded between All-Union Foreign Trade Association "Sojuznefteexport" (Sojuznefteexport) and Joc Oil Limited (Joc Oil) in Paris on 17 November 1976.The contract contained an arbitration clause. In case of any dispute the arbitration proceedings would be held at the Foreign Trade Arbitration Commission of the USSR Chamber of Commerce and Industry, Moscow (FTAC) in accordance with FTAC's rules of procedure. The dispute was raised by Sojuznefteexport on late delivery. Joc Oil objected to the jurisdiction of FTAC, because the contract did not met the requirements of the Decree of the Central Executive Committee and the Council of People's Commissars of the USSR of 26 December 1935according to which, "in the event of the necessity for concluding foreign trade transactions by the above (Foreign Trade) organizations ... outside of Moscow (both on the territory of the USSR as well as abroad) such transactions ... must be signed by two persons who have received a Power of Attorney signed by the chairman of the Association".[14] However these requirements were not necessary to conclude the arbitration agreement. Thus, arbitration clause contained in the contract signed on one side by the Chairman of the "Sojuznefteexport" Association V.E. Merkulow and John Deuss in the name of the firm "JOC Oil was valid. Besides the Joc Oil challenged the applicability of the principle of autonomy of the arbitration clause as it was not explicitly reflected in Soviet Union's arbitration doctrine.

The explanation and position by the Court of Appeal reviewing the case in 1989, Sir Alistair Blair-Kerr P. held that: "the Rules of the FTAC there are no direct references to the fact that an arbitration agreement (arbitration clause) is autonomous in relation to the contract. ...analysis of the Statute of the FTAC and of its Rules which have defined the competence of the Commission, and also the practice of the Commission allows the conclusion to be drawn that the independence of an arbitration clause is not subject to doubt. Thus, in the ruling of the FTAC on 29 January 1974, taken on hearing a dispute between a Soviet and an Indian organization, the arbitration agreement is treated as a procedural contract and not as an element (condition) of a material-legal contract". [15] The Commission of FTAC acted within the scope of their authority. From the analysis of above case it can be said that the doctrine was successfully applied and led to the hearing of the case by the Commission of FTAC.

The other landmark decision was held on 17 October 2007, the House of Lords in Fiona Trust ruled the decision in support of the doctrine. The Lords upheld, unanimously, the Court of Appeal's ruling in a case concerning the scope and effect of arbitration clauses. Two major issues were observed:

(i) the Lords underlined the ideas of separability principle and maintained arbitration clauses should "be construed liberally, without making fine semantic distinctions between disputes "arising out of", "arising under" or "in connection with" the contract".

(ii) the Lords defined "arbitration clauses are to be treated as "distinct agreements" from the main agreements and can only be invalidated on grounds

[14] Award in case no. 109/1980 of 9 July 1984
[15] *Ibid.*

that relate to the arbitration clause itself". Moreover, even in cases where that contract has been concluded by fraud, misrepresentation or bribery, only arbitration tribunals have jurisdiction to consider the validity of that contract.[16]

The judgment in the Fiona Trust case is a further important affirmation that an arbitration clause is a separate contract which survives the termination of the main contract.

III. Doctrine of separability in Azerbaijani law

With regard to the Republic of Azerbaijan and its position in the application of this doctrine the fact that, it has ratified the New York Convention on 29 February, 2000 and incorporated the Model Law by adopting Law on International Arbitration dated 18 February 1999, particularly the article 16.1 of the law sets the grounds to believe the principle of separability is one, which is accepted on the national level.

In addition the Civil Code of Azerbaijan contains article 352 defines the invalidity of a part of transaction does not result in invalidity of the other parts of the contract if the contract could be concluded without including the invalid part into the transaction. This article can be a strong argument in support of the doctrine of separability. The sense of the principle of severability is to distinguish invalid main contact and invalid arbitration agreement. Arbitration is separate and thus invalidation of any part if many contract would not affect the validity of arbitration clause, which indirectly maybe read through in the above mentioned article of the Civil Code of Republic of Azerbaijan.

On this occasion, the issue of the governing law of an arbitration agreement is important. The recognition of severability principle provides arbitration agreement to be considered "separable" from the underlying contract in which it appears.[17] Therefore, the substance law of main contact should not be necessarily the same to the arbitration agreement.

If the parties have identified the governing law of the arbitration agreement in a very expressive manner, then no problems would arise. Where such identification is missed, the law applicable to arbitration clause will go through some tests.For instance, courts in many countries may decide to apply the law of the seat of arbitration. On the other hand, English courts may apply the close connection principle. The attempts in defining the law most closely connected to the arbitration agreement need to concern many factors "which apply specifically to that agreement (for example, the chosen arbitration rules and the seat or the language of the arbitration)". [18] It seems to be very complicated issue. However, the courts and arbitral tribunals try to establish some conditions. As an example, the recent case of *Sulamérica*, where the English Court of Appeal formulated and applied a three-stage test to define the law of an arbitration agreement:

(i) is there an express choice of law governing the arbitration agreement;
(ii) if not, can a choice be implied; and
(iii) in the absence of a choice, with which law does the arbitration

[16] Source: http://www.whitecase.com/idq/winter_2008_ca1_4/#.VOm_mPmsXq0
[17] Born, p. 28
[18] Goldman International Commercial Arbitration, p. 170

agreement have the "closest and most real connection". [19]

The application of this test is logical, but leaves some doubts to the sequence of these stages. What if there may arise any other "sufficient factors" which will strictly lead to the application of the third stage displacing the stage of implying a choice of law on the basis of the chosen seat. The fact that English courts have recently developed a new three-stage step shows that the issue of governing law of arbitration clause is still the most problematic. Broadly speaking, the parties are free to choose the law applicable to the agreement. In case of not choosing the governing law, the most common criteria are: the law applicable to the contract containing the clause; the procedural law applicable to the arbitration; or the substantive law chosen by the parties or determined as applicable to settle the conflict.[20]

Conclusion

Summarizing all the points is that the arbitration agreement is accepted as a separate agreement and the concept of the separability is essential. The following consequences exist under this principle:

(i) The invalidity of the contract does not necessarily invalidate their arbitration agreement;

(ii) The invalidity of the main contract does not necessarily deprive an arbitral award of validity;

(iii) Invalidity of the parties' arbitration agreement does not necessarily invalidate the main contract;

(iv) Substantive governing the arbitration agreement may be different from the law, governing the main contract;

(v) The arbitration clause may survive termination or expiration of the main contract, as long as the claims arise from relations during the term of the agreement.

Overall, the doctrine of separability is widely recognized and leads to many other significant issues in arbitration law. Additionally this principle provides the effectiveness and the integrity of the arbitral process.

[19] Source: www.dlapiper.com/en/europe/insights/publications/2013/03/determining-the-law-of-an-arbitration-agreement

[20] A. Redfern, M. Hunter, N. Blackaby and C. Partasides "Law and Practice of International Commercial Arbitration", p. 52 (Kluwer Law International, 2004)