

## THE PRESUMPTIVE APPROACH TO THE CONSTRUCTION OF ARBITRATION AGREEMENTS AND THE PRINCIPLE OF SEPARABILITY — ENGLISH LAW POST *FIONA TRUST* AND AUSTRALIAN LAW CONTRASTED

JOACHIM DELANEY AND KATHARINA LEWIS\*

### I INTRODUCTION

The recent decision of the House of Lords in *Fiona Trust & Holding Corporation v Privalov*<sup>1</sup> has established the general approach to be taken to the construction of the wording of arbitration clauses and has clarified the English law position on the principle of separability. The approach taken to construction and the strong support and clear delineation of the principle of separability in *Fiona Trust* should be adopted in Australia, to bring Australian law into line with international commercial practice.

Arbitration is a creature of contract with the jurisdiction of the tribunal determined by the parties' agreement to arbitrate. The parties may limit the scope of that jurisdiction and, accordingly, special attention has been given to the wording of the arbitration clause. In the past, English courts held, for example, that a referral of disputes arising 'under' a contract was more limited than a referral of disputes arising 'out of' a contract.

Issues of jurisdiction raise questions relating to which forum should determine the jurisdiction of the arbitral tribunal. Arbitration law favours jurisdiction to be first determined by the arbitral tribunal, under the doctrine of *Kompetenz-Kompetenz*, subject to the right of subsequent review by the courts of the place of arbitration and at any place of enforcement. In the past, it was argued that an allegation that the underlying agreement was void ab initio, on grounds that the agreement was illegal or had been induced by fraud for example, deprived the arbitral tribunal of the jurisdiction to determine its own jurisdiction. Arguments were advanced that – logically – an arbitral tribunal could not make a determination that the very agreement on which it relied for its jurisdiction never existed. When fraud was alleged, the rules of arbitrability would also have been relevant. Despite the increasing acceptance by national courts of the principle of

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\* Lawyers, Arbitration Group, Clifford Chance LLP, London, United Kingdom. The authors thank Paul Coates (Lawyer) and Audley Sheppard (Partner) for their assistance. Any errors remain the authors' alone.

1 [2007] Bus L R 1719 ('*Fiona Trust*') under the changed name of *Fili Shipping Co Ltd v Premium Nafta Products Ltd*, on appeal from *Fiona Trust and Holding Corporation and others v Privalov and others* [2007] Bus L R 686 from the Court of Appeal (Civil Division).

separability, whereby the agreement to arbitrate is considered to be separate from the underlying agreement, arguments were nevertheless still being raised that the separability principle was trumped by challenges to the validity of the main contract.

The decision in *Fiona Trust* has dismissed nuanced semantic debates regarding the construction of the arbitration clause and has rejected challenges to the principle of separability. The arbitration clause in *Fiona Trust* provided for all disputes ‘arising under’ the charterparties to be referred to arbitration. The House of Lords observed that previous decisions on the construction of the wording of the arbitration clause had been too pre-occupied with ‘linguistic nuances’.<sup>2</sup> Accordingly, the House of Lords felt that the time had come ‘to draw a line under the authorities to date and make a fresh start’.<sup>3</sup> Focussing on the commercial purpose of the arbitration agreement and the likely intention of rational businessmen, a presumption in favour of ‘a one-stop method of adjudication’<sup>4</sup> was established which could only be rebutted by clear words to the contrary.

The House of Lords also fully endorsed the principle of separability, concluding that an arbitration agreement could be invalidated only on a ground which related specifically to the arbitration agreement itself and was not merely a consequence of the invalidity of the main agreement. The House of Lords held that allegations that the underlying contract had been procured by and rendered void as a result of fraud or bribery did not invalidate the arbitration agreement and that the arbitral tribunal, rather than the courts, had jurisdiction to hear such disputes with Lord Hope applying the ‘exacting’ test of ‘direct impeachment’ of the arbitration agreement.<sup>5</sup> Only if the arbitration agreement itself had been procured by fraud or bribery would the arbitral tribunal be deprived of jurisdiction.

The decision has brought English law, which – according to the House of Lords – was at the risk of being isolated, specifically in relation to the approach to be taken to construction, into line with international commercial practice. The ruling has been hailed as a landmark decision that will further strengthen the reputation of London as a leading venue for international arbitration and was one of the most significant cases in the tenth anniversary year of the English *Arbitration Act (1996)* (UK) (‘Act’).

In contrast to the clear guidance provided by the House of Lords in *Fiona Trust*, the position in Australia remains uncertain. Semantic debates on construction are ongoing even though a commercial presumption in favour of one-stop adjudication has recently been recognised<sup>6</sup>. Separability has not been comprehensively delineated. Whilst the New South Wales (‘NSW’) courts have generally adopted a more liberal approach to the construction of arbitration agreements than the Federal Court, a structured approach to construing

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2 [2007] Bus L R 1719 [12] (Lord Hoffmann).

3 Ibid.

4 Ibid 1729 (Lord Hope of Craighead).

5 Ibid 1731 (Lord Hope of Craighead).

6 *Comandate Marine Corp v Pan Australia Shipping Pty Ltd* [10026] FCAFC 192 (‘Comandate’).

arbitration clauses has not been established. Although the Australian courts have fully endorsed the principle of separability, they have so far refrained from spelling out clearly the limits of the principle.

First, this article sets out the position on the construction of arbitration clauses and separability under English law post *Fiona Trust* and, secondly, it charts the development of Australian law in the Federal Court and the NSW courts in these areas. In the authors' view, a clear statement on the approach to construction of the arbitration clause would help prevent unnecessary discussion of 'linguistic nuances' by the Australian courts, and bring Australian law in line with international commercial practice. The full endorsement of the principle of separability by the NSW courts and the Federal Court is to be welcomed. However, a confirmation of the endorsement of the principle by the Australian High Court, together with a clarification of its limits (such as the test of 'direct impeachment' in *Fiona Trust*), would help further delineate the principle in Australia.

## II ENGLAND

Arbitration proceedings in England are governed by the Act.<sup>7</sup> The Act was introduced after a review<sup>8</sup> of English arbitration law and practice in light of the Model Law of International Arbitration adopted by the United Nations Commission on International Trade Law ('Model Law'). The Act reflected many provisions of the Model Law. It also took account of developments that had occurred in English arbitration case law.<sup>9</sup>

*Fiona Trust* concerned a dispute arising under a series of charterparties. The shipowners claimed that the charterers' option to refer to arbitration any disputes 'arising under' the charterparties had been rendered inoperative because the charterparties had been procured by bribery and were rescinded. The shipowners sought substantial damages in the English courts whilst the charterers wanted to refer the dispute to arbitration. Finding for the charterers, the Court of Appeal held that there was a valid arbitration agreement, granted the charterers a stay of the court proceedings and refused the shipowners' application to end the arbitration proceedings.<sup>10</sup> The House of Lords<sup>11</sup> dismissed the shipowners' appeal and, in a clear and concise judgment, explained the English law position on construction of arbitration agreements and principle of separability.

7 Section 2(1) of the Act provides: 'The provisions of this Part apply where the seat of the arbitration is in England and Wales or Northern Ireland.'

8 Departmental Advisory Committee on Arbitration Law, 'A Report on the UNCITRAL Model Law on International Commercial Arbitration' (1989) reproduced in (1990) 6 *Arbitration International* 3.

9 See, eg, s 7 of the Act (discussed below) which codifies the principle of separability as confirmed in *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1992] 1 Lloyd's Rep 81 ('*Harbour Assurance*') (Steyn J).

10 [2007] Bus L R 686.

11 Lord Hoffmann gave the leading speech and the four other Lords agreed with him. Lord Hope gave a separate speech. Lord Browne agreed with both Lords Hoffmann and Hope.

## A Construction of Arbitration Agreements

### 1 *The Presumptive Approach*

The wording of arbitration agreements has generated much case law in England,<sup>12</sup> and the authorities existing prior to *Fiona Trust* were difficult to reconcile with one another.<sup>13</sup> For example, as noted by Lord Hoffmann<sup>14</sup>, the House of Lords in *Heyman v Darwins Ltd*<sup>15</sup> observed that a reference to arbitration of disputes ‘arising under’ the agreement had a narrower meaning than disputes ‘arising out of’ the agreement. In *The Evje*,<sup>16</sup> the House of Lords could see no difference between the two terms. In *Overseas Union Insurance Ltd v AA Mutual International Insurance Co Ltd*,<sup>17</sup> Evans J held at first instance that disputes that arise regarding the rights and obligations created by the contract itself could be said to arise ‘under’ the contract whereas a wider class of disputes could be said to arise ‘in relation to’ or ‘in connection with’ the contract. In *Mackender v Feldia AG*,<sup>18</sup> the Court of Appeal held that the question whether the contract could be avoided for non-disclosure was covered by a reference to arbitration of disputes ‘arising thereunder’, whereas in *Fillite (Runcorn) Ltd v Aqua-Lift*,<sup>19</sup> the Court of Appeal observed that the phrase ‘under a contract’ was not wide enough to include disputes which did not concern obligations created by or incorporated into the contract.

Having referred to conflicting decisions on the construction of arbitration clauses, and having set out the principle of separability as codified in section 7 of the Act (further discussed below), Lord Hoffmann stated:

[T]he time has come to draw a line under the authorities to date and make a fresh start. I think that a fresh start is justified by the developments which have occurred in this branch of the law in recent years and in particular by the adoption of the principle of separability by Parliament in section 7 of the 1996 Act. That section was obviously intended to enable the courts to give effect to the reasonable commercial expectations of the parties about the questions which they intended to be decided by arbitration. But section 7 will not achieve its purpose if the courts adopt an approach to construction which is likely in many cases to defeat those expectations. The approach to construction therefore needs to be re-examined.<sup>20</sup>

Lord Hoffmann explained that a presumptive approach should be taken to the construction of arbitration agreements:

[T]he construction of an arbitration clause should start from the assumption that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal. The clause should be construed in accordance with this

12 For a review of the approaches to construction taken prior to the decision of the House of Lords in *Fiona Trust*, see Professor Robert Merkin, *Arbitration Law*, Service Issue No 47, 7 September 2007, [5.39]–[5.57].

13 [2007] Bus L R 686.

14 [2007] Bus L R 1719, 1725.

15 [1942] 1 All ER 337, 360 (Lord Porter).

16 *Union of India v EB Aaby's Rederi A/S* [1974] 2 All ER 874, 885 (Viscount Dilhorne); 887 (Lord Salmon).

17 [1988] 2 Lloyd's Rep 63, 67.

18 [1966] 3 All ER 847.

19 (1989) 26 Con LR 66, 76 (Lord Slade).

20 [2007] Bus L R 1719, 1725–6.

presumption unless the language makes it clear that certain questions were intended to be excluded from the arbitrator's jurisdiction.<sup>21</sup>

Whilst Lord Hoffmann did not expressly refer to the 'presumption in favour of one-stop arbitration' advocated by the Court of Appeal<sup>22</sup> and endorsed by Lord Hope,<sup>23</sup> he did explain that, rather than focussing primarily on the effects of 'linguistic nuances',<sup>24</sup> the presumptive approach was intended to give effect to the commercial purpose of arbitration agreements, namely to refer all disputes arising out of the parties' relationship to arbitration, rather than leaving some to the national courts:<sup>25</sup>

The parties have entered into a relationship, an agreement or what is alleged to be an agreement or what appears on its face to be an agreement, which may give rise to disputes. They want those disputes decided by a tribunal which they have chosen... Particularly in the case of international contracts, they want a quick and efficient adjudication and do not want to take the risks of delay and, in too many cases, partiality, in proceedings before a national jurisdiction. If one accepts that this is the purpose of an arbitration clause, its construction must be influenced by whether the parties, as rational businessmen, were likely to have intended that only some of the questions arising out of their relationship were to be submitted to arbitration and others were to be decided by national courts... A proper approach to construction... requires the court to give effect, so far as the language used by the parties will permit, to the commercial purpose of the arbitration clause.<sup>26</sup>

## 2 *The Limits of the Presumptive Approach*

Nonetheless, Lord Hoffmann went on to identify the limits of the presumptive approach, noting that 'very clear' language to the contrary would be capable of rebutting the presumption in favour of all disputes being determined by arbitration:

If, as appears to be generally accepted, there is no rational basis upon which businessmen would be likely to wish to have questions of the validity or enforceability of the contract decided by one tribunal and questions about its performance decided by another, one would need to find very clear language before deciding that they must have had such an intention.<sup>27</sup>

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21 Ibid 1726.

22 [2007] Bus L R 686, 698. For a previous discussion of this presumption, see *Ashville Investments Ltd v Elmer Contractors* [1989] QB 488, 517 (Lord Bingham).

23 [2007] Bus L R 1719, 1729.

24 Ibid 1725.

25 See Alan Berg, 'Arbitration Under A Contract Alleged Not To Exist' (2007) 123 *Law Quarterly Review* 353 referring to [2007] Bus L R 686, 698: Berg states, referring to the Court of Appeal decision in *Fiona Trust*, that 'two adjudications were inevitable if the rescission dispute came within the arbitration clause because the question of bribery would still have to be resolved in the High Court action for damages for conspiracy, bribery and breach of fiduciary duty against the very same defendants, among others. The argument was rejected... Longmore LJ said that the prospect of two adjudicators was "merely how things have happened in this particular case and cannot affect the true construction of the clause".'

26 [2007] Bus L R 1719, 1724.

27 Ibid.

Lord Hope added:

The proposition that any jurisdiction or arbitration clause in an international commercial contract should be liberally construed promotes legal certainty. It serves to underline the golden rule that if the parties wish to have issues as to the validity of their contract decided by one tribunal and issues as to its meaning or performance decided by another, they must say so expressly.<sup>28</sup>

### 3 *The Presumptive Approach Reflects International Commercial Practice*

Both Lords Hoffmann and Hope referred to international practice when discussing the approach to be taken to the interpretation of arbitration agreements. Lord Hoffmann quoted the approach adopted in a German case,<sup>29</sup> and Lord Hope went on to refer to two additional American cases,<sup>30</sup> before concluding with a reference to an Australian decision:<sup>31</sup>

It has indeed been clear for many years that the trend of recent authority has risked isolating the approach that English law takes to the wording of such clauses from that which is taken internationally. It makes sense in the context of international commerce for decisions about their effect to be informed by what has been decided elsewhere ... In *Comandate Marine Corp v Pan Australia Shipping Pty Ltd* ... the Federal Court of Australia said that a liberal approach to the words chosen by the parties was underpinned by the sensible commercial presumption that the parties did not intend the inconvenience of having possible disputes from their transaction being heard in two places, particularly when they were operating in a truly international market. This approach to the issue of construction is now firmly embedded as part of the law of international commerce ... [I]t must now be accepted as part of our law too.<sup>32</sup>

Lord Hope added that the widespread use of standard forms, together with the relative lack of importance attached to the language of the arbitration clause compared to other clauses in the contract, were additional justifications for the adoption of the presumptive approach to the interpretation of arbitration agreements.<sup>33</sup>

### 4 *Application of the Presumptive Approach*

In *Fiona Trust*, a claim that a contract was procured by bribery was deemed within the scope of the reference to arbitration of disputes arising ‘under’ the contract. Lord Hope concluded, with respect to the clause at issue:

It indicates to the reader that he need not trouble himself with fussy distinctions as to what the words ‘arising under’ and ‘arising out of’ may mean. Taken overall, the wording indicates that arbitration may be chosen as a one-stop method of adjudication for the determination of all disputes.<sup>34</sup>

28 Ibid 1729.

29 Ibid 1726; Professor Peter Schlosser, ‘The Decision of 27 February 1970 of the Federal Supreme Court of the Federal Republic of Germany (Bundesgerichtshof)’ (1990) 6 *Arbitration International* 79.

30 Ibid 1730; *AT&T Technologies Inc v Communications Workers of America* (1986) 475 US 643; *Threlkeld & Co Inc v Metallgesellschaft Ltd* (London) (1991) 923 F 2d 245.

31 This is further discussed below.

32 [2007] Bus L R 1719, 1730.

33 Ibid 1728.

34 Ibid 1729.

It remains to be seen where the boundaries of the presumptive approach will be drawn and in particular, what will be deemed to constitute ‘very clear language’ to the contrary, sufficient to rebut the presumption that all disputes are to be settled by arbitration.

## B The Principle of Separability

### 1 *The Principle of Separability and the Removal of ‘Conceptual Obstacles’ to the Principle*

The doctrine of separability requires that the arbitration agreement be treated as a separate contractual undertaking, that is, the agreement to arbitrate disputes arising out of a contract is distinct from the main contract, such that disputes as to the scope or even the existence of the main contract can be arbitrated.<sup>35</sup>

Despite some notable hiccups,<sup>36</sup> the principle of separability has been accepted by the English courts, and the decision in *Harbour Assurance* confirmed that separability of the arbitration agreement was part of English common law. Justice Steyn at first instance noted that ‘[o]nce it became accepted that the arbitration clause is a separate agreement, ancillary to the contract, the logical impediment to referring an issue of the invalidity of the contract to arbitration disappears.’<sup>37</sup> This was confirmed by the Court of Appeal in *Harbour Assurance*.

The principle of separability was recognised and included in section 7<sup>38</sup> of the Act,<sup>39</sup> which provides:

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.

The principle of separability, as codified in section 7 of the Act, has been decisively confirmed by the House of Lords in *Fiona Trust*. Dismissing arguments that questions as to the validity of a contract are not suitable for reference to arbitration, Lord Hoffmann stated:

35 Merkin, above n 12, [5.40].

36 See, eg, *Heyman v Darwins Ltd* [1942] AC 356 (HL); *Overseas Union Insurance Ltd v AA Mutual International Insurance Co Ltd* [1988] 2 Lloyd’s Reports 63, 66 where Evans J stated that the rule that arbitrators could never have jurisdiction to decide whether a contract was valid ‘owes as much to logic as it does to authority’.

37 *Harbour Assurance* [1992] 1 Lloyd’s Rep 81, 92 (Steyn J).

38 Section 2(5) provides: ‘Section 7 (Separability of arbitration agreement)...appl[ies] where the law applicable to the arbitration agreement is the law of England and Wales or Northern Ireland even if the seat of the arbitration is outside England and Wales or Northern Ireland or has not been designated or determined.’

39 This expressly follows Article 16(1) of the UNCITRAL Model Law (see below).

Section [7 of the Act] shows a recognition by Parliament that, for the reasons I have given in discussing the approach to construction, businessmen frequently do want the question of whether their contract was valid, or came into existence, or has become ineffective, submitted to arbitration and that the law should not place conceptual obstacles in their way.<sup>40</sup>

In confirming the effects of the principle, and clarifying its limits, the House of Lords recognised that English law ought to be in line with international practice.<sup>41</sup> Separability is applied by international arbitral tribunals, both in cases where the underlying agreement is alleged to have been terminated and in cases where it is alleged to have been invalid or non-existent ab initio.<sup>42</sup> For example, in *Elf Acquitaine Iran v National Iranian Oil Company*,<sup>43</sup> separability was referred to as ‘a generally recognised principle of the law of international arbitration’.<sup>44</sup>

Nonetheless, section 7 of the Act is not mandatory and may be excluded by the parties’ contrary agreement. It has been suggested that the courts have recognised that a contrary agreement is less likely to come in the form of an express ouster provision, but rather in the wording of the arbitration clause itself,<sup>45</sup> and have thus taken into consideration the wording of the clause when determining whether an arbitration agreement was severable from the underlying contract.<sup>46</sup>

## **2 The Limits of the Principle of Separability – the Test of ‘Direct Impeachment’**

Whilst questions as to the validity of a contract may be referred to arbitration under English law, questions as to the validity of the arbitration agreement itself may not be unless the parties agree otherwise. In order to invalidate an arbitration agreement, an objection must relate to or impeach directly such agreement, and not be a mere consequence of an objection to the validity of the underlying contract.

In *Fiona Trust*, the shipowners contended that, were it not for the alleged bribery, they would never have entered into any charterparties, and hence would not have entered into any arbitration agreement; the arbitration agreements were invalid because the charterparties had been rescinded for bribery. Lord Hoffmann rejected the shipowners’ argument:

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40 [2007] Bus L R 1719, 1725. Lord Hoffmann’s reasons for his approach to construction are discussed below.

41 Ibid 1730. In particular, Lord Hope recognised that English law ought to be consistent with international practice, and referred directly to s 4 of the United States Arbitration Act 1925 which was in similar terms to s 7 of the English Act, as well as a case of the Supreme Court of the United States, *Prima Paint Corporation v Flood & Conklin Manufacturing Co* (1967) 388 US 395 at 404.

42 T D Grant, ‘International Arbitration and English Courts’ (2007) *International & Comparative Law Quarterly* 873.

43 (1986) 11 *Yearbook of Commercial Arbitration* 98.

44 Ibid 102.

45 Merkin, above n 12, [5.44].

46 For a discussion of the construction of the arbitration agreement in the context of separability, see Merkin, above n 12, [5.46]–[5.73].



[T]hat is in my opinion exactly the kind of argument which section 7 was intended to prevent. It amounts to saying that because the main agreement and the arbitration agreement were bound up with each other, the invalidity of the main agreement should result in the invalidity of the arbitration agreement. The one should fall with the other because they would never have been separately concluded. But section 7 in my opinion means that they must be treated as having been separately concluded and the arbitration agreement can be invalidated only on a ground which relates to the arbitration agreement and is not merely a consequence of the invalidity of the main agreement.<sup>47</sup>

Lord Hoffmann went on to list examples of circumstances in which the principle of separability would not apply, and accordingly the dispute would not be referred to arbitration:

For example, if the main agreement and the arbitration agreement are contained in the same document and one of the parties claims that he never agreed to anything in the document and that his signature was forged, that will be an attack on the validity of the arbitration agreement...Similarly, if a party alleges that someone who purported to sign as agent on his behalf had no authority whatever to conclude any agreement on his behalf, that is an attack on both the main agreement and the arbitration agreement...Even if the allegation is that there was no concluded agreement (for example, that terms of the main agreement remained to be agreed) that is not necessarily an attack on the arbitration agreement.<sup>48</sup>

In his concurring opinion, Lord Hope expanded upon Lord Hoffmann's conclusion and, referring to the test of 'direct impeachment',<sup>49</sup> formulated the limits to separability slightly differently:

The doctrine of separability requires direct impeachment of the arbitration agreement before it can be set aside. This is an exacting test. The argument must be based on facts which are specific to the arbitration agreement. Allegations that are parasitical to a challenge to the validity of the main agreement will not do.<sup>50</sup>

Lord Hope considered the owner's 'causation argument' in *Fiona Trust* parasitical to their challenge to the validity of the underlying contract, and concluded that the test of direct impeachment had not been met.<sup>51</sup>

It now seems clear that the threshold for invalidating an arbitration agreement is a high one, although it remains to be seen how the 'direct impeachment' test will be applied in practice.<sup>52</sup> As one commentator has noted in relation to this test:

The analytic challenge is to define what degree of directness in the relation between an alleged fraud and the arbitration clause can be tolerated, before the clause fails.<sup>53</sup>

47 [2007] Bus L R 1719, 1727.

48 Ibid 1726–7. For a criticism of the Court of Appeal's dismissal of the shipowners' agency analysis in *Fiona Trust*, see Berg, above n 25, 352–8.

49 Originally established in *Harbour Assurance* [1992] 1 Lloyd's Rep 81 (Steyn J).

50 [2007] Bus L R 1719, 1731. Lord Hope's test of direct impeachment borrows the language of Steyn J in *Harbour Assurance* at 92.

51 [2007] Bus L R 1719, 1731.

52 At the time of writing, the English courts have applied *Fiona Trust* in one case only. Dismissing claims that the arbitration agreement was not valid because the underlying contract had been obtained by duress, Tomlinson J granted a stay of court proceedings pursuant to s 9 of the Arbitration Act 1996: *Amr Amin Hamza El Nasharty v J Sainsbury Plc* [2007] EWHC 2618 (Comm).

53 Grant, above n 42, 873–4. The author's comments were made in relation to the Court of Appeal decision in *Fiona Trust* at 692 which referred to Steyn J's test of direct impeachment in *Harbour Assurance*.

### III AUSTRALIA

The Australian Legislature has brought the statutory framework addressing international commercial arbitration in line with international practice, particularly with the adoption of the Model Law into the *International Arbitration Act 1974* (Cth) ('IAA') in 1989.<sup>54</sup>

For want of High Court authority, jurisprudence has focussed on the approach of the Federal Court and the NSW courts.<sup>55</sup> The decisions of the High Court that have dealt with questions of arbitration, such as *Tanner Research Laboratories Inv v O'Brien*<sup>56</sup> and *Government Insurance Office (NSW) v Atkinson-Leighton Joint Venture*,<sup>57</sup> have provided little guidance on the construction of arbitration clauses and the principle of separability.

Whilst the NSW courts have been relatively supportive of arbitration, the Federal Court, in contrast, has been more reluctant to provide full support to international arbitration. In cases as recent as 2000, the Australian courts referred to the 'judicial hostility'<sup>58</sup> towards international arbitration that has existed in the past. However, in the 2006 decision of *Comandate Marine Corp v Pan Australia Shipping Pty Ltd*,<sup>59</sup> cited with approval by the House of Lords in *Fiona Trust*, the Full Court recognised that Australia's involvement in international trade and commerce required that Australian law foster and support international commercial arbitration.<sup>60</sup>

With respect to the construction of the arbitration clause, the NSW courts have – on the whole – taken a more liberal approach towards arbitration agreements.<sup>61</sup> The Federal Court eventually followed suit and in *Comandate* referred to a presumption in favour of one-stop adjudication. However, such presumption was not referred to in the subsequent decision of *Seeley International Pty Ltd v Electra Air Conditioning BV*.<sup>62</sup>

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54 Section 16(1), IAA.

55 For want of space, this article will focus on the approach of the NSW courts rather than the other State courts.

56 (1990) 169 CLR 332.

57 (1990) 91 ALR 180 ('*Tanner Research*').

58 See, eg, the NSW Court of Appeal in *Raguz v Sullivan* (2000) 50 NSWLR 236.

59 [2006] FCAFC 192.

60 *Ibid* 194.

61 For want of space, the discussion here has focussed on the approach of the NSW courts and the Federal Court. However, the Victorian courts have also adopted a more liberal approach: see, eg, *Abigroup Contractors Pty Ltd v Transfield Pty Ltd and Obayashi Corporation* [1998] VSC 103 and *Manningham City Council v Dura (Australia) Constructions Pty Ltd* [1999] VSC 63 discussed in Romauld Andrew, 'The ILL-Favoured Child of Litigation: International Commercial Arbitration and the Trade Practices Act 1974' (2004) 21 *Journal of International Arbitration Law* 239, 256–8. On the other hand, other state courts such as the Tasmanian Supreme Court have referred to the restrictive approach in *Hi-Fert Pty Ltd v Kiukiang Maritime Carriers Inc* (1998) 90 FCR 1 ('*Hi-Fert*'): see the second judgment of Slicer J in *Origin Energy Resources Ltd v Benaris International NV* [2002] TASSC 104, discussed in Andrew, above in note, 260–1.

62 [2008] FCA 29 ('*Seeley*').

As regards separability, the principle as set out in section 16 of the Model Law forms part of the IAA and has been endorsed by the Australia courts.<sup>63</sup>

## A Construction of Arbitration Agreements

### 1 Construction of the Arbitration Agreement in the Context of Parallel Statutory Claims

In contrast to the presumptive approach that has recently been endorsed by the House of Lords in *Fiona Trust*, the Australian courts are still preoccupied with ‘fuzzy distinctions’<sup>64</sup> between different wordings used in arbitration agreements<sup>65</sup> even though they have referred to a commercial presumption in favour of one-stop adjudication.<sup>66</sup> The words ‘arising out of’ or ‘arising from’ the underlying agreement continue to be given a wide interpretation,<sup>67</sup> whilst ‘arising under’ the agreement is considered to be more restrictive. There appears to be little practical relevance to these purported distinctions and, as noted by Lord Hope in *Fiona Trust*, business persons ‘are unlikely to linger over the words which are used’.<sup>68</sup>

It is usually in the context of parallel statutory claims under the *Trade Practices Act 1974* (Cth) (*Trade Practices Act*) or the *Corporations Act 2001* (Cth) that the scope of the arbitration agreement has been at issue before the Australian courts. For example, the question of whether or not an arbitration agreement encompasses statutory claims relating to representations made before a contract was entered into or after it was terminated will depend upon the wording of the arbitration agreement.

### 2 The Requirement for a ‘Substantive Nexus or Connection’ with the Contract

The decision of Beaumont J in *Allergan Pharmaceuticals Inc v Bausch & Lomb Inc* in 1985 brought about the conservative approach of the Federal Court.<sup>69</sup> That decision contrasted sharply with the approach of the NSW Supreme Court at the time, where Rogers CJ was calling for the courts to ‘disregard their former hostility to arbitration and create a hospitable climate for arbitral resolution of disputes’.<sup>70</sup> In *Allergan*, Beaumont J acknowledged that ‘arising out of or relating to the agreement’ was ‘capable of the widest construction’ but

63 *Ferris v Plaister* (1994) 34 NSWLR 474; *Walter Rau Neusser Oel und Fett AG v Cross Pacific Trading Ltd* [2005] FCA 1102 (*Walter Rau*).

64 [2007] Bus L R 1719, 1725 (Lord Hope).

65 See, eg, *ACD Tridon v Tridon Australia* [2002] NSWSC 896 (*ACD Tridon*), [123], [127], [135]–[136].

66 See, eg, *Comandate* [2006] FCAFC 192, [164]–[165]; *Walter Rau* [2005] FCA 1102, [41]–[2]; *Francis Travel Marketing P/L v Virgin Atlantic Airways Ltd* [1996] NSWSC 104 (*Francis Travel*); *IBM Australia Ltd v National Distribution Services Ltd* (1991) 100 ALR 361 (*IBM Australia*).

67 See especially *Comandate* [2006] FCAFC 192, [175]; *Walter Rau* [2005] FCA 1102, [45]–[56]; *Francis Travel* [1996] NSWSC 104, where Gleeson CJ approved of the comments of Hirst J in *Ethiopian Oilseeds and Pulses Export Corporation v Rio del Mar Foods Inc* [1990] 1 Lloyd’s Rep 86 (*Ethiopian Oilseeds*).

68 [2007] Bus L R 1719, 1728.

69 [1985] FCA 369. The case concerned alleged breaches of a distribution agreement between the parties, as well as alleged breaches of the *Trade Practices Act 1974* (Cth) and the *Patents Act 1952* (Cth).

70 *Qantas Airways Ltd v Dillingham Corporation* (1985) 4 NSWLR 113, 118.

found that the causes of action under the *Trade Practices Act* and the *Patents Act 1990* (Cth) arose ‘exclusively from the statutory provisions themselves’.<sup>71</sup> Justice Beaumont considered that the agreement was merely part of the background and that, ‘in the absence of any substantive nexus or connection’ with the contract, the statutory claims existed ‘independently of contract’.<sup>72</sup>

This case was heavily criticised<sup>73</sup> and has the undesirable consequence that a party may be able to circumvent an arbitration clause by simply raising claims under the *Trade Practices Act* or indeed other Australian legislation.<sup>74</sup> Subsequent decisions in the Federal Court and the NSW courts, however, have sought to restrict the application of *Allergan* to its facts by distinguishing it on the basis that the contract Beaumont J considered was merely part of the background of the dispute.<sup>75</sup>

### 3 *Emergence of a Liberal Approach to Construction in the NSW Courts*

In *IBM Australia*<sup>76</sup>, the NSW Court of Appeal confirmed in 1991 that the reference to arbitration of ‘any controversy or claim arising out of or related to this agreement or breach thereof’ was to be given a wide construction such that the claims under the *Trade Practices Act*, including the alleged pre-contractual misrepresentations, could be referred to arbitration. President Kirby stressed the importance of international practice.<sup>77</sup> Justice of Appeal Clarke focussed on the need for efficiency and cost-effectiveness, and acknowledged that he would find it ‘difficult to ascribe to the parties to a contract an intention to submit only part of a dispute to an arbitral tribunal reserving the remainder for consideration by the court as this would, on any view, be inefficient and costly’.<sup>78</sup>

The 1994 decision of *Ferris v Plaister*<sup>79</sup> was a case not unlike *Fiona Trust*, being concerned with a challenge on account of fraud to the validity of the arbitration agreement, which provided in relation to the contract for ‘any matter or thing of whatsoever nature arising thereunder or in connection therewith to be referred to arbitration’.<sup>80</sup> President Kirby reiterated the importance of international practice when considering arbitration agreements.<sup>81</sup> When confirming the validity of the arbitration agreement, Clarke JA observed that, apart from the principle of separability, there were ‘powerful practical and

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71 [1985] FCA 369, [34].

72 Ibid.

73 Andrew, above n 61, 240.

74 Ibid 242–3.

75 See, eg, *Comandate* [2006] FCAFC 192, [185–6] *ACD Tridon*; [2002] NSWSC 896, [158]; *Francis Travel* [1996] NSWSC 104.

76 (1991) 100 ALR 361.

77 President Kirby also referred to the decision in *Mir Brothers Developments Pty Ltd v Attonic Constructions Pty Ltd* (1984) 1 BCL 80 (*Mir Brothers*) and emphasised that, as the clause in *Mir Brothers* did not include the wording ‘or related to this agreement or the breach thereof’, a wider approach could be adopted in *IBM Australia*.

78 (1991) 100 ALR 361.

79 (1994) 34 NSWLR 474.

80 Ibid 477–92 (Kirby P).

81 As discussed below, Kirby P referred to decisions in common law and civil law jurisdictions and international jurisprudence in considering the doctrine of separability.

commercial reasons why that result should follow in any event'.<sup>82</sup> Justice of Appeal Clarke first referred to the 'desirability of giving effect to the right of the parties to choose a tribunal to resolve their disputes' and secondly endorsed one-stop adjudication as an 'even more compelling reason' for holding the arbitration agreement valid:

[I]t is unlikely that the parties would have determined to bear the increased legal costs flowing from having parts of their dispute heard in one tribunal and parts in another. Where the parties have indicated the tribunal of their choice there would need to be compelling reasons before one could conclude that that tribunal could or should hear only part of the dispute between the parties.<sup>83</sup>

The more liberal approach of the Court of Appeal in *IBM Australia* was followed in *Francis Travel Marketing Pty Ltd v Virgin Atlantic Airways Ltd*,<sup>84</sup> where the NSW Court of Appeal held that 'any dispute or difference arising out of the agreement' encompassed claims under the *Trade Practices Act* and that the parties were 'unlikely to have intended that different disputes should be resolved before different tribunals'<sup>85</sup> and in *QH Tours Ltd v Ship Design & Management (Aust) Pty Ltd*,<sup>86</sup> where Foster J of the Federal Court held that the reference to 'any dispute or difference ... arising thereunder or in connection therewith' was wide enough to encompass claims under the *Trade Practices Act*.

In *Paper Products Pty Ltd v Tomlinsons (Rochdale) Ltd*,<sup>87</sup> French J, also of the Federal Court, accepted that the more liberal approach in *IBM Australia* would apply if the language of the clause was 'sufficiently elastic'.<sup>88</sup> However, he considered that the words 'arising under' the agreement were more restrictive<sup>89</sup> and did not encompass trade practices claims, claims for breach of warranty and negligent misstatement:

A wide construction of such clauses can be supported on the basis advanced by Clarke JA that it is unlikely to have been the intention of the parties to artificially divide their disputes into contractual matters which could be dealt with by an arbitrator and non-contractual matters which would fall to be dealt with in the courts. When, as here, the parties have agreed upon a restricted form of words which in their terms, and as construed in the courts, limit the reference to matters arising ex contractu, there is little room for movement.<sup>90</sup>

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82 Ibid 504.

83 Ibid.

84 [1996] NSWSC 104.

85 [1996] NSWSC 104 (Gleeson CJ).

86 (1991) 105 ALR 371 ('*QH Tours*').

87 [1993] FCA 346.

88 Ibid [16].

89 Somewhat surprisingly given the Australian courts' apparent fixation on the wording of arbitration agreements, French J appears to have taken the view that the words 'arising under' in the arbitration agreement were synonymous with the more widely expressed words, 'arising out of', as indicated by his use of these words in the following quote: 'I am satisfied that neither the trade practices claim, nor the claims for breach of warranty and negligent mis-statement can be said to *arise out of the agreement*. They all *arise out of* matters which are antecedent to the contract even though they may involve questions which also go to its performance' (emphasis added): *ibid*.

90 Ibid [16].

#### 4 Return to a Restrictive Approach to Construction by the Federal Courts

The decision of the Full Court of the Federal Court in *Hi-Fert* returned to the restrictive approach adopted by Beaumont J in *Allergan*. The case concerned a shipment of cargo which was held by quarantine and could not be discharged in Australia; the claim was for the loss suffered as a result of the representations made before the consignment was dispatched. Justice Beaumont, sitting as a member of the Full Court, again confined the contract in question to the background of the dispute holding that the statutory claims under the *Trade Practices Act* were ‘independent and free-standing’. In contrast to the liberal approach taken by the NSW Court of Appeal in the line of decisions starting with *IBM Australia*, Beaumont J was of the view that it was not practical to refer statutory claims under Australian law to an arbitral tribunal considering English law. He stated that:

We should not attribute such a bizarre intention to these parties. It is not likely that they intended to refer to these arbitrators in London any dispute however remotely connected with the charter party or the bill of lading and however special its legal characteristics in terms of English law. It appears that there is no counterpart of the *Trade Practices Act 1976* in England. The consumer protection provisions in Part V of the *Trade Practices Act* were derived from American legislation and constitute an exhaustive code in the field covered.<sup>91</sup>

Similarly, Emmett J<sup>92</sup> relied heavily on Justice Beaumont’s decision in *Allergan*.<sup>93</sup> He emphasised the need, in light of *Allergan*, for a ‘substantive nexus or connection’ with the contract for the statutory claims to be referred to arbitration, and found that representations occurring during the course of a contract were connected with the contract, whilst pre-contractual representations did not ‘arise out of’ or ‘arise from’ the contract.<sup>94</sup>

In a decision that seemed more aligned with the general approach of the Federal Court, the NSW Supreme Court in *ACD Tridon v Tridon Australia*<sup>95</sup> in 2002 concluded that statutory claims did not have sufficient connection with the contract. The arbitration clause in a distribution agreement provided for disputes ‘with respect to...the rights and liabilities of the parties hereto’ to be referred to arbitration, and the arbitration clause in a shareholders agreement provided for disputes ‘touching and concerning...the rights and liabilities hereunder’ to be

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91 Ibid [16].

92 With whom Beaumont and Branson JJ agreed.

93 Justice Emmett attempted to elevate the reference to *Allergan* that had been made by Deane and Gaudron JJ in obiter dicta in *Tanning Research*, stating that *Allergan* had been referred to with approval by the High Court. *Tanning Research* was more concerned with the narrower question of whether the liquidator was claiming ‘through or under’ the party to the arbitration agreement rather than the scope of the agreement itself. In considering that proof of debt proceedings may be referring to arbitration, Deane and Gaudron JJ had stated at (1990) 91 ALR 180, 188, referring to *Allergan*: ‘By requiring that the proceedings or so much of the proceedings as involves the determination of a matter capable of settlement by arbitration be stayed, s 7(2) clearly contemplates that the proceedings may encompass issues additional to those constituting ‘a matter ... capable of settlement by arbitration’. That was the extent of the reference to *Allergan*: (1998) 90 FCR 1, 18. See also the discussion in Andrew, above n 61, 246, 252.

94 Justice Emmett went on to distinguish *Francis Travel* on the basis that the alleged representations in that case occurred during the contract and were in this way connected with the contract.

95 [2002] NSWSC 896.

referred to arbitration.<sup>96</sup> Justice Austin focussed on the construction of the clauses and emphasised that statutory claims were not sufficiently connected to the contracts. Regarding the liberal approach, he held:

I am not aware of any Australian case that has in terms endorsed the idea that, in construing an international arbitration clause, the court should apply a presumption in favour of arbitration...The question whether the arbitrator has the power to deal with non-contractual matters is<sup>97</sup> to be resolved by careful construction of the wording of the arbitration clause.<sup>97</sup>

### 5 Gradual Adoption of a Liberal Approach to Construction by the Federal Courts

Until the recent decision in *Comandate*, the Federal Court found itself constrained by the decision in *Hi-Fert*, which had adopted a restrictive approach to the construction of arbitration agreements.<sup>98</sup> For example, in the 2005 decision of *Walter Rau Neusser Oel und Fett AG v Cross Pacific Trading Ltd*<sup>99</sup>, Allsop J felt bound by the Full Court decision in *Hi-Fert* (despite the fact that he felt that that decision was inconsistent with the approach of other Australian courts and international practice) to exclude the claims under the *Trade Practices Act* that related to pre-contractual representations from the arbitration agreement in the absence of additional linking words in the arbitration clause.<sup>100</sup> However, with respect to the general approach to construing arbitration agreements, Allsop J observed that there was ‘no legal rule that a dispute necessarily falls within an arbitration clause’ and that there was ‘no legal presumption at work’.<sup>101</sup> The courts were required to adopt a liberal approach and would ‘presume that the parties did not intend the inconvenience of having possible disputes from their transaction being heard in two places.’<sup>102</sup>

It was only recently in the 2006 case of *Comandate* that the Full Court finally accepted the liberal approach to arbitration agreements that had been adopted by

96 Ibid [45], [51].

97 Ibid [123], [136].

98 Perhaps to avoid the constraints of *Hi-Fert*, in *Recyclers of Australia Pty Ltd v Hettinga Equipment Inc* [2000] FCA 547, Merkel J adopted the unique approach of focussing on the governing law of the contract to determine the scope of the arbitration agreement when assessing the words ‘all disputes hereunder’ and concluded that they encompassed trade practices claims. In that case, the governing law of the contract was the law of Iowa and the place of arbitration was Iowa. The parties had agreed that the scope of the arbitration agreement was to be determined by the law of Iowa. Justice Merkel said at [59] that the Australian cases were ‘not of assistance in determining the law of Iowa’. This approach needs to be contrasted with *Allergan* (where the governing law was New York law and the place of arbitration was New York) and *Hi-Fert* (where the governing law was English law and the place of arbitration was London) where the Court still applied the relevant state or federal law in Australia to determine the scope of the arbitration agreement.

99 [2005] FCA 1102.

100 Ibid [38]. The arbitration agreement provided for ‘any dispute arising out of this contract, including any question of law arising in connection therewith’.

101 Ibid [41].

102 Ibid [42].

the NSW courts. Justice Allsop, as a member of the Full Court,<sup>103</sup> stated that *Hi-Fert* could be distinguished on the basis that it did not deal with the words ‘arising out of’, the words in the arbitration agreement before the Court. Allsop J felt compelled to bring the Federal Court approach in line with modern authorities in Australia and overseas and due to the importance of the issue to international arbitration and international commerce in Australia, he went further and stated that the Full Court’s decision in *Hi-Fert* was ‘wrong’ and ‘inconsistent with modern authority’:

Because of the importance of the issue to commerce in this country, my view is that I should not merely expose my disagreement, but should take the step so far as it is up to me to bring the views of this Court into conformity with the Court of Appeal of New South Wales and other decisions of courts in Australia and elsewhere concerning the approach to the construction of arbitration clauses.<sup>104</sup>

Justice Allsop also disagreed with Beaumont J in *Allergan* to the extent that Beaumont J found that a claim under the *Trade Practices Act* could never be considered to be ‘arising out of a contract’.<sup>105</sup>

Justice Allsop re-emphasised the need for a ‘liberal approach’ to the construction of the arbitration agreement, particularly in the context of international commerce:

The court should, however, construe the contract giving meaning to the words chosen by the parties and giving liberal width and flexibility to elastic and general words of the contractual submission to arbitration.

This liberal approach is underpinned by the sensible commercial presumption that the parties did not intend the inconvenience of having possible disputes from their transaction being heard in two places. This may be seen to be especially so in circumstances where disputes can be given different labels, or placed into different judicial categories, possibly by reference to the approaches of different legal systems. The benevolent and encouraging approach to consensual alternative non-curial dispute resolution assists in the conclusion that words capable of broad and flexible meaning will be given liberal construction and content. This approach conforms with a common-sense approach to commercial agreements, in particular when the parties are operating in a truly international market and come from different countries and legal systems and it provides appropriate respect for party autonomy.<sup>106</sup>

After considering the significant number of authorities in England and Australia,<sup>107</sup> Allsop J concluded that:

[T]he words ‘arise out of the contract’ are apt, or at least sufficiently flexible, to encompass a sufficiently close connection with the making, the terms and the performance of the contract...The width of the phrase ‘arising out of’ in this context and its synonymity with the expression ‘in connection with’ reflect the practical, rather than theoretical meaning to be given to the word ‘contract’.<sup>108</sup>

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103 Justice Finkelstein agreed with Allsop J. Justice Finn also agreed with Allsop J’s construction of the scope of the arbitration agreement, including his comments on Emmett J’s reasoning in *Hi-Fert* and the fact that they were not bound by that decision.

104 [2006] FCAFC 192, [184].

105 *Ibid* [186].

106 *Ibid* [164]–[165].

107 See especially *Ethipion Oilseeds* [1990] 1 Lloyd’s Rep 86 (Hirst J) and *Francis Travel* [1996] NSWSC 104.

108 [2006] FCAFC 192, [175].



On this basis, Allsop J concluded that the arbitration agreement should be given a wide meaning to include representations made before the contract was entered into, and thus it extended to claims under the *Trade Practices Act* that related to the formation of the contract.

In a recent, post *Fiona Trust* decision, Mansfield J of the Federal Court in *Seeley*<sup>109</sup> was called upon to examine an arbitration agreement that expressly provided that the parties thereto were not prevented from seeking declaratory or injunctive relief (without specifying whether such relief was to be available from the courts or the tribunal). In refusing an application to stay court proceedings for declaratory relief in favour of arbitration, Mansfield J observed that a ‘robust and commonsense view’<sup>110</sup> to construing arbitration clauses should be adopted, and that it did not ‘flaunt business common sense that the parties, having agreed upon arbitrating their disputes, should nevertheless agree upon an optional alternative dispute resolution process – by way of court proceedings – in certain circumstances.’<sup>111</sup> Even though Mansfield J endorsed the decision in *Comandate* he did not appear to consider the presumption in favour of one-stop adjudication. When examining the wording of the arbitration agreement, Mansfield J emphasised the ‘care’ demonstrated by the parties ‘in arriving at, and expressing, their bargain’ and concluded that the ‘availability of such access to the courts would not defeat the commercial purpose of the agreement; indeed it may serve it’.<sup>112</sup>

## 6 Comparison with *Fiona Trust*

There remains a significant gap between the approach of the Australian courts to the interpretation of arbitration agreements and that articulated by the House of Lords in *Fiona Trust* (which approach was expressly noted to be in accordance with international practice).

Whilst the recent decisions of the Federal Court in *Walter Rau*, *Comandate* and *Seeley* have evidenced a move towards a more liberal approach to the construction of arbitration agreements, and a rejection of the restrictive approach adopted in *Allergan* and *Hi-Fert*, such decisions still fall short of adopting the presumptive approach as endorsed by the House of Lords in *Fiona Trust*. The commercial presumption in favour of one-stop adjudication was endorsed in *Comandate*, as the House of Lords acknowledged in *Fiona Trust*, but the Australian courts have not yet rejected the artificial differences that have been drawn between the common formulations used to describe the scope of arbitration agreements nor have they explained what can rebut the presumption in favour of one-stop adjudication.

It is therefore the authors’ view that, in order to ensure that the approach of the Australian courts is consistent with international practice, the Australian High Court - when next given the opportunity - should endorse the presumptive

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109 [2008] FCA 29.

110 *Ibid* [36]

111 *Ibid* [37].

112 *Ibid*.

approach presented by the House of Lords, ‘draw a line’ beneath the authorities that have undertaken too semantic an analysis of arbitration agreements, and emphasise that ‘very clear wording’ to the contrary is required to rebut the presumption that the parties intended all disputes between them to be submitted to the same tribunal.

## B The Principle of Separability

### 1 Separability Under the IAA

The principle of separability has been recognised and endorsed by the Australian Legislature and the courts. It was confirmed by statute in Article 16(1) of the Model Law when it was incorporated into the IAA. Article 16(1) provides that:

The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an 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.<sup>113</sup>

### 2 Early Rejection of Separability by the Federal Courts

The principle of separability has also been recognised and endorsed by the Australian courts although the path to doing so has not been smooth. For example, the following statement was made in the NSW Supreme Court:

For reasons which I have already discussed, an arbitrator is not able to decide, or make a declaration, that the contract containing the submission is void ab initio for that would be tantamount to deciding he had no jurisdiction at all. That this is the law has been long understood and there is no reason that principle should not operate to exclude from the ambit of an arbitrator’s powers that authority to make a declaration under s 87 [under the TPA] that a contract is void ab initio.<sup>114</sup>

This obiter statement by Clarke JA in *IBM Australia*, together with a similar statement by Handley JA,<sup>115</sup> was heavily criticised for ignoring the principle of separability, and hence being in conflict with the IAA and inconsistent with international arbitration practice.<sup>116</sup> In *QH Tours*,<sup>117</sup> Foster J of the Federal Court, considered that ‘generally speaking, [an arbitration clause] can be regarded as severable from the main contract with the result that, logically, an arbitrator, if otherwise empowered to do so, can declare the main contract void ab initio without at the same time destroying the basis of his power to do so.’<sup>118</sup>

113 Section 1(1) and 1(2) provide that Article 16(1) applies to international arbitrations if the place of arbitration is within Australian territory.

114 *IBM Australia* (1991) 100 ALR 361, 379 (Clarke JA). Justice of Appeal Clarke relied upon *Heyman v Darwins Ltd* [1942] AC 356, 367, 383, 395; and *Codelfa Constructions Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 (*‘Codelfa’*), 364 (Mason J) particularly.

115 (1991) 100 ALR 361, 381.

116 See Professor The Hon Andrew Rogers QC and Rachel Launders, ‘Separability – the Indestructible Arbitration Clause’ (1994) 10 *Arbitration International* 77.

117 (1991) 105 ALR 371.

118 *Ibid* 384.

### 3 *Acceptance of Separability by the NSW Courts*

Subsequent decisions of the NSW courts have not followed Clarke JA's statements in *IBM Australia*. The Court of Appeal in *Ferris v Plaister*<sup>119</sup> confirmed the principle of separability as part of Australian law. In considering the question of separability, Kirby P gave extensive consideration to the approach of the courts in England, the United States and other common law jurisdictions, as well as various civil law jurisdictions, and drew analogies with other areas of law. He also considered the acceptance of separability by the Australian Legislature, bringing Australian law in line with international practice. After examining the practical reasons and the need for a common approach, Kirby P rejected Clarke JA's statements in *IBM Australia* and followed the 'trend of legal authority'.<sup>120</sup> He concluded that the principle was the 'preferable approach'<sup>121</sup> to be taken by the Australian courts:

Depending upon the language of the particular arbitration clause in question I would therefore accept that an arbitrator may, in principle, decide that the contract (containing the arbitration clause) is void *ab initio* without thereby depriving the arbitrator of jurisdiction. The arbitrator does not thereby destroy the arbitral jurisdiction or the authority to make an award. To the extent that *obiter* remarks in *IBM* (above) suggested otherwise, I would not follow them.<sup>122</sup>

President Kirby referred to two limitations of the principle of separability recognised by the Bermudan Court of Appeal: first, where the existence of the contract itself was contested; and, secondly, 'where the attack is not upon the principal agreement but upon the validity of the arbitration clause itself'<sup>123</sup> and concluded that they did not apply in *Ferris v Plaister*.<sup>124</sup>

Justice of Appeal Clarke agreed that there was 'nothing in the evidence to suggest that the misrepresentation tainted the arbitration agreement'.<sup>125</sup> He concluded that it was not only desirable to give effect to the parties' rights to choose a tribunal to resolve their disputes, but 'even more compelling[ly]', it was undesirable that parts of the claim be heard by a tribunal and parts heard by a court. There would need to be 'compelling reasons' before the court ignored the parties' choice and split the dispute between a tribunal and a court.<sup>126</sup>

### 4 *'Qualification' on Separability – Doing 'Justice' to the Parties*

However, in contrast to the decisions of Kirby P and Clarke JA, Mahoney JA was reluctant to surrender authority to an arbitral tribunal in circumstances where justice would be 'best served' by resolution of the dispute within the courts. Mahoney JA stated:

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119 (1994) 34 NSWLR 474.

120 *Ibid* 489.

121 *Ibid* 485.

122 *Ibid* 492.

123 *Ibid* 487. President Kirby quoted from *Sojuznefteexport (SNE) v Joc Oil Limited* [1990] 15 *Yearbook of Commercial Arbitration* 384.

124 *Ibid*.

125 *Ibid* 504.

126 *Ibid*.

I accept the device of severability as a useful device for achieving the accommodation of legal logic ('the invalidity of the contract carries with it the invalidity of the arbitration clause') to the wide view of the scope of an arbitration clause. But I would add a qualification. The court should keep steadily in mind that its function is to decide what is before it, a particular dispute between particular parties, and to decide it in a way which will do justice between them. Its discretions are to be exercised and legal devices are to be employed so that that function is performed...[T]he existence of an arbitration clause does not oust the jurisdiction of the Court to determine the dispute: it gives to the Court a discretion to stay the proceeding before it and permit arbitration or to allow the proceeding to continue and to stay the arbitration. There are cases in which the dispute is such that justice will be best served by allowing the Court to resolve it...If this be so, the Court should not be diverted from the procedure which will best achieve justice in the particular case by current enthusiasms.<sup>127</sup>

Justice of Appeal Mahoney's exceptional comments appear to have been motivated by a misconception that arbitration was nothing more than a passing fad:

In saying these things, I do not deprecate the use of arbitration for the resolution of disputes or the current enthusiasm for it...But in the light of experience, enthusiasms wane as well as wax. And what is to be seen to have been intended in international disputes is not necessarily what was intended by the parties to, as here, a dispute between a small builder and two home owners about work on domestic dwellings. The Court must, I think, maintain a firm grip upon reality in deciding what was intended and what it should do.<sup>128</sup>

Whilst these comments were made in the context of a domestic arbitration and Mahoney JA may have sought to distinguish international arbitration, there is still a serious risk that they will have an adverse affect upon the development of international arbitration practice in Australia, as observed by one practitioner:

Although Mahoney JA states that he does not intend to 'deprecate the use of arbitration', it is difficult to envisage a statement that could be more disparaging of the status of arbitration in Australia. While it is tempting to dismiss these statements as being representative of the minority view of a lone judge, following the *obiter* statements of the court in *IBM*, there is a significant risk that these statements may be seized upon by subsequent courts in defence of the position that an arbitrator is not entitled to determine the validity of the arbitration agreement from which it derives its power.<sup>129</sup>

So far Mahoney JA's statements have not been applied by other courts. However, despite the lengths that the Court of Appeal went to, to dispel the misconception in Australian law that an arbitral tribunal could not determine whether a contract was void ab initio, *Ferris v Plaister* appears to have been ignored by Austin J in *ACD Tridon*. In considering whether a matter was arbitrable, Austin J referred to *IBM Australia* and took the view 'on the present state of authority'<sup>130</sup> that there was a limitation preventing an arbitral tribunal from having the power to declare a contract void ab initio. Whilst he noted that

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127 Ibid 497.

128 Ibid 487.

129 Jennifer Galatas, 'The Role and Attitude of the Courts in Australia in relation to International Commercial Arbitration' (2005) 27 *The International Construction Law Review* 44.

130 [2002] NSWSC 896, [187].

Foster J had taken a different approach in *QH Tours*, he did not refer to the endorsement of separability in *Ferris v Plaister*.<sup>131</sup>

### 5 Endorsement of Separability by the Federal Court

Consistent with international practice, subsequent cases have accepted the principle of separability even in the face of allegations of fraud, unless the allegations have been directed to the arbitration agreement itself. As Allsop J stated in *Walter Rau*, after referring to *Ferris v Plaister*:

The arbitration clause is seen as constituting a severable and separate agreement between the parties. Thus, what is required for s7(5) to be engaged and to justify the matter of avoidance for fraud or otherwise not being referred to the arbitrator for decision, is that the fraud or vitiating conduct be directed to the arbitration clause itself.<sup>132</sup>

Similarly, the Full Court of the Federal Court endorsed separability in *Comandate*, in a decision that was directly referred to by the House of Lords in *Fiona Trust*. Justice Allsop in *Comandate* again considered *Ferris v Plaister*, recognising that the case was ‘in conformity with the development of the common law in other jurisdictions’,<sup>133</sup> including England.<sup>134</sup> He acknowledged that the principle was now incorporated in the English Act as well as the Model Law.<sup>135</sup> Allsop J rejected the argument that ‘this doctrine of separability was not part of the law of Australia’<sup>136</sup> and dismissed criticism of separability on the basis that it was ‘sometimes said to be based on a fiction’.<sup>137</sup> Upholding *Ferris v Plaister*, he concluded:

[T]he doctrine of separability is not so much a fiction as an approach by the law to accommodating commercial practicality and commonsense to the operation of legal rules. Commercial law and honest, practical common sense should never be far apart. The approach to construing and dealing with commercial contracts in this way, subject always of course to the particular contract at hand, is not to introduce a fiction, but to apply a legal rule or perspective borne of precedent and common sense better to facilitate the intentions (express and inferred) of the commercial parties involved.<sup>138</sup>

131 If it was not for the extensive consideration of international arbitral practice, including that of the English and the United States courts, by Kirby P and Clarke JA, *Ferris v Plaister* could be seen as irrelevant as it was a domestic, rather than international, arbitration case.

132 [2005] FCA 1102, [89].

133 [2006] FCAFC 192, [222].

134 Justice Allsop also rejected the approach of Mason J in *Codelfa* on the basis that he was not dealing with the question of separability but the jurisdiction of the arbitrator. Justice Allsop focused on the need for ‘commercial practicality and commonsense to the operation of legal rules’: [2006] FCAFC 192, [228].

135 Article 16(1) did not apply in this case as the seat was not in Australia.

136 [2006] FCAFC 192, [220].

137 *Ibid* [228].

138 *Ibid*.

## 6 Comparison with Fiona Trust

There is a significant degree of overlap between the approach of the Australian Courts to the principle of separability and the reasoning employed by the House of Lords in *Fiona Trust*. The dismissal of any criticism of the principle as a ‘legal fiction’ in *Comandate*<sup>139</sup> is echoed in Lord Hoffmann’s rejection of ‘conceptual obstacles’.<sup>140</sup> As emphasised by Clarke JA in *Ferris v Plaister*, separability is supported by ‘practical and commercial reasons’ that the parties are unlikely to want ‘to bear the increased legal costs flowing from having parts of their disputes heard in one tribunal and parts in another’<sup>141</sup>. Similarly, Lord Hoffmann refers to commercial reasons of ‘practical businessmen’ in favour of ‘quick and efficient adjudication’ before an arbitral tribunal in support of the principle of separability.<sup>142</sup> However, Australian law does not go as far as English law in its endorsement and delineation of the principle of separability. What remains to be clearly enunciated in Australian law is a test for the limits of the principle of separability. President Kirby in *Ferris v Plaister* referred to circumstances where the existence of the contract itself was contested<sup>143</sup> and ‘where the attack is not upon the principal agreement but upon the validity of the arbitration clause itself’<sup>144</sup> as qualifications to the separability principle and *Walter Rau* demands that ‘the fraud or vitiating conduct be directed to the arbitration clause itself’<sup>145</sup> for the principle of separability not to apply.

While the acceptance of the principle of separability in *Ferris v Plaister* was wholeheartedly endorsed in *Comandate*,<sup>146</sup> *Comandate* remains silent on the limits of the principle. Furthermore, no express denunciation of Mahoney JA’s wide ‘qualification’ of the principle in order ‘to decide in a way which will do justice’ to the parties has taken place and inconsistent judgments, such as that in *ACD Tridon*, have so far prevented any definitive statement of the Australian law position on separability from being made.

When the High Court is next seized of an argument relating to separability, the Court should take the opportunity to provide a clear summary of the principle, including its limitations, such as that presented by the House of Lords in *Fiona Trust (HL)*, in order to remove the inconsistencies currently existing in the case law, and to confirm that Australian law is consistent with international practice.

## IV CONCLUSION

As one commentator has pointed out, ‘[i]n terms of what the case strictly decided - that a claim that a contract was procured by bribery arises ‘under’ or

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139 Ibid.

140 [2007] Bus L R 1719, 1725.

141 (1994) 34 NSW LR 474, 504.

142 [2007] Bus LR 1719, [6].

143 Reference to this exception to the principle of separability is made by Lord Longmore in *Fiona Trust (CA)* at 272.

144 President Kirby quoted from from *Sojuznefteexport (SNE) v Joc Oil Limited* [1990] Yearbook of Commercial Arbitration XV 384.

145 [2005] FCA 1102, [89].

146 [2006] FCAFC 192, [228].

‘out of’ a contract and that a general defect in a contract containing an arbitration clause does not render the arbitration clause ineffective to vest jurisdiction in the arbitral tribunal to determine the issue of that defect – *Fiona Trust* actually broke little new ground.<sup>147</sup>

Nevertheless, the Court of Appeal and the House of Lords in *Fiona Trust* took the opportunity unequivocally to set out a presumptive approach to be taken to the construction of arbitration clauses, to explain what circumstances will rebut this presumption and to fully endorse the principle of separability and clearly delineate its limits, thus bringing English law in line with international commercial practice. Confirming the *Kompetenz-Kompetenz* doctrine, *Fiona Trust* sent a clear signal that the scope of the arbitral tribunal’s jurisdiction should initially be decided by the arbitral tribunal itself and not by the courts.

Whilst the English law position on the construction of arbitration clauses was at the risk of being isolated prior to *Fiona Trust*, Australian case law has had to grapple with the additional tension created between the parties’ autonomy to submit disputes to arbitration and parallel claims in the context of the *Trade Practices Act* and other statutes. This – together with a less positive approach to arbitration overall in some Australian Courts - has resulted in decisions focussing on the ‘linguistic nuances’ dismissed by the House of Lords. Similar to the position in English law prior to *Fiona Trust*, Australian law would benefit from a decision of its highest court aimed at definitively stating the Australian law approach to the construction of arbitration agreements and to the principle of separability, and ensuring that the law is in line with international practice. It is the authors’ view that such a decision should, firstly, establish a presumptive approach to the construction of arbitration agreements in favour of one-stop adjudication, together with a statement that only ‘clear words’ to the contrary will rebut this presumption and a rejection of any further semantic discussions of ‘linguistic nuances’. Secondly the decision should fully endorse the acceptance of the principle of separability that has already taken place and establish a definitive test delineating the limits of the principle.

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147 Elizabeth Snodgrass, ‘*Fiona Trust v Privalov*: the Arbitration Act 1996 Comes of Age’ (2007) 10(2) *International Arbitration Law Review* 1, 30.