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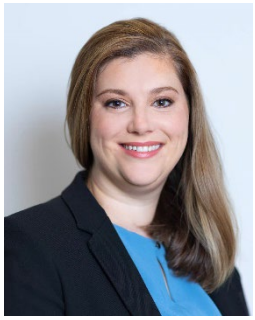
The Separability Principle: the *Newcastle Express* Case



Article by Stuart Isaacs KC and Elizabeth Houghton, 10th June 2023

Ever since the House of Lords decision in *Fiona Trust & Holding Corporation v Privalov* [2007] UKHL 40, the principle of the separability of arbitration agreements has been the subject of much debate. Attention continues to be drawn to the distinct nature of an arbitration agreement within a contract. In last month's article in this series, the question of the governing law of an arbitration agreement as being potentially distinct from the governing law of the contract in which it appears was considered, in the context of the Singapore Court of Appeal's important decision in *Anupam Mittal v Westbridge Ventures II Investment Holdings* [2023] SGCA 1.

In *DHL Project v Gemini Ocean Shipping (The Newcastle Express)* [2022] EWCA Civ 1555 the English Court of Appeal has returned to consider the separability principle and has limited the scope of its application. Again like *Mittal*, the case is also another illustration of the cross-fertilisation of English and Singapore law in the arbitration field.

In simple terms, the separability principle is that an arbitration clause in a contract is not affected by invalidity or termination of the main contract in which it appears since it exists as a separate agreement.

In *The Newcastle Express*, the Court of Appeal distinguished between contract formation and contract validity: although the separability principle applied to contract validity, it did not apply to contract formation. In effect, if a contract containing an arbitration agreement never came into effect (in this case, because a pre-condition was not met) then the separability principle did not apply and could not rescue the arbitration agreement. In contrast, where a contract is formed but later found to be invalid (by reason of mistake, misrepresentation or duress, for example), then the arbitration agreement survives the invalidity of the main contract.

The separability principle is given statutory effect by section 7 of the Arbitration Act 1996 (the **Act**) 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 Newcastle Express concerned whether a concluded agreement had been reached between the parties, and whether an arbitration clause in the purported main agreement gave rise to a binding arbitration agreement.

The facts of the case are somewhat complex. In brief, the Owner of the vessel *Newcastle Express* and the Charterer were negotiating via a broker a proposed voyage charter for the carriage of coal from Newcastle, Australia to Zhoushan, China. The main terms of the charterparty had been agreed but the charterparty was subject to a condition precedent that the "shipper/receivers" give their approval to the vessel (the **Pre-Condition**). The recitals recorded that "Rightship Inspection" - a widely used vetting system which identifies vessels which are suitable for the carriage of iron ore and coal - was to be conducted on 3 September. The Owners were to provide the required certifications at the latest before vessel sailing (intended to be on 5 September). Clause 17 of the charterparty contained a choice of law and arbitration clause.

By 3 September, Rightship approval had not been obtained. That led to a series of messages from the Charterer that day to the effect that the shippers did not accept the vessel because Rightship approval had not been obtained and that the Owner should consider the vessel "free". It was common ground that, at the times the messages were sent, the Charterer had not fulfilled the Pre-Condition and, specifically, had not confirmed to the Owner that there had been approval by the shipper or the receiver.

The Owner claimed that a binding charterparty containing an arbitration clause had been concluded which the Charterer had repudiated because the Owner had until 5 September to obtain Rightship approval. The Owner accordingly commenced an arbitration against the Charterer. The Charterer's position was that there was no binding contract because the Pre-Condition had not been fulfilled and, accordingly, no binding arbitration agreement. The Charterer did not participate in the arbitration. The arbitrator found in favour of the Owner and awarded damages of US $283,416.21 plus interest and costs. The Charterer then applied under section 67 of the Act challenging the award on the ground that the arbitrator had no substantive jurisdiction or in the alternative seeking permission to appeal on a question of law under section 69 of the Act.

Jacobs J at first instance concluded that the Pre-Condition had not been fulfilled: the Pre-Condition applied to the arbitration clause just as much as to the rest of the contract. Accordingly, the arbitrator lacked jurisdiction and the section 67 challenge succeeded. The Court of Appeal upheld the first instance decision.

Before the Court of Appeal, the Owner submitted the separability principle applied where the main contract was invalid or even non-existent. The Court of Appeal rejected this submission and concluded that the separability principle did not extend to cases of contractual formation. Accordingly, the principle did not apply where the main contract was "non-existent".

The Court of Appeal said at [47]:

> *[…] where the issue is one of contract formation, it will generally impeach the arbitration clause: the argument "I never agreed to that" applies to the arbitration clause as much as it does to any other part of the contract. But where the issue is*

> *one of contract validity, that is not necessarily so. It is necessary "to pay close attention to the precise nature of each dispute" in order to see whether the ground on which the main contract is attacked is one which also impeaches the arbitration clause.*

The Court found that the judgment of Steyn J in *Harbour v Kansa* [1992] 1 Lloyd's Rep 81 and the Court of Appeal decision in that case ([1993] QB 701), as well as the *Fiona Trust* decision, were consistent with an approach which distinguished between contractual formation and contract validity. The Court noted that a similar approach has been adopted in Singapore in *BCY v BCZ* [2016] SGHC 249.

In summary, the Court of Appeal concluded that the Pre-Condition applied to all of the proposed charterparty, including the arbitration clause. Because the Pre-Condition was not fulfilled, both the main contract and the arbitration clause did not come into effect. The separability principle had no application in this case.
The case is a welcome restatement of the separability principle. It provides a clear and logical distinction between cases where the separability principle applies, and those where it does not. The Court of Appeal judgment gives practitioners a clear roadmap as to how Courts will deal with the separability principle on particular facts. However, there are nonetheless likely to be difficult cases, of which some have already emerged in practice in arbitrations which have not (yet) found their way to the courts, where the line between contract formation and contract validity is blurred.

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