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The existence of a valid arbitration agreement as a prerequisite for arbitration

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Abstract
The parties' arbitration agreement confers the power to resolve the dispute on the arbitrators. By virtue of the principle of separability, the arbitration agreement is regarded as separate and distinct from the main contract. This article examines the principle that a valid arbitration agreement is essential for arbitral proceedings. It highlights the functions of an arbitration agreement, and analyses the necessary requirements which must be present for an arbitration agreement to be considered as valid. This analysis is relevant in light of the fact that there is no basis for the conduct of arbitral proceedings with a view to settling the dispute between the parties in the absence of a valid arbitration agreement.

Keywords: arbitration, arbitration agreement, dispute, validity, separability

Introduction

A consequence of consenting to the use of arbitration for the resolution of disputes by parties in an arbitration agreement is the 'relinquishment of an important right - to have the dispute resolved judicially' [1] Fundamentally therefore, where a dispute covered by an arbitration agreement is referred to a court for determination, the courts are in most cases required, under the various applicable laws to refer the parties back to arbitration. An example of such a provision is Article II (3) of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention) which provides that a court '…when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration…'. Nevertheless, the court may in some instances, preside on a case, where it '…finds that the said agreement is null and void, inoperative or incapable of being performed…'. It follows therefore that in order to have a valid arbitration agreement and proceed to have the dispute settled by arbitration certain requirements must be fulfilled.

Arbitration is 'a process used by the agreement of the parties to resolve disputes. In arbitrations, disputes are resolved, with binding effect, by a person or persons acting in a judicial manner in private, rather than by a national court of law that would have jurisdiction but for the agreement of the parties to exclude it'. An arbitration agreement therefore, 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' [3] It is usually referred to as the 'foundation stone' of arbitral proceedings and serves as proof that the parties are willing to have their dispute settled through arbitration [2]. Contrary to what is obtainable under the legal systems of various countries, whereby the power of a court to adjudicate on a particular matter is derived from statutes, the power of the arbitrator(s) to settle the dispute arises from the agreement made by the parties to have the matter resolved by arbitration [4]. An arbitration agreement therefore contains the extent of the arbitrator's authority in respect of the matter in question. The agreement to submit a dispute to arbitration has been said to be contractual and jurisdictional in nature. It is considered contractual because it involves a consensus between the parties [5] and jurisdictional because it vests the arbitrator(s) with the power to make a decision about the issue in dispute [6]. The agreement to refer a dispute to arbitration may be made either by the use of an arbitration clause or a submission agreement. The arbitration clause covers potential disputes which may occur between the parties in the course of carrying out the terms of the contract or arrangement. Submission agreements on the other hand are arbitration agreements which are entered into when there is in fact a disagreement between the parties to a contract or some other form of agreement. Although arbitration clauses are often part of a contract or agreement between the parties, it is in most cases regarded as independent of that contract [7].

The principle of separability ensures that an arbitration clause contained in a contract is a free-standing contract of its own. The effect of this is that in the event of the main contract being declared void this will not affect the arbitration clause and so arbitral proceedings can still take place in respect of any dispute between the parties. Furthermore, it gives the arbitrators the chance to decide on the issues between the parties which is the reason why the arbitration agreement was entered into in the first place [8]. This provides protection against any calculated act of a party to deprive the other of a fair determination of the issues in contention. The importance of the principle is recognised and it is provided for in both domestic arbitration laws and international rules. Article 16 of the UNCITRAL Model Law 1985(Model Law) 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.

This position has also been reflected in judicial decisions in different countries. The United States (US) Supreme Court in *Prima Paint Corp v Flood Conklin Manufacturing Corporation (Prima* case*)* [9] noted that as a result of the separability of the arbitration clause from the contract in which it was contained the arbitrators could decide on the matter since the allegation of fraud did not concern the arbitration clause and so '… a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud'. In support of the decision in the *Prima* case it has been posited that the principle of separability requires that a claim that the main contract which contains the arbitration agreement is void should not be taken to affect the validity of the arbitration agreement unless called into question by one of the parties [10]. In *Fili Shipping Co Ltd and others v Premium Nafta Products Ltd and others* (on appeal from Fiona Trust) [11] the claimants based on accusations that the charterparties had been obtained by bribery instituted the action for the invalidation of the charterparties which included arbitration agreements. The House of Lords affirming the decision of the Court of Appeal held that by virtue of the arbitration agreement being separate from the contract it could not be said to be unenforceable because of the nullity of the contract as the arbitration agreement is a 'distinct agreement' which can only be rendered unenforceable for reasons solely related to it.

The separability of the arbitration agreement will however be defeated where the same matter which has rendered the contract void is also a part of the arbitration agreement. This was noted in *Fili Shipping Co Ltd and others v Premium Nafta Products Ltd and others* [12] where it was stated that in a situation where an arbitration clause is contained in a contract and one of the parties to the said contract insists that he was never a party to the contract as his signature was forged, the validity of the arbitration agreement will be called into question. A possible effect of the autonomy or separability principle is that the law which governs the arbitration agreement may not be the same as the law that governs the contract by reason of which the arbitration clause came into existence [12].

Validity of An Arbitration Agreement

The validity of the arbitration agreement is usually called into question when one of the parties is unwilling to submit to arbitration when there eventually is a disagreement, and as a result it is vital that the parties ensure when making the arbitration agreement that it conforms to all the necessary requirements [13]. The New York Convention and the Model Law contain provisions on the requirements which will ensure that the agreement to arbitrate will be considered valid. By virtue of the provisions of article II(1) of the New York Convention and article 7(1) of the Model Law the arbitration agreement must be in writing, in respect of potential or already existing disagreements, relating to a 'defined legal relationship' and the dispute must be over an issue which can be resolved by arbitration [14]. In addition it is also vital that the parties have the legal capacity to enter into an arbitration agreement [15]. These conditions which are necessary to ensure the validity of the arbitration agreement are discussed below.

A Written Agreement

One of the fundamental tenets of arbitration is the requirement of consent, that is under arbitration it is vitally important that the parties bringing the dispute for settlement have agreed that arbitration is the means of alternative dispute resolution by which they want the matter resolved. The condition that the arbitration agreement be made in writing therefore arises from the need to ensure that this consent has been duly obtained [16]. In addition, the written arbitration agreement serves as proof when a dispute does arise, of the terms of the agreement [16]. The requirement that the arbitration agreement should be in writing is contained in both the New York Convention and in the arbitration laws of various countries. By virtue of Article II (2) of the New York Convention an 'agreement in writing' refers to '…an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams'. With time, however, it was realised that the writing requirement contained in Article II of the New York Convention and Article 7 of the Model Law were not up to date and it was necessary to adjust the requirement to conform with what is currently obtainable with regard to the different means of communication in use [17]. This led to recommendations being put forward by UNCITRAL on the application of Articles II (2) and VII (I) of the New York Convention. With respect to Article II (2) it has been suggested that it is should be used 'recognizing that the circumstances described therein are not exhaustive' [18]. Furthermore, it has been recommended that Article VII (1) of the New York Convention which provides for a 'more favourable right' [19] should also be used in respect of arbitration agreements. This means that a party should be able to enforce the validity of an arbitration agreement in a country where the provisions of the law are wider or more lenient than the provisions of the Convention. It is submitted that while this recommendation is welcome because it is a realization of the need for the New York Convention to be more in line with the practice today, it may be argued that the failure to refer to any particular elements regarding the writing requirement add to the inconsistency which is feared will result [20] on amendment of the Convention. On the other hand, it is obvious that the recommendation will help the courts in different counties to interpret Article II of the Convention more liberally [21].

Additionally, the Model Law was amended and as a result, article 7 provides two options for countries to implement. The first option in article 7(3) and (4) provides for the arbitration agreement to be in writing and states that such an agreement is deemed to be written when it is 'recorded in any form' even if it was 'concluded orally' and includes 'electronic communication…accessible…for subsequent reference…'. It has been noted that the words 'subsequent reference' signify that irrespective of the form which the arbitration agreement takes its contents should be retrievable and capable of being reproduced in writing [22]. The second option of Article 7 of the Model Law does not contain any provision for the arbitration agreement to be written. An arbitration agreement is simply described as 'an agreement by the parties to submit to arbitration all or certain disputes'. However, it has been pointed out that a problem which may arise from making arbitration agreements which are not in the traditional written form is that the final award may not be recognised in the jurisdiction where it is sought to be enforced [24]. The problem with this option is that a party who entered into an oral arbitration agreement may take advantage of it to deny the existence of an arbitration agreement knowing that there is no documentary proof that such an agreement was ever made. It has been noted that the introduction of two options in respect of the writing requirement in the model law does not promote uniformity in the practice of international arbitration [23]. Article 7(6) of the Model Law also provides that an arbitration agreement will be deemed to be in writing where an arbitration clause contained in a separate document is properly incorporated by reference.

Defined Legal Relationship

Arbitration is usually the result of a dispute between parties who are connected in some way by a contract [25]. The arbitration agreement must cover disagreements which are '…in respect of a defined legal relationship…'. This means that must be in existence a link which is recognised in law 'whether contractual or not' [26]. It follows therefore that by virtue of the provisions of the New York Convention and the Model Law a disagreement based on 'tortious or delictual liabilities' will be subject to arbitration [27]. In *Kaverit Steel Crane Limited v Kone Corporation* [28] the Alberta Court of Appeal held that any disagreement between the parties which arose from the contract even though it was of a tortious nature could be arbitrated upon because the arbitration clause was widely drafted and the disagreement stemmed from a contract between the parties. Depending on the pertinent laws in a particular country an arbitration agreement determines the extent of the arbitrators' authority and jurisdiction and as a result it is important that the arbitration agreement is properly drafted to cover all possible disagreements which may occur between the parties [29]. The arbitrators will examine the arbitration agreement to determine whether the issue in question is covered by the arbitration agreement. In *Fili Shipping Co Ltd v Premium Nafta Products Ltd* [30] it was stated that it is naturally presumed that the parties entered into the arbitration agreement with the view that all disagreements 'arising out of the relationship' would be settled by arbitration.

Arbitrability

In order for an arbitration agreement to be regarded as valid the disagreement between the parties must be in respect of a matter which can be resolved by arbitration. The laws of a particular country may contain provisions on issues which can be the subject of arbitral proceedings, this is referred to as 'objective arbitrability'. In the event that any of the matters regarded as inappropriate for arbitration is decided on by arbitrators there is a possibility that the award will not be recognised [31]. The question of which matters can be the subject to arbitration is dependent on the public policy of the particular state concerned, which will require that such matters be decided on only by the law courts [32]. In addition to the requirement in article II(1) that the disagreement must be one which can be resolved by arbitration, the New York Convention in article V(2)(a) also provides that an arbitral award may not be enforced in a particular country if by virtue of its laws the disagreement is one which cannot be resolved by arbitration. Similarly, article 1(5) of the Model Law provides that it will have no effect on any applicable law which provides for the type of disagreements which may be subject to arbitration.

In recent times the courts in some countries have held that certain matters which used to be regarded as unsuitable for arbitration can in fact be subject to arbitration. Antitrust or competition law matters which used to classified as not being arbitrable have been held to capable of being resolved by arbitration. In *Mitsubishi Motors Corporation v Soler Chrysler Plymouth Inc* [33] the US Supreme Court held that the provisions of the Federal Arbitration Act did not preclude disagreements concerning antitrust matters in international contracts from being arbitrated. The arbitrability of matters dealing with securities has also been accepted by the US Supreme Court, in *Scherk v Alberto-Culver* [34] where it was held that the decision to submit any disagreement based on an international contract was to be recognised by the courts.

Capacity

The rule that parties must be capable under the relevant law of entering into a contract or agreement in order for the said contract or agreement to be binding also applies in respect of the arbitration agreement. The lack of capacity of any of the parties to the arbitration agreement will render the agreement void [34]. The capacity of the parties to enter into an arbitration agreement is decided by the relevant law which 'is applicable to them' [35] or in the case of a company by the law of the place of registration, location of its offices and the provisions of the documents of incorporation [36]. In an instance where a company has offices in different locations article 1(4)(a)

of the Model Law provides that the law of the place 'which has the closest relationship to the arbitration agreement' will be the law used to determine its capacity, as the location in question will be deemed to be its 'place of business'. Additionally, state and public entities may be parties to an arbitration agreement depending on the provisions of the relevant law [37]. The lack of capacity of one of the parties to the arbitration agreement may be raised and dealt with as provided under the provisions of the New York Convention or the Model Law either on commencement of the arbitral process or at the stage of enforcement of the award [38]. An action may be instituted by one of the parties on commencement of the arbitral proceedings on the ground that the arbitration agreement is 'void, inoperative or incapable of being performed' [39]. In the alternative, if the party against whom the award has been made is able to establish to the satisfaction of the court that any of the parties lacked capacity under the relevant law at the time the arbitration agreement was made, the award will not be enforced [40].

Although consent to settle the disagreement between the parties by arbitration is a fundamental aspect of arbitration there are instances where parties who did not directly enter into the arbitration agreement will nevertheless be bound by it [41]. This occurs in cases concerning related companies also known as the 'group of companies' doctrine, in *Dow Chemical France v ISOVER Saint Gobain (France)* [42] the main company within a group was allowed to be part of the arbitral proceedings because it had taken part in the making and execution of the terms of the contract.

Law Governing the Arbitration Agreement

The issue as to whether the arbitration agreement is valid may be called into question at any point during arbitration including when the award is sought to be enforced. Although the parties will have stipulated the particular law which will be used to settle the dispute between them this does not mean that it is the same law that governs the arbitration agreement [43]. An arbitration agreement may be governed by a particular law chosen by the parties in dispute. Where there is no provision for the law which is applicable to the arbitration agreement and by extension to deal with issues concerning the validity of the agreement, it may be decided that either the law applicable to the contract or the law of the seat of arbitration is the law which governs the arbitration agreement [44]. It has been posited that the appropriate law which should govern the arbitration agreement is the law which is applicable to all the terms of the main contract which contains the agreement to submit the dispute to arbitration [45]. In *Sulamerica Cia Nacional de Seguros SA and others v Enesa Engenharia SA and others (Sulamerica)* [46] it was noted that it may be assumed that the law applicable to the entire contract also covers the arbitration agreement where no obvious choice has been made. However, the separability of the arbitration agreement makes the question of which law governs the arbitration clause a pertinent one, because if an arbitration agreement is really separable from the main contract it may be argued that it cannot be said to be subject to the same law which is applicable to the said contract [47].

The law of the seat of arbitration may also be regarded as the law which is applicable to the arbitration agreement [48]. Under Article V (I) (a) of the New York Convention an arbitration agreement will be valid by virtue of the law of the seat of arbitration in a situation where the parties did not choose a particular law to govern the arbitration agreement [49]. In the *Sulamerica* case [50] the English Court of Appeal held that by electing to have the arbitral proceedings held in London the parties intended for English law to govern the arbitration agreement. In criticizing the judgement of the Court of Appeal in the *Sulamerica* case, it has been postulated that noting the importance of having regard to the implied choice of the parties when determining the law governing the arbitration agreement without an in-depth explanation as to why the law of the seat of arbitration was applicable only serves to create confusion in respect of a matter which was previously generally understood [51].

The question of what law governs the arbitration agreement is a vital one which has been treated differently in various countries. In France, the law which governs the arbitration agreement is decided by having regard to the intentions of the parties [52]. In *Municipalite de Khoms El Mergeb c/Ste Dalico* [53] it was held that the question of whether an arbitration agreement is valid will be decided by considering the 'parties common intention, there being no need to refer to any national law'. The French position was noted by the UK Supreme Court in *Dallah Real Estate and Tourism Holding Co V Ministry of Religious Affairs, Government of Pakistan* [54] where it was stated that 'arbitration agreements derive their existence, validity and effect from supra-national law, without it being necessary to refer to any national law'.

Conclusion

'The arbitration agreement is the foundational contract in any consensual arbitral reference' [55]. Therefore, the validity of an arbitration agreement is extremely fundamental, specifically because when parties agree to arbitrate, they relinquish the right to bring an action in court in respect of the dispute in question. In order to ensure that the parties have agreed to submit the dispute to arbitration and that the arbitration agreement is valid and enforceable, several requirements have been created to guarantee that the arbitration agreement does not give rise to issues which will render it void. These requirements as discussed above include the form of the arbitration agreement, existence of a relationship recognised under the law, capacity of the parties and an appropriate subject matter for resolution by arbitration. Where all these requirements are fulfilled it entrenches the validity of the arbitration agreement and there cannot be said to be an impediment to the successful conduct of arbitral proceedings based on questions as to the whether the arbitration agreement is valid.

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