Arbitration agreements "subject to contract", and the limited scope of the separability principle (DHL Project & Chartering Ltd v Gemini Ocean Shipping Co Ltd [2022] EWCA Civ 1555)

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Introduction

For the purpose of determining whether an arbitration agreement is invalid, non-existent or ineffective, it is to be treated (unless otherwise agreed by the parties) as a distinct agreement from any other agreement (the Main Contract) of which it was intended to form part (**"the Separability Principle"**). The principle is now reflected in section 7 of the Arbitration Act 1996.

The issue in this case was whether a proposed charterparty (**"the Main Contract"**), which had expressly been stated to have been 'subject shipper/receivers approval', contained a binding arbitration agreement conferring jurisdiction on an arbitrator to determine the validity of the Main Contract. In particular, did the Separability Principle have the effect of rescuing the arbitration agreement, if the Main Contract negotiations never ceased to be "subject to contract"?

The Court of Appeal held that the Separability Principle creates no presumption that an arbitration agreement *has been reached*. Indeed, it refers to an arbitration that *has* been reached, and thus to one which satisfies the usual principles of contract formation. So, where the conclusion on the facts was that the Main Contract had never been formed, that defect also extended to the arbitration clause within it, and the Separability Principle would not necessarily (and did not on the facts) create an arbitration agreement or confer jurisdiction on the arbitrator to determine that dispute.

The facts of the case

In August 2020 the parties were in the process of negotiating the terms of a proposed voyage charter for a voyage from Newcastle, Australia to Zhoushan in China. The vessel in question

was the “Newcastle Express”, which had recently been purchased by Gemini Ocean Shipping Ltd (“the Owner”). On 25th August 2020 the broker circulated the main terms agreed by the parties (‘M’Term recap’), which included the following term: ‘*Sub shipper/receivers approval within one working day AFMT [after fixing main terms] & receipt of all required/corrected certs/docs.*’ The effect of such a clause (as held by the Court of Appeal) is equivalent to “subject to contract”; it negatived any intention to conclude a binding contract until shipper’s or receivers’ approval was received.

The main terms also contained a law and arbitration clause which stated that ‘GA/Arbitration to be in London, English [sc. Law] to be applied, small claims procedure to apply for claims USD 50,000 or less.’

The Owner intended the vessel to be inspected by Rightship, a vetting system used to identify the suitability of vessels for the carriage of iron ore and coal cargoes. The inspection had been planned for 3rd September 2020 before the vessel’s departure from Zhoushan. The vessel had not been approved by Rightship by that date, when the charterer advised that the shipper was not accepting the vessel. It was common ground that, at the time, the Charterer had not lifted the ‘subject’ of ‘shipper/receivers approval’, and thus there had been no confirmation that there was now a ‘clean’ fixture.

The Owner argued that a binding charterparty containing an arbitration clause had been concluded, and that by releasing the vessel, the Charterer had repudiated the contract. Subsequently, the Owner commenced an arbitration against the Charterer, who was called upon to appoint an arbitrator. The Charterer took no part in the arbitration, in which the arbitrator found in favour of the Owner and awarded the Owner damages accordingly.

The Charterer issued an application under section 67 of the Arbitration Act 1996 (“the Act”) challenging the arbitration award in the ground that the arbitrator had no substantive jurisdiction. (An alternative appeal on a question of law, pursuant to section 69 of the Act, did not arise for consideration.)

Judgment below

The matter was heard by Mr Justice Jacobs, who found the following:

(a) The effect of the ‘subject’ was that no binding contract was concluded until the subject was lifted, which never happened.

(b) The subject in this case, 'subject shipper/receivers approval' which had the above effect, applied as much to the arbitration clause as to any other clauses of the recap.

(c) Accordingly, the arbitrator did not have substantive jurisdiction, and the Charterer's section 67 challenge succeeded.

(d) Whilst the application pursuant to section 69 did not arise on the facts, given the significant overlap and the arguments that had been advanced at the hearing, the Judge made clear that he would have allowed the appeal and granted leave to appeal pursuant to section 69 of the Act.

The judgment of the Court of Appeal

The Court of Appeal had to consider the scope and applicability of the separability principle by reference the facts of this case. Males LJ, who delivered the judgment of the Court, held that although an agreement "on subjects" usually leaves the parties free to withdraw until the "subject" or "subjects" in question are "lifted", an agreement of this type nevertheless serves a *useful commercial purpose*. The particular subject of 'shipper\receivers approval' was a pre-condition which negatived contractual intent, as opposed to a performance condition, and was one which was for the Charterer to 'lift', it being a commercial decision for the Charterer whether to do so or not.[1]

The Court considered a number of authorities, including the authorities of *Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd* [1993] QB 70 and *Fiona Trust & Holding Corporation v Privalov* [2007] UKHL 40, the leading authorities on the separability principle found in s.7 of the Act. Males LJ concluded that *Harbour v Hansa* provides no support for any argument that an arbitrator has jurisdiction to determine an issue of contract formation. This is because *Harbour v Kansa* concerned a scenario in which the issue was the *validity* of the main contract, as opposed to the *formation* of the contract. On review of the relevant authorities, it followed that where an arbitration agreement had not in truth existed, the arbitrator had no authority to decide anything. Where the issue was whether a party ever assented to a contract containing an arbitration clause, that issue 'impeached' both the main contract and the arbitration agreement itself. However, where the issue was one of validity of the contract, and provided that the arbitration clause had not been impeached, the arbitrator could have jurisdiction under the clause to determine the initial validity of the contract. Thus,

[1] See paragraphs 34 – 42 of the judgment.

the correct approach is that where the issue is one of formation of contract, this will generally impeach the arbitration clause. However, where the issue is one of contract validity, this will not necessarily be the case.[2]

The Court further drew support from leading academic literature in the field, and referred specifically to *BCY v BCZ* [2016] SGHC 249, [2016] 2 Lloyd's Rep 538, a case decided by the Singapore High Court, which the Court considered to be the 'fullest treatment cited' of the application of the separability principle to issues of contract formation, and a case where a similar approach had been adopted. The Court further held that this approach was not antithetical to the modern 'one-stop shop' dispute resolution presumption in *Fiona Trust*, as that presumption was concerned with the interpretation of dispute resolution clauses, and the present case did not concern the interpretation of the arbitration clause.[3] In any event, the issue in *Fiona Trust,* just like in *Harbour v Kansa,* was in relation to the validity of the contract, not the formation of the contract.[4] Furthermore, the presumption had nothing to do with the question whether the parties had actually concluded a contract (including a contract to arbitrate) in the first place. That would be a question of contract formation, and to hold so in relation to the question whether a binding arbitration agreement has been concluded, is a principled approach. Males LJ further stated that whilst 'one-stop shopping is all very well', where the parties have not entered into an arbitration agreement, 'the shop is not open for business in the first place'.[5]

The Court of Appeal reached the following conclusions:[6]

(a) The use of 'subjects' in charterparty negotiations is a conventional and well-recognised way of ensuring that no binding contract is concluded. It is in many cases equivalent to the expression 'subject to contract', although that expression is not generally used in this field.

(b) The 'subject' in the present case was a pre-condition whose effect was to negative any intention to conclude a binding contract until such time as the subject was 'lifted'.

(c) Either party was free to walk away from the proposed fixture at any time and until the subject was 'lifted', which it never was.

[2] See paragraphs 43 – 54 of the judgment.
[3] See paragraph 75 of the judgment.
[4] See paragraph 58 of the judgment.
[5] See paragraph 75 of the judgment.
[6] Paragraph 80 of the judgment.

(d) The negativing of an intention to conclude a binding contract applies as much to the arbitration clause as much as any other clauses set out in the recap. Commercial parties would reasonably expect a 'subject' to apply to the *whole* proposed contract and not to everything except the arbitration clause.

(e) The conclusions above are unaffected by the separability principle, which applies where the parties have reached an agreement to refer a dispute between them to arbitration, which they intend (applying an objective test of intention) to be legally binding. It means that a dispute as to the validity of the main contract in which the arbitration agreement is contained does not affect the arbitration agreement unless the ground of invalidity relied on is one that 'impeaches' the arbitration agreement itself as well as the main agreement. But it has no application when, as in the present case, the issue is whether agreement to a legally binding arbitration agreement has been reached in the first place.

(f) What the parties agreed in their negotiations in the present case was that, if a binding agreement was concluded as a result of the subject being lifted, that contract would contain an arbitration clause.

Key points to consider following the decision of the Court of Appeal

When negotiating a commercial contract intended to contain an arbitration clause, parties need to be mindful of the following:

(i) The ordinary inference where the parties negotiate "subject to contract" is that that qualification extends to all of their proposed terms, including the arbitration clause. The mere fact that the parties agree the *wording* of an arbitration clause in their travelling drafts, does not typically amount to a mutual intention to be *bound* by it, absent conclusion of the underlying contract.

(ii) Therefore, if the parties intend the arbitration clause/agreement to survive the potential breakdown of a main agreement that is subject to pre-conditions, they must express their common intention clearly.

(iii) There is a distinction between a pre-condition and a performance condition. The former prevents a binding contact being formed, whilst the latter has the effect that

performance does not need to be rendered if the subject is not satisfied for reasons other than a breach of contract by one of the parties. The parties need to make sure that proper language is used to avoid any ambiguity.

(iv) Even though agreements subject to 'subjects' are not generally binding on the parties until the relevant 'subjects' are 'lifted', they still serve a useful commercial purpose in the context of charterparty negotiations. It is thus important for the parties to use as clear and precise language as possible, from the very early stages of negotiations, and all the way through to conclusion and the 'lifting' of any relevant 'subjects'.

(v) The Court of Appeal gave useful guidance for a mechanism to resolve a dispute about the validity of their arbitration agreement. Where the parties find themselves in circumstances similar to the ones in the present case, it is not inevitable that a party seeking to rely on the disputed arbitration agreement has to commence an arbitration and face the expense of proceedings before arbitrators, followed by a s.67 challenge. Instead, the parties may make an *ad hoc* agreement to submit that issue alone (i.e. whether a binding contract has been concluded) to arbitration, without prejudice to any issue whether such an *ad hoc* agreement is necessary (see paragraph [86] of the judgment).

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