

Comparative Analysis of Doctrine of Separability between China and the UK

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1. Background

Separability is a world-recognized doctrine in commercial arbitration. It means that an arbitration clause is presumed to be a separate and autonomous agreement, reflecting contractual commitments that are independent and distinct from its underlying contract.[1] Such a doctrine is embraced and acknowledged by numerous jurisdictions and arbitral institutions in the world.[2]

However, there are different views on the consequences of separability. One of the most critical divergences is the application of separability in the contract formation issue. Some national courts and arbitral tribunals held that in relatively limited cases, the circumstances giving rise to the non-existence of the underlying contract have also resulted in the non-existence of the associated arbitration agreement, which is criticized as an inadequacy of the doctrine of separability.[3] On the contrary, other courts hold the doctrine of separability applicable in such a situation, where the non-existence of the underlying contract would not affect the existence and validity of the arbitration agreement. This divergence would directly affect the interest of commercial parties since it is decisive for the existence of the arbitration agreement, which is the basis of arbitration.

Two contrary judgements were recently issued by two jurisdictions. The Chinese Supreme People's Court (hereinafter "**SPC**") issued the Thirty-Sixth Set of Guiding Cases, consisting of six guiding cases concerning arbitration. In Guiding Case No. 196 *Yun Yu v. Zhong Yun Cheng*, the SPC explains the Chinese version of separability should apply when the formation of the underlying contract is in dispute.[4] Although the SPC's Guiding Cases are not binding, they have an important persuasive effect and Chinese courts of the lower hierarchy are responsible for quoting or referring to the Guiding Cases when they hear similar cases. On the other hand, the English Court of Appeal also issued a judgement relating to separability, holding this doctrine not applicable in the contractual

formation issue.[5]

2. Chinese judgment

The Chinese case concerns a share transfer transaction between Yun Yu Limited. (hereinafter “**YY**”) and Shenzhen Zhong Yuan Cheng Commercial Investment Holding Co. Limited. (hereinafter “**ZYC**”). On 9th May 2017, YY sent the Property Transaction Agreement (hereinafter “**PTA**”) and the Settlement of Debts Agreement (hereinafter “**SDA**”) to ZYC. The PTA was based on the Beijing Stock Exchange (hereinafter “**BSE**”) model agreement. PTA and SDA included a dispute resolution clause in which the parties agreed that the governing law should be Chinese law and the dispute should be submitted to Beijing Arbitration Commission. On 10th May 2017, ZYC returned the PTA and SDA to YY with some revisions, including a modification on the dispute resolution clause, which changed the arbitration institution to the Shenzhen Court of International Arbitration. On 11st May 2017, YY commented on the revised version of the PTA and SDA but kept the dispute resolution clause untouched. In the accompanying email, YY stated, “Contracts confirmed by both parties would be submitted to Beijing Stock Exchange and our internal approval process. We would sign contracts only if we got approval from BSE and our parent company.” On the same day, ZYC returned the PTA and SDA with its stamp to YY. On 27th October 2017, YY announced to ZYC that the negotiation was terminated. On 4th April 2018, ZYC commenced arbitration based on the dispute resolution clause in PTA and SDA.

The SPC held that separability means the arbitration agreement could be separate and independent from the main contract in its existence, validity and governing law. To support its opinion, the SPC refers to Article 19 of the People’s Republic of China’s Arbitration Law (hereinafter “**Arbitration Law**”), which stipulates that: “An arbitration agreement shall exist independently, the amendment, rescission, termination or invalidity of a contract shall not affect the validity of the arbitration agreement.” SPC submits that the expression “(t)he arbitration agreement shall exist independently” is general and thus should cover the issue of the existence of the arbitration agreement. This position is also supported by the SPC’s Interpretation of Several Issues concerning the

Application of Arbitration Law (hereinafter “**Interpretation of Arbitration Law**”), [6]Article 10 of which stipulates: “Insofar as the parties reach an arbitration agreement during the negotiation, the non-existence of the contract would not affect the validity of the arbitration agreement.” Thus, the SPC concluded that the existence of an arbitration clause should be examined separately, independent from the main contract. Courts should apply the general rules of contractual formation, to examine whether there is consent to arbitrate. If the court found the arbitration clause formed and valid, the very existence of the main contract should be determined by arbitration, unless it is “necessary” for the court to determine this matter. The SPC concludes that the PTA and SDA sent by YY on 11st May 2017 constituted an offer to arbitrate. The stamped PTA and SDA sent by ZYC on the same day constituted an acceptance and came into effect when the acceptance reached YY. Thus, there exists an arbitration agreement between the parties. It is the arbitral tribunal that should determine whether the main contract was concluded.

3. English judgment

The English case concerns a proposed voyage charter between DHL Project & Chartering Limited (hereinafter “**DHL**”) and Gemini Ocean Shipping Co. Limited (hereinafter “**Gemini**”). The negotiations were carried on through a broker. On 25th August 2020, the broker circulated what was described as the Main Terms Recap. It is common ground that the recap accurately reflected the state of the negotiations thus far. Within the Recap, both parties agreed that the vessel would be inspected by Rightship. This widely used vetting system aims to identify vessels suitable for the carriage of iron ore and coal cargoes. Also, both parties agreed that the dispute should be submitted to arbitration. There was an attached proforma, including a provision that the vessel to be nominated should be acceptable to the charterer. Still, that acceptance in accordance with detailed requirements set out in clause 20.1.4 “shall not be unreasonably withheld”. By 3rd September, however, Rightship approval had not been obtained. DHL advised that “(p)lease arrange for a substitute vessel” and finally, “(w)e hereby release the vessel due to Rightship and not holding her any longer.” In this situation, the attached proforma was not approved by DHL, and there is no “clean” fixture, [7]which means the parties did not reach an agreement. After that, Gemini submitted that there is a binding charter party containing an arbitration clause

and commenced arbitration accordingly.

The Court of Appeal made a detailed analysis of separability. Combining analysis of numerous cases, including *Harbour v. Kansa*, [8]*Fiona Trust*, [9]*BCY v. BCZ*[10] and *Enka v. Chubb*, [11]and analysis of *International Commercial Arbitration* written by Prof. Gary Born, the Courts of Appeal concluded that separability should not be applied if the formation of the underlying contract is in dispute. Separability applies only when the parties have reached an agreement to refer a dispute to arbitration, which they intend (applying an objective test of intention) to be legally binding. In other words, disputes as to the validity of the underlying contract in which the arbitration agreement is contained do not affect the arbitration agreement unless the ground of invalidity impeaches the arbitration agreement itself. But separability is not applicable when the issue is whether an agreement to a legally binding arbitration agreement has been reached in the first place. In this case, the parties agreed in their negotiations that if a binding contract were concluded as a result of the subject being lifted, that contract would contain an arbitration clause. However, based on the analysis of the negotiation and the commercial practice in the industry, the Court of Appeal concludes that either party was free to walk away from the proposed fixture until the subject was lifted, which it never was. Thus, there was neither a binding arbitration agreement between the parties.

4. Comments

Before discussing the scope of the application of separability, one thing needed to be clarified in advance: Separability does not decide the validity or existence of the arbitration agreement in itself. Separability is a legal presumption based on the practical desirability to get away from a theoretical dilemma. However, separability does not mean the arbitration agreement necessarily exists or is valid. It only means the arbitration agreement is separable from the underlying contract, and it cannot escape the need for consent to arbitrate.[12] Therefore, the existence of the arbitration agreement should not be considered when discussing the scope of application of the arbitration agreement.

The justification of the doctrine of separability should be considered when discussing its scope of application. The justification for the doctrine of

separability can be divided into three factors: (a) The commercial parties' expectations. Parties to arbitration agreements generally "intended to require arbitration of any dispute not otherwise settled, including disputes over the validity of the contract or treaty. (b) Justice and efficiency in commerce. Without the separability doctrine, "it would always be open to a party to an agreement containing an arbitration clause to vitiate its arbitration obligation by the simple expedient of declaring the agreement void." and (c) Nature of the arbitration agreement.[13] The arbitration agreement is a procedural contract, different from the substantive underlying contract in function. If these justifications still exist in the contract formation issue, the doctrine of separability should be applied.

It is necessary to distinguish the contract formation issue and contract validity issue, especially the substantive validity issue, when discussing the applicability of those justifications. The contract formation issue concerns whether parties have agreed on a contract. The ground to challenge the formation of a contract would be that the parties never agree on something, or the legal condition for the formation is not satisfied. The contract substantive validity issue is where the parties have agreed on a contract, but one party argue that the agreement is invalidated because the true intent is tainted. The grounds to challenge the substantive validity would be that even if the parties have reached an agreement, the agreement is not valid because of duress, fraud, lack of capacity or illegality. The formation and validity issues are two different stages of examining whether the parties have concluded a valid contract. The validity issue would only occur after the formation of the contract. In other words, an agreement can be valid or invalid only if the agreement exists.

It is argued that separability should be applicable to the formation of contract. Firstly, separability satisfies the parties expectation where most commercial parties expect a one-stop solution to their dispute, irrespective of whether it is for breach of contract, invalidity or formation. Furthermore, the application of separability would achieve justice and efficiency in commerce. Separability is necessary to prevent the party from vitiating the arbitration obligation by simply declaring a contract not concluded. In short, since the justifications still stand in the issue of contract formation, separability should also apply in such an issue.

The English Court of Appeal rejected the application of separability in the formation of contract holding the parties' challenge to the existence of the main contract would generally constitute a challenge to the arbitration clause.

However, the same argument may apply for invalidity of the underlying contract. Since the arbitration agreement is indeed concluded in the same circumstances as the underlying contract the challenging to the validity of the contract may also challenge the validity of the arbitration clause, while separability still applies. On the contrary, the Chinese approach probably is more realistic. The SPC ruled that separability applies where the formation of the underlying contract is disputed. But before referring the dispute to arbitration, the SPC separately considered the formation of the arbitration clause. Only after being satisfied the arbitration clause is prima facie concluded, the court declined jurisdiction and referred the parties to arbitration.

[1] Ronan Feehily, *Separability in international commercial arbitration; confluence, conflict and the appropriate limitations in the development and application of the doctrine*, 34 *Arbitration International* 355 (2018), p. 356.

[2] See Blackaby Niegel, Constantine Partasides et al., *Redfern and Hunter on International Arbitration*, Kluwer Law International; Oxford University Press 2015, pp. 104-107.

[3] See Gary B. Born, *International Commercial Arbitration* (3rd edition), Kluwer Law International 2021, pp. 492-493.

[4] The Guiding Case No. 196: Dispute in Validity of Arbitration Agreement between YunYu Limited and Shenzhen ZhongYuanCheng Commercial Investment Holding Co. Limited.

[5] *DHL Project & Chartering Ltd v Gemini Ocean Shipping Co Ltd* [2022] EWCA Civ 1555 (24 November 2022)

[6] SPC's Interpretation of Several Issues concerning the Application of Arbitration Law, Fa Shi?2006?No. 7.

[7] Clean Fixture is a concept in the maritime area. It means the Parties' confirmation that the contract has been concluded and that there are no further Subjects and/or restrictions to the execution of the agreed Contract. The Fixture is not clean until both parties have waived their subjects/restrictions.

[8] Harbour Assurance Co (UK) Ltd v Kansa General International Insurance Co Ltd [1993] QB 701.

[9] Fiona Trust & Holding Corporation v Privalov [2007] UKHL 40, [2007] 4 All ER 951.

[10] BCY v BCZ [2016] SGHC 249, [2016] 2 Lloyd's Rep 583.

[11] Enka Insaat ve Sanayi AS v OOO Insurance Company Chubb [2020] UKSC 38, [2020] 1 WLR 4117

[12] See McNeill M. S. & Juratowitch B., *Agora: Thoughts on Fiona Trust: The Doctrine of Separability and Consent to Arbitrate*, 3 *Arbitration International* 475 (2008).

[13] See Gary B. Born, *International Commercial Arbitration* (3rd edition), Kluwer Law International 2021, p. 428.