CASE UPDATE

The Singapore High Court considers the issue of whether there is a binding independent arbitration agreement, when parties dispute the existence of the underlying contract

16 November 2016

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Introduction

1. In *BCY v. BCZ* [2016] SGHC 249, the Singapore High Court had to consider the issue of whether parties were bound by an independent arbitration agreement, when the main contract, which contained an arbitration clause, was not executed.

2. The judgment of the Court examined, in the context of negotiations of a contract which incorporates an arbitration clause, when and under what circumstances, parties would intend to create legal relations by entering into a discrete arbitration agreement independently and prior to the conclusion of the contract itself.

3. On the facts of the case, the Judge decided that the parties had not entered into an independent binding arbitration agreement. Consequently, the arbitrator (in the arbitration) did not have jurisdiction to hear the claims that had been submitted to arbitration.

Facts

4. The dispute arose from a proposed sale of shares by the Plaintiff to the Defendant under a sale and purchase agreement (the "**Agreement**"). Parties had exchanged seven drafts of the Agreement, but the Agreement was eventually not signed.

5. The following facts (among others) were material:

   (a) The first draft of the Agreement was circulated on 17 June 2013.

   It provided that:

   (i) the governing law of the Agreement is New York law; and

   (ii) any disputes arising out of or in connection with the Agreement shall be referred to the New York courts (the "**Dispute Clause**").

   (b) The second draft of the Agreement was circulated by the Defendant on 25 June 2013. The Defendant had replaced the Dispute Clause with an arbitration clause, which provided that:

> *"All disputes (including a dispute, controversy or claim regarding the existence, validity or termination of this Agreement – a "Dispute") arising out of or in connection with this Agreement shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules, such arbitration to take place in Singapore."*
>
> (the "**Arbitration Clause**")

(c) The Arbitration Clause remained unchanged even after the final draft of the Agreement was exchanged;

(d) On 18 July 2013, the Plaintiff circulated the sixth draft of the Agreement (which contained the Arbitration Clause, with no amendments). The Plaintiff also indicated that it was "ready to sign" the Agreement.

6. The parties ultimately did not sign the Agreement, and the sale of shares did not proceed.

7. Subsequently, the Defendant commenced arbitration against the Plaintiff for, among other things, damages for breach of the Agreement for failing to complete the transfer of the shares.

8. The Plaintiff (who was the respondent in the arbitration) challenged the arbitrator's jurisdiction on the basis that there was no binding arbitration agreement.

9. In the jurisdictional challenge heard by the arbitrator, the parties agreed that the arbitrator would decide the jurisdictional issue without examining the question of whether the underlying Agreement had been concluded; the Defendant's case was that a binding arbitration agreement was concluded independently of the underlying Agreement.

10. The arbitrator agreed with the Defendant's position, and the Plaintiff subsequently applied to the Singapore High Court for a declaration that the arbitrator had no jurisdiction.

Decision of the Judge

11. The Judge observed that generally, when the jurisdiction of an arbitral tribunal is challenged on the basis that there is no binding arbitration agreement, the usual ground for such a challenge is that the contract which incorporates the arbitration clause was never concluded. The validity and existence of the arbitration agreement and the underlying contract are usually resolved together.

12. In the rather unique facts of this case, the Judge only had to examine whether parties intended to create legal relations by entering into a discrete arbitration agreement independently and prior to the conclusion of the Agreement. The Judge did not have to decide whether or not the parties were bound by the Agreement.

Governing law of the arbitration agreement

13. The Judge confirmed that the governing law of an arbitration agreement is to be determined in accordance with a three-step test:

    (a) the parties' express choice;

    (b) the implied choice of the parties as gleaned from their intentions at the time of contracting; or

    (c) the system of law with which the arbitration agreement has the closest and most real connection.

14. As the Arbitration Clause does not contain an express choice of law to govern the arbitration agreement, the issue of the governing law of the arbitration agreement has to be resolved by applying the second step.

15. The contentious point was whether the implied choice of governing law of the arbitration agreement should be (i) the governing law of the Agreement (in which the Arbitration Clause was set out); or (ii) the law of the seat of the arbitration (as set out in the Arbitration Clause).

16. The Judge considered the following 2 cases (among others):

    (a) The first case was *Sulamérica Cia Nacional de Seguros SA and others v Enesa Engelharia SA and others* [2013] 1 WLR 102 ("***Sulamérica***"). In *Sulamérica*, the court there applied the three-steps test above, and held that in the absence of an express choice of law for the arbitration agreement, there was a rebuttable presumption that the proper law of the main contract should also govern the arbitration agreement.

    (b) The second case was *FirstLink Investments Corp Ltd v GT Payment Pte Ltd and others* [2014] SGHCR 12 ("***FirstLink***"). In *Firstlink*, the Assistant Registrar preferred the contrary view that in the absence of an express choice of law for the arbitration agreement, the law of the seat of arbitration should by default be the governing law of the arbitration agreement.

17. The Judge disagreed with the reasoning in *Firstlink*, and affirmed the approach in *Sulamérica* as part of Singapore law.

18. In the Judge's view, when the arbitration agreement is a clause forming part of a main contract, it is reasonable to assume that the contracting parties intend that the same system of law to govern all clauses in the contract, including the arbitration clause.

19. The Judge further observed that, in practice:

    (a) arbitration clauses are typically negotiated as part of the main contract, and are unlikely to be negotiated independently from the main contract; and

    (b) consequently, parties rarely specify the law applicable to the arbitration agreement as distinct from the main contract.

20. The Judge considered how a presumption, that the governing law of the main contract also governs the arbitration agreement, may be rebutted.

21. In his view, the presumption is not displaced by a choice of a seat of arbitration which is different from the governing law of the main contract. The presumption may be displaced if the consequences of applying the governing law of the main contract to the arbitration agreement would negate the arbitration agreement.

    No valid arbitration agreement formed independently and prior to the conclusion of the Agreement

22. On the facts, the Judge found that there was no objective manifestation of any mutual intention by the parties to be bound by the arbitration agreement as at 18 July 2013 (when the Plaintiff indicated that it was "ready to sign" the sixth draft of the Agreement).

23. In arriving at this finding, the Judge noted, among other things:

    (a) It was immaterial that the Plaintiff proposed the Arbitration Clause. This proposal was clearly part of the negotiations of the Agreement;

    (b) It was immaterial that the Plaintiff agreed to the wording of the Arbitration Clause and proposed no further amendments thereto. Agreeing to the wording of the Arbitration Clause did not in itself equate to an intention to be contractually bound to an agreement to arbitrate in the absence of the conclusion of the Agreement (under which the Arbitration Clause was negotiated); and

    (c) The drafts of the Agreement circulated were expressed to be "subject to contract". This meant that all the provisions in the draft Agreement, including the Arbitration Clause, remained open for negotiation until parties executed a final agreement. The Plaintiff could not have intended for any particular provision in the draft Agreement to be binding until and unless parties executed a final agreement.

24. The Judge was of the view that taking into account commercial reality, parties generally do not intend to enter into an arbitration agreement independently and prior to entering the main contract, from which the relevant arbitration clause arose.

25. Ultimately, the Judge decided that:

    (a) The governing law of the arbitration agreement (if there was one) was New York law (the governing law of the draft Agreement), and not Singapore law (the seat of the arbitration as set out in the Arbitration Clause).

        However, the Judge also observed that whether New York law or Singapore law was applied, this did not affect the conclusion on the issue of whether a valid arbitration agreement had been formed. This was because there was no material difference between the two systems of law on this issue; and

    (b) Applying New York law, there was no binding arbitration agreement between the Plaintiff and the Defendant, formed independently of the Agreement.

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