Articles

Incorporation of Arbitration Clauses Revisited

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1. Introduction

Eight years ago in an article in *Arbitration*[1] we noted the divergent views of a number of first-instance judges on the subject of the incorporation of arbitration clauses. The key issue was whether an arbitration clause could be incorporated into a contract by general words or whether this required clear express words only. The question of whether an arbitration agreement is incorporated into a contract is fundamental as it determines whether the parties are required to proceed to resolve their dispute by arbitration rather than court proceedings. The starting point for any analysis is the wording of the Arbitration Act 1996 s.6. This states:

> "6. Definition of arbitration agreement
>
> (1) In this Part an 'arbitration agreement' means an agreement to submit to arbitration present or future disputes (whether they are contractual or not).
>
> (2) The reference in an agreement to a written form of arbitration clause or to a document containing an arbitration clause constitutes an arbitration agreement if the reference is such as to make that clause part of the agreement."

The difficulty arises because of the final words in s.6(2): "if the reference is such as to make that clause part of the agreement". There has been conflicting authority as to what is required to make "that clause part of the agreement". Traditionally the courts have drawn a distinction between general words of incorporation and specific words.[2] The case law has been largely inconsistent and in *Aughton*[3] the matter split the Court of Appeal. However a trend had emerged from judgments which showed that the courts were willing to find that general words of incorporation were sufficient where parties had notice of the terms of the underlying agreement because they were standard terms[4] and that express words were required when they did not have notice, such as in bill of lading cases.[5]

When we considered this issue again in 2005[6] we found other trends which showed that certain characteristics in the underlying contract would make it either appropriate or inappropriate to allow incorporation of the arbitration clause into the contract by general words. These characteristics included matters such as: (a) whether the underlying agreement

[1] (2002) 68 *Arbitration* 48.

[2] *TW Thomas & Co Ltd v Portsea Steamship Co Ltd (The Portsmouth)* [1912] A.C. 1 and in particular the judgment of Lord Atkinson.

[3] *Aughton Ltd (formerly Aughton Group Ltd) v MF Kent Services Ltd* (1991) 57 B.L.R. 1.

[4] *Modern Building (Wales) Ltd v Limmer & Trinidad Co Ltd* [1975] 1 W.L.R. 1281; [1975] 2 Lloyd's Rep. 318 CA; *Secretary of State for Foreign and Commonwealth Affairs v Percy International & Kier International* (1998) 65 Con. L.R. 11; and *Roche Products Ltd v Freeman Process Systems Ltd* (1996) 80 B.L.R. 10.

[5] *Thomas v Portsea* [1912] A.C. 1; *Skips A/S Nordheim v Syrian Petroleum Co and Petrofina SA (The Varenna)* [1984] Q.B. 599; [1984] 2 W.L.R. 156 and *Federal Bulk Carriers Inc v C Itoh & Co Ltd (The Federal Bulker)* [1989] 1 Lloyd's Rep. 103.

[6] A. Tweedale and K. Tweedale, *Arbitration of Commercial Disputes, International and English Law and Practice* (Oxford: OUP, 2005, re-published 2007), Ch.21.

which contained the arbitration clause was negotiable, in which case general terms were insufficient because of the risk that one party could be unaware of the arbitration clause[7]; (b) the intent of the parties which depended on the construction and circumstances of the underlying contract[8]; (c) whether the arbitration clause required modification so as to enable it to apply to disputes arising from the underlying contract[9]; and (d) whether it led to uncertainty so that the presumption was that the arbitration clause had not been effectively incorporated.[10]

The conclusion reached was that despite these trends it was not always clear whether an arbitration agreement had been incorporated into a contract or not. The courts decided the question case by case and this was less than satisfactory. Recently this issue has come before the courts again and a clearer test has emerged.

2. The Four-Category Approach

In *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri AS v Sometal SAL*[11] Clarke J. observed that the parties are free to agree to incorporate any terms they choose by any method they choose and that therefore there are no absolute rules. Clarke J. therefore noted[12] that "it is unwise to formulate definitive categories" but he went on and identified four broad categories from the cases that have come before the courts where the parties have sought to incorporate by reference an arbitration clause into their contract. These are:

1. A and B make a contract in which they incorporate standard terms.
2. A and B make a contract incorporating terms previously agreed between A and B in another contract or contract to which they were both parties.
3. A and B make a contract incorporating terms agreed between A (or B) and C.
4. A and B make a contract incorporating terms agreed between C and D.

Category 3 and 4 cases

The courts have, in the absence of any other expressed intention of the parties, dealt with category 3 and 4 cases in a consistent manner. Within these types of cases, which can include charterparty cases,[13] re-insurance contracts[14] and retrocession contracts,[15] the courts have generally held that to incorporate the arbitration clause from one contract to another express reference is required. An example of a category-3 case is:

[7] *Thomas v Portsea* [1912] A.C. 1.

[8] *Giffen v Drake and Scull* (1993) 37 Con. L.R. 85 CA; The *Ethiniki* [2000] 1 Lloyd's Rep. 343 and *Excess Insurance Co Ltd v Mander* [1997] 2 Lloyd's Rep. 119; [1995] L.R.L.R. 358.

[9] Contrast the court's strict approach in *Thomas v Portsea* [1912] A.C. 1 which held that general words were insufficient where the clause required modification with *TB&S Batchelor & Co Ltd v Owners of the SS Merak (The Merak)* [1965] P. 223; [1965] 2 W.L.R. 250; [1964] 2 Lloyd's Rep. 527 where the court interpreted general words of incorporation broadly so as to incorporate the arbitration clause.

[10] *Stansted Shipping Co Ltd v Shenzen Nantian Oil Mills Co Ltd* [2000] All E.R. (D) 1175. The importance of certainty was emphasised by Lord Denning M.R. in *Owners of the Annefield v Owners of Cargo Lately Laden on Board the Annefield* [1971] P. 168; [1971] 2 W.L.R. 320; and by Sir John Donaldson M.R. in *The Varenna* [1984] Q.B. 599; [1984] 2 W.L.R. 156; [1983] 2 Lloyd's Rep. 592.

[11] *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri AS v Sometal SAL* [2010] EWHC 29 (Comm) at [13].

[12] *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri AS v Sometal SAL* [2010] EWHC 29 (Comm) at [13].

[13] See, e.g. *Thomas v Portsea* [1912] A.C. 1; *The Annefield* [1971] P. 168; [1971] 2 W.L.R. 320; *The Varenna* [1984] Q.B. 599; [1984] 2 W.L.R. 156; [1983] 2 Lloyd's Rep. 592; and *The Federal Bulker* [1989] 1 Lloyd's Rep. 103.

[14] *Trygg Hansa Insurance Co Ltd v Equitas Ltd* [1998] 2 Lloyd's Rep. 439; *The Ethiniki* [2000] 1 Lloyd's Rep. 343; *American International Specialty Lines Insurance Co v Abbott Laboratories* [2002] EWHC 2714 (Comm); [2004] Lloyd's Rep. I.R. 815.

[15] *Excess Insurance Co Ltd v Mander* [1997] 2 Lloyd's Rep. 119; [1995] L.R.L.R. 358.

> A (a shipowner) and C (a charterer) enter into a contract which includes an arbitration clause. Where A subsequently enters into a contract with B (the holder of the bill of lading) and this incorporates the terms and conditions of the charter agreement, the arbitration clause within the charter agreement does not become a term of the contract between A and B unless there is a specific reference to it.

The reasoning of the court as to why an express reference is required has not always been consistent. In one case it was argued that clear words were needed to oust the jurisdiction of the court.[16] In other cases the courts have stated that a bill of lading might come into the hands of someone who did not know and could not discover whether it had an arbitration clause.[17] In these circumstances it could not be said that that party had agreed to arbitration. In another case Bingham L.J. referred to the need for certainty in regard to what the parties contracted for.[18] It has also been argued that express reference is needed because of the ancillary nature of arbitration clauses.[19]

Category 1 and 2 cases

In respect of category 1 and 2 cases a more consistent approach is also beginning to emerge. In *The Athena (No.2)*[20] Langley J. looked at this issue from a fresh perspective. He concluded that the four categories which arose were either "single contract" or "two-contract" cases. Where there were "two-contract" cases an express reference to the arbitration clause would be required. However, in "single contract" cases Langley J. held that general words of incorporation would suffice. He dismissed as "hopeless" the argument submitted by the claimants that the rationale in *Thomas v Portsea* applied to a single contract case as much as to a two-contract case or that that an arbitration clause as a discrete contract was therefore subject to special principles. Langley J. stated[21] that this argument failed because:

> "It would involve the exception swallowing the rule. It is contrary to authority binding upon me. It puts a weight on *Thomas v Portsea* which it cannot begin to bear."

He relied on authorities where the courts had held that general words of incorporation were sufficient to incorporate an arbitration clause.[22] These cases held that, where the parties made reference to a standard form of contract that contained an arbitration clause, then this would be sufficient to incorporate that arbitration clause.[23] The overall rationale was that the parties would be familiar with the standard terms and would know that an arbitration clause would be included. This approach also accords with the views of *Mustill & Boyd*[24] regarding commercial practice and is further supported in *Hudson*.[25] The recent case of *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri AS v Sometal SAL*[26] followed Langley J.'s approach in *The Athena (No.2)*. Habas, a Turkish company, applied to the court to set aside an interim final award on jurisdiction and costs made by the arbitral tribunal of the London Court of International Arbitration (LCIA). The underlying contract contained some terms

[16] *Thomas v Portsea* [1912] A.C. 1.
[17] *Excess Insurance Co Ltd v Mander* [1997] 2 Lloyd's Rep. 119; [1995] L.R.L.R. 358; and *Federal Bulker* [1981] 1 Lloyd's Rep. 103.
[18] *Federal Bulker* [1981] 1 Lloyd's Rep. 103.
[19] *The Delos* [1999] 2 Lloyd's Rep. 685.
[20] Sea *Trade Maritime Corp v Hellenic Mutual War Risks Association (Bermuda) Ltd (The Athena)* [2006] EWHC 2530 (Comm); [2007] 1 Lloyd's Rep. 280.
[21] *The Athena* [2006] EWHC 2530 (Comm); [2007] 1 Lloyd's Rep. 280 at [68].
[22] *Modern Building Wales Ltd v Limmer & Trinidad Co Ltd* [1975] 1 W.L.R. 1281; [1975] 2 Lloyd's Rep. 318; *Tracomin SA v Sudan Oil Seed Co* [1983] 1 Lloyd's Rep. 560; *Excomm Ltd v Ahmed Abdul-Qawi Bamaodah (The St Raphael)* [1985] 1 Lloyd's Rep. 403; and *Wyndham Rather Ltd v Eagle Star & British Dominions Insurance Co Ltd* (1925) 21 Ll. L. Rep. 214.
[23] See the commentary to *Roche Products v Freeman* (1996) 80 B.L.R. 102 at 108.
[24] M.J Mustill and S.C. Boyd, *Commercial Arbitration*, 2nd edn (London: LexisNexis Butterworths, 2001).
[25] *Hudson's Building and Engineering Contracts*, 11th edn (London: Sweet & Maxwell, 2003), para.18.033.
[26] *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri AS v Sometal SAL* [2010] EWHC 29 (Comm).

and then incorporated other terms by this general reference to terms in previous contracts: "All the rest will be the same as our previous contract." A key issue between the parties was whether these general words incorporated a London arbitration clause. In total there had been 14 previous contracts between the parties, some of which expressly incorporated a London arbitration clause.

Clarke J. applied Langley J.'s reasoning that parties need to be clear about what terms have been incorporated into their underlying agreement and that they had to have a clear intention to incorporate an arbitration clause but that this could be evinced from general words of incorporation in certain cases. Clarke J. elected to follow the approach of Langley J. and considered whether this case involved a "single contract" or a "two-contract" situation. Although Clarke J. accepted that "literally" there was more than one contract, as the contract in issue in *Habas* incorporated terms from the previous contracts, the important distinction was whether the parties to all these contracts were the same. Clarke J. therefore concluded that a category-2 situation, where the parties to all the contracts are the same, should be construed as a "single contract" under Langley J.'s test and therefore an express reference to the arbitration clause was not required. The rationale for this is that it would be clear to the parties that the arbitration clause had been incorporated. Clarke J. agreed with Langley J. that, although an arbitration clause is a collateral contract, this of itself did require clear words to incorporate it into a contract when the facts show that this is what the parties intended. By way of example Clarke J. stated[27]:

> "[A] businessman would have no difficulty in regarding the arbitration clause (as he would call it) as part of a contract and as capable of incorporation, by appropriate wording, as any other term of such a contract; and it is, as it seems to me, to a businessman's understanding that the court should be disposed to give effect. A businessman who had agreed with his counterparty a contract with 10 specific terms under various headings and then agreed with the same counterparty terms 1–5 under the same headings as before and, as to the rest, that all the terms of the previous contract should apply, would, I think, be surprised to find that '*all*' should be interpreted so as to mean '*all but the arbitration clause*'."

Clarke J. was therefore of the view that House of Lords cases such as *Thomas v Portsea*[28] and Court of Appeal authorities such as *Aughton Ltd v MF Kent Ltd*[29] and *The Ethniki*[30] did not apply to the case of *Habas* as it was in effect a "one contract" case.

3. Comment

Both *The Athena*[31] and *Habas v Sometal*[32] are first-instance decisions and we must now wait to see whether the Court of Appeal and the House of Lords follow the same approach. We consider that there are three reasons why the approach should be adopted.

First, the approach fits more comfortably with how the legislature intended the Arbitration Act 1996 to be applied. The explanatory memorandum to the Arbitration Bill stated that s.6 was intended to correspond to the UNCITRAL Model Law art.7.[33] In cases where the UNCITRAL Model Law art.7 has been considered it has been held that general words of

[27] *Habas Sinai Ve Tibbi Gazlar Isthisal Endustri AS v Sometal SAL* [2010] EWHC 29 (Comm) at [51].
[28] *Thomas v Portsea* [1912] A.C. 1.
[29] *Aughton Ltd v MF Kent Ltd* (1991) 57 B.L.R. 6.
[30] *The Ethiniki* [2000] 1 Lloyd's Rep. 343.
[31] *The Athena* [2006] EWHC 2530 (Comm); [2007] 1 Lloyd's Rep. 280.
[32] *Habas v Sometal* [2010] EWHC 29 (Comm).
[33] The UNCITRAL Arbitration Rules 1976. Article 7 states, inter alia: "The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract."

incorporation would suffice.[34] HH Judge Jack QC however noted in *Trygg Hansa Insurance Co Ltd v Equitas Ltd*[35] that the Arbitration Act 1996 was not identical to the Model Law and if the Model Law had been adopted in England then it would have been right to put the English authorities to one side. However, he concluded that the Model Law had not been adopted and therefore it should not be followed—although H.H. Judge Jack was not referred by counsel to the intention of Parliament as set out in the memorandum of the Bill.

Secondly, the approach adopted by Langley J. is supportive of arbitration as a form of dispute resolution. The comment made in *Thomas v Portsea*[36] that clear words are needed to oust the jurisdiction of the courts is over 100 years old and different factors are now relevant. The courts actively support alternative dispute resolution (ADR) and there is no reason to treat an arbitration clause differently from any other clause of the contract. As Clarke J. points out, if a party were asked whether a reference to "all terms of a contract" included the arbitration provisions the answer would be, "of course it does". The party would not know whether an arbitration clause is a separate contract—this distinction is a legal nicety which should have no place in deciding what parties intended when they entered into a contract.

Thirdly, the approach provides greater certainty. In our 2002 article we made the comment that there was no objection per se to having different approaches to the issue of incorporation of arbitration clauses. What was, however, objectionable was that too often the different approaches become blurred. The approaches of both Langley J. and Clarke J. provide a simple test that should give a consistent answer as to whether an arbitration clause has been incorporated into a contract. The previous state of the law was less than satisfactory. This new approach is therefore to be welcomed.

[34] *Astel-Peiniger Joint Venture v Argos Engineering & Heavy Industries Co Ltd* (78) in *Case Law on UNCITRAL texts* (CLOUT) and *Gay Constructions Pty Ltd and Spaceframe Buildings (North Asia) Ltd v Caledonian Techmore (Building) Ltd and Hanison Construction Co Ltd (as a third party)* (87) in *Case Law on UNCITRAL texts* (CLOUT), both cases available at *http://www.uncitral.org/* [Accessed September 16, 2010].

[35] *Trygg Hansa Insurance Co Ltd v Equitas Ltd* [1998] 2 Lloyd's Rep. 439.

[36] *Thomas v Portsea* [1912] A.C. 1.