IN THE HIGH COURT OF JUSTICE
(QUEEN'S BENCH DIVISION)
(COMMERCIAL COURT)

A

1991-F-218

Royal Courts of Justice,
Strand,
London WC2A 2LL.

Monday, 18th February 1991.

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Before:

MR JUSTICE STEYN

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PAUL SMITH LIMITED — Plaintiffs

D

-v-

H & S INTERNATIONAL HOLDING CO. INC. — Defendants

E

Mr T. DUTTON (*instructed by Hunt Dickins*) appeared on behalf of the Plaintiffs.

F

Mr C. HOLLANDER (*instructed by Lawrence Graham*) appeared on behalf of the Defendants.

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Tape transcription by D. L. Sellers & Co.
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10 High Street, Leatherhead, Surrey, KT22 8AN.

H

JUDGMENT

(*As approved*)

MR JUSTICE STEYN: There are three applications to be considered. The first summons is dated 31 January 1991. In terms of this summons Paul Smith Limited *("the Plaintiffs")* seek an injunction restraining H & S International Holdings Company Incorporated *("the Defendants")* from pursuing arbitration proceedings against the Plaintiffs under the Rules of the International Chamber of Commerce. The second summons is dated 11 February 1991. In terms of this summons the Defendants seek a stay of the English High Court proceedings which the Plaintiffs have brought against the Defendants. This is an application pursuant to Section 1 of the Arbitration Act 1975. The third summons is dated 14 February 1991. In terms of this summons the Plaintiffs seeks judgment under Order XIV in the sum of US $53,875.81.

The background to these applications is as follows. The Plaintiffs are designers and manufacturers of sports clothing under the Paul Smith trade mark. By a written agreement dated 1st March 1988 between the Plaintiffs, as grantors, and the Defendants, as licensees, the Plaintiffs granted to the Defendants a licence to manufacture, promote, distribute and sell sports clothing designed by the Plaintiffs. The licensed territory was North, Central and South America. The licence was agreed for a period ending in December 1997. The Agreement provided for the payment of royalties by the Defendants.

Clause 10 provided that the Plaintiffs could summarily terminate the Agreement by written notice if the Defendants failed to pay any sum to the Plaintiffs that fell due.

The following two clauses are of critical importance:

> "13. SETTLEMENT OF DISPUTES
>
> *If any dispute or difference shall arise between the parties hereto concerning the construction of this Agreement or the rights or liabilities of either party hereunder the parties shall strive to settle the same amicably but if they are unable to do so the dispute or difference shall be adjudicated upon under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more Arbitrators appointed in accordance with those Rules.*
>
> "14. LANGUAGE AND LAW
>
> *This Agreement is written in the English language and shall be interpreted according to English law.*
>
> *The Courts of England shall have exclusive jurisdiction over it to which jurisdiction the parties hereby submit."*

It is the Plaintiffs' case that the Defendants failed to pay royalties for the April, May and June 1990 quarter on time, and that the Plaintiffs validly terminated the Agreement by letter dated 31 July 1990. The Defendants rely on a course of dealing between the parties as giving rise to a variation of the Agreement, a waiver or an

estoppel, and deny that the Plaintiffs were entitled to terminate the Agreement. The details of the parties' allegations can be put to one side at this stage.

After some exchanges, and negotiations, the Defendants requested arbitration under the Rules of the ICC. The Defendants' Demand is dated 28 September 1990. The Plaintiffs contended that the arbitration agreement was invalid and sought a preliminary ruling to that effect. The Court of Arbitration of the ICC ruled pursuant to Article 8.3 of the ICC Rules that *prima facie* there was a valid arbitration agreement. The Court of Arbitration further ruled that the dispute warranted the appointment of three arbitrators, each party to propose one for approval by the Court of Arbitration. The Court further ruled:

> *"England is confirmed and London is fixed as place of arbitration."*

The Defendants have lodged a deposit for costs in the sum of US $45,500.00 with the Secretariat of the ICC. Both the Defendants and the Plaintiffs have nominated arbitrators but the Plaintiffs' nomination is without prejudice to their contention that the arbitration agreement is invalid.

On 30 January 1991 the Plaintiffs issued a Writ claiming a declaration that the Plaintiffs had validly terminated the Agreement. At the same time the Plaintiffs claimed a declaration that the pending ICC arbitration is not validly constituted as well as an injunction restraining the Defendants from proceeding with the arbitration. On 6 February 1991 Points of Claim were served.

Against this background I now turn to the first two summonses, which raise common issues. Eventually, the Plaintiffs confined their challenge to the validity of the current ICC proceedings to three grounds, namely:

(a) that the arbitration agreement is devoid of effect because of an alleged inconsistency between clauses 13 and 14;

(b) that the arbitration agreement only bites in respect of pre-termination disputes while the major extant dispute between the parties relates to the validity of the notice of termination;

(c) that service of claim by a party claiming arbitration on the other party is a pre-condition to a valid request for arbitration.

The interaction of Clauses 13 and 14

The Plaintiffs emphasize that Clause 13 provides that any dispute or difference *"shall be adjudicated upon under the Rules of Arbitration of the International Chamber of Commerce"* while Clause 14 provides that the *"Courts of England shall have exclusive jurisdiction over it to which jurisdiction the parties hereby submit."* The Plaintiffs point out that this is not one of those cases where there is an option to resort to arbitration or legal proceedings.

A possible reconciliation, which was mentioned in argument, is that the High Court will have jurisdiction in cases falling outside the scope of Clause 13, i.e. in relation to disputes or differences outside the words *"the construction of this Agreement or the rights or liabilities of either party hereunder."* In other words, this interpretation would necessitate reading the second sentence of Clause 14 as providing *"subject to Clause 13 ..."* In my view, the linguistic manipulation required and the unbusinesslike spectre of some disputes going to court

and some to arbitration, militate strongly against this interpretation.

The Plaintiffs submit that one is driven to read Clauses 13 and 14 as hopelessly inconsistent and accordingly insofar as those clauses provide for dispute resolution they must fall to the ground. That is a drastic and very unattractive result. It involves the total failure of the agreed method of dispute resolution in an international commercial contract. An incidental further result of such a conclusion would be that Article 9 (Force Majeure), which provides for a modification of the terms of the Agreement by an arbitrator, will be deprived of all legal effect. On the other hand, if the arbitration agreement is valid, there is no legal difficulty in giving effect to the so-called hardship clause.

Fortunately, there is a simple and straight forward answer to the suggestion that Clauses 13 and 14 are inconsistent. Clause 13 is a self-contained agreement providing for the resolution of disputes by arbitration. Clause 14 specifies the *lex arbitri*, the curial law or the law governing the arbitration, which will apply to this particular arbitration. The law governing the arbitration is not to be confused with (1) the proper law of the contract, (2) the proper law of the arbitration agreement, or (3) the procedural rules which will apply in the

arbitration. These three regimes depend on the choice, express or presumed, of the parties. In this case it is common ground that both the contract and the arbitration agreement are governed by English law. The procedural rules applicable to the arbitration are not rules derived from English law. On the contrary, the procedural regime is the comprehensive and sophisticated ICC Rules which apply by virtue of the parties' agreement.

What then is the law governing the arbitration? It is, as Martin Hunter and Alan Redfern, International Commercial Arbitration, p. 83, trenchantly explain, a body of rules which sets a standard external to the arbitration agreement, and the wishes of the parties, for the conduct of the arbitration. The law governing the arbitration comprises the rules governing interim measures (e.g. court orders for the preservation or storage of goods), the rules empowering the exercise by the court of supportive measures to assist an arbitration which has run into difficulties (e.g. filling a vacancy in the composition of the arbitral tribunal if there is no other mechanism) and the rules providing for the exercise by the court of its supervisory jurisdiction over arbitrations (e.g. removing an arbitrator for misconduct).

If Section 14 is read as specifying the law governing the arbitration, there is no inconsistency between Clauses 13 and 14. Admittedly, the language is not felicitous: it provides for the exclusive jurisdiction of the English Courts *"over it,"* i.e. the Agreement. Strictly, it should refer to the law governing the arbitration. This incongruity pales into insignificance, however, when compared to the unfortunate consequences of treating the arbitration clause in a non-domestic commercial agreement as *pro non scripto*.

In my view there is no inconsistency between Clauses 13 and 14, and both clauses are valid and binding.

Arbitrability: Pre-termination disputes only

Under this heading the challenge to the arbitration is put forward on the basis that there is a valid arbitration agreement. This point raises an issue of arbitrability: it is said that the arbitration agreement, properly construed, only applies to pre-termination disputes. Again, the consequences of an adoption of this argument would be startling. Presumably, some pre-termination disputes will still be arbitrable (e.g. in respect of matters preceding the alleged breaches giving rise to termination) but not the issues as to termination

itself. In the result the dispute between the parties will have to be unscrambled partly in arbitration and partly in litigation. It is unlikely that the parties could have intended such an inconvenient and costly result.

It is a wide arbitration clause. It covers disputes regarding *"the rights or liabilities of either party hereunder."* The notice of termination was given under the terms of the Agreement. On this simple ground the Plaintiffs' argument must fail. But it would be wrong to base my judgment entirely on such a narrow linguistic approach. After all, the emphasis on termination under the express terms of the Agreement, leaves untouched a termination on the grounds of fundamental or repudiatory breach. How should such a matter be approached?

It is important to bear in mind the evolution of the doctrine of the separability and independence of an arbitration agreement which forms part of a written contract. While the arbitration agreement was regarded as simply one of the terms of the contract, it was plausible to say that the arbitration clause is terminated with the contract of which it forms part. See ***Heyman v. Darwins Ltd*** [1942] A.C. 356. Fortunately, our arbitration law is today in a more advanced state. Rescission, termination on the ground of fundamental breach, breach of condition, frustration and subsequent invalidity of the contract, have

all been held to fall within arbitration clauses. Even what was once perceived to be the "rule" that a rectification issue always falls outside the scope of an arbitration clause has given way to the realism of the separability doctrine. See ***Ashville Investments Ltd v. Elmer*** [1989] Q.B. 488.

Admittedly, no English court has yet been asked to take the final step of ruling that an arbitration clause, which forms part of a written contract, may be wide enough to cover a dispute as to whether the contract was valid *ab initio*. An arbitration agreement separately executed at the same time as the principal contract is capable of conferring authority on an arbitrator to decide an issue as to the validity *ab initio* of the contract. If that is so, why should the same not apply to the arbitration agreement which physically forms part of the contract? After all, it has been recognised as having an independent existence. But I am not asked to take this final step in this case. Given the development of English arbitration law, this step may be a logical and sensible one which an English court may be prepared to take when it arises. In the meantime it is possible to say with confidence that the evolution of the separability doctrine in English law is virtually complete.

Against this background I return to the scope of the arbitration agreement. It is apt to cover a dispute about the lawfulness of a notice of termination. It would be absurd to confine the words *"rights and liabilities"* to primary rights and obligations expressly conferred by the contract. Those words clearly extend to secondary rights and remedies conferred by law in respect of contractual relations, such as rescission, termination for breach, acceptance of repudiation, the right to recover damages for breach, and so forth. All those rights arise under the terms of the contract.

It follows that the second ground of challenge of the arbitration proceedings must also fail.

Pre-condition: Service of claim

The Plaintiffs rightly conceded that the provisions that the parties shall strive to settle the matter amicably, and that a dispute shall, in the first place, be submitted for conciliation, do not create enforceable legal obligations. See ***Courtney and Fairbairn v. Tolaini Bros Hotels Ltd*** [1975] 1 W.L.R 297. It was, however, submitted that it was an implied term of the arbitration agreement that service of a claim by a party claiming arbitration on the other party was a pre-condition

to a valid request for arbitration. Such an implication would confer no rights of value for it would still be possible to request arbitration immediately after despatch and receipt of the claim. Such a virtually meaningless implication cannot possibly meet the stringent tests of our law for the implication of contractual terms.

The third challenge to the arbitration proceedings is without substance.

The Order XIV proceedings

The summons for judgment under Order XIV is based on an acknowledgment in a letter dated 21 November 1990 from the Defendants' US lawyers to the Plaintiffs' English solicitors to the following effect:

> *"the net balance due from H & S to your client with respect to the third quarter shipments is US $53,875.81."*

The Plaintiffs point out that Clause 5.10 of the Agreement precludes any set-off by the Defendants. The Plaintiffs submit that within the meaning of Article 1(1) of the Arbitration Act 1975 there is "not in fact any dispute" regarding the sum of US $53,875.81; that there should be no

stay to that extent; and that the Plaintiffs are entitled to judgment under Order XIV to that extent.

There was some controversy regarding the proper test to be applied. Undoubtedly, there are divergent views. In ***John C. Helmsing*** [1990] 2 LL.R. 290 Bingham L.J. reviewed the relevant authorities, and pointed out that there are two lines of authority. I must confess a distinct preference for the line of authority represented by Saville J.'s analysis in ***Hayter v. Nelson*** [1990] 2 LL.R. 265. In other words, it seems to me that the Defendants can only be deprived of their contractual right to arbitrate if it is readily and immediately demonstrable that the respondent has no arguable grounds at all for disputing the claim. The Plaintiffs have urged me to adopt the test represented by the other line of authority, namely, whether the relevant part of the Plaintiffs' claim is genuinely disputable. However, if I adopt this test the result should in my view be exactly the same on the facts of this particular case.

The affidavit of Mr Morley, the Plaintiffs' accountant, treats the Agreement as unaltered by subsequent conduct in any way. In so deposing, it seems to me, Mr Morley has clearly been in error. On the other hand, the affidavit of Mr Dobson, a solicitor, sworn on behalf of the Defendants, shows convincingly that there was a course

of dealing between the parties which in one respect at least varied the 'no set-off' clause. By course of dealing it was agreed that the Defendants would be entitled to set off the purchase price of goods sold to the Plaintiffs against the royalties. It may be said that this is a variation of the 'no set-off' clause only *quoad* the purchase price of the goods. On the other hand, it seems to me arguable that the course of conduct, which on any view had an impact on the 'no set-off' clause, in fact had the consequence of deleting it altogether. The claim for US $53,875.81 is therefore, in my judgment, a genuinely disputable claim.

The stay must be in respect of the entirety of the Plaintiffs' claim in the legal proceedings.

It is right, however, that I should add that the Plaintiffs' application for judgment under Order XIV was only made after the first hearing before me. The Defendants wanted time to put in further evidence. In view of the fact that on the materials before me the Plaintiff was not entitled to judgment under Order XIV I did not adjourn the matter.

It follows that I must dismiss the Plaintiffs' two applications and grant an order in terms of the Defendants' summons for a stay of the High Court proceedings. There is now no impediment to the continuance of the ICC arbitration.

(*Discussion re costs*)
