UK 39

[COURT OF APPEAL]

HARBOUR ASSURANCE CO. (U.K.) LTD. v. KANSA GENERAL INTERNATIONAL INSURANCE CO. LTD. AND OTHERS

1993 Jan. 25, 26; 28 Ralph Gibson, Leggatt and Hoffmann L.JJ.

Arbitration—Arbitrator—Jurisdiction—Dispute under reinsurance contracts—Allegations of illegality—Whether illegality dispute covered by arbitration clause—Whether arbitration clause severable—Whether defendants entitled to stay of action

The plaintiffs agreed to reinsure the defendants in respect of risks for the years 1980, 1981 and 1982. The agreement contained an arbitration clause which provided that all disputes arising thereunder should be submitted to arbitration. The plaintiffs claimed that the defendants were not registered or approved to effect or carry on insurance or reinsurance business in Great Britain under the Insurance Companies Acts 1974 and 1981 and that the agreement was therefore void for illegality and sought a declaration to that effect. The defendants applied for an order that the action should be stayed pursuant to section 1 of the Arbitration Act 1975. The judge held that the issue of initial illegality was not within the jurisdiction of an arbitrator and dismissed the application.

On appeal by the defendants:—

Held, allowing the appeal, that an arbitration clause contained in a written contract was a collateral agreement which fell to be construed according to its terms and the wishes of the parties; that the question of initial illegality of a contract, not directly impeaching the arbitration clause, was capable of being within the jurisdiction of an arbitrator; that whether a particular form of illegality rendered void both the arbitration clause and the contract depended upon the nature of the illegality; that the illegality pleaded had not affected the validity of the arbitration clause which, as a matter of construction, was wide enough to cover the issue, and the question of initial illegality was, therefore, a dispute arising out of the agreement; and that, accordingly, a stay of the action would be granted (post, pp. 47E–F, 49C–D, 50C, 51B–C, 52A–F, 53A–D, 56D–G, 57B, 62E—63C).

Heyman v. Darwins Ltd. [1942] A.C. 356, H.L.(E.) considered.

David Taylor & Son Ltd. v. Barnett Trading Co. [1953] 1 W.L.R. 562, C.A. distinguished.

Decision of Steyn J. [1992] 1 Lloyd's Rep. 81 reversed.

The following cases are referred to in the judgments:

Ashville Investments Ltd. v. Elmer Contractors Ltd. [1989] Q.B. 488; [1988] 3 W.L.R. 867; [1988] 2 All E.R. 577, C.A.

Bremer Vulkan Schiffbau und Maschinenfabrik v. South India Shipping Corporation Ltd. [1981] A.C. 909; [1981] 2 W.L.R. 141; [1981] 1 All E.R. 289, H.L.(E.)

Dalmia Dairy Industries Ltd. v. National Bank of Pakistan [1978] 2 Lloyd's Rep. 223, C.A.

Decision of 27 February 1970 (1990) Arbitration International, vol. 6, No. 1, p. 79

Fillite (Runcorn) Ltd. v. Aqua-Lift (a firm) (1989) 45 B.L.R. 27, C.A.

Heyman v. Darwins Ltd. [1942] A.C. 356; [1942] 1 All E.R. 337, H.L.(E.)

Hirji Mulji v. Cheong Yue Steamship Co. Ltd. [1926] A.C. 497, P.C.

Langton v. Hughes (1813) 1 M. & S. 593

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Lee (Joe) Ltd. v. Lord Dalmeny [1927] 1 Ch. 300
Mackender v. Feldia A.G. [1967] 2 Q.B. 590; [1967] 2 W.L.R. 119; [1966] 3 All E.R. 847, C.A.
Mahmoud and Ispahani, In re [1921] 2 K.B. 716, C.A.
Paal Wilson & Co. A/S v. Partenreederei Hannah Blumenthal [1983] 1 A.C. 854; [1982] 3 W.L.R. 1149; [1983] 1 All E.R. 34, H.L.(E.)
Phoenix General Insurance Co. of Greece S.A. v. Halvanon Insurance Co. Ltd. [1988] Q.B. 216; [1987] 2 W.L.R. 512; [1987] 2 All E.R. 152, C.A.
Prenn v. Simmonds [1971] 1 W.L.R. 1381; [1971] 3 All E.R. 237, H.L.(E.)
Prima Paint Corporation v. Flood & Conklin Manufacturing Co. (1967) 388 U.S. 395
Prodexport State Co. for Foreign Trade v. E. D. & F. Man Ltd. [1973] Q.B. 389; [1972] 3 W.L.R. 845; [1973] 1 All E.R. 355
Smith, Coney & Barrett v. Becker, Gray & Co. [1916] 2 Ch. 86
Sojuznefteexport v. Joc Oil Ltd. (unreported), 7 July 1989; (1990) Yearbook of Commercial Arbitration 384
Taylor (David) & Son Ltd. v. Barnett Trading Co. [1953] 1 W.L.R. 562; [1953] 1 All E.R. 843, C.A.
Union of India v. E. B. Aaby's Rederi A/S [1975] A.C. 797; [1974] 3 W.L.R. 269; [1974] 2 All E.R. 874, H.L.(E.)

The following additional cases were cited in argument:

Antonio P. Lemos, The [1985] A.C. 771; [1985] 2 W.L.R. 468; [1985] 1 All E.R. 695, H.L.(E.)
Craig v. National Indemnity Co. (unreported), 25 July 1980, Lloyd J.
Deutsche Schachtbau-und Tiefbohrgesellschaft m.b.H. v. R'As al-Khaimah National Oil Co. [1990] 1 A.C. 295; [1987] 3 W.L.R. 1023; [1987] 2 All E.R. 769, C.A.
Empresa Exportadora de Azucar v. Industria Azucarera Nacional S.A. [1983] 2 Lloyd's Rep. 171, C.A.
Gibraltar (Government of) v. Kenney [1956] 2 Q.B. 410; [1956] 3 W.L.R. 466; [1956] 3 All E.R. 22
Kruse v. Questier & Co. Ltd. [1953] 1 Q.B. 669; [1953] 2 W.L.R. 850; [1953] 1 All E.R. 954
Sykes v. Fine Fare Ltd. [1967] 1 Lloyd's Rep. 53, C.A.
Willcock v. Pickfords Removals Ltd. [1979] 1 Lloyd's Rep. 244, C.A.

INTERLOCUTORY APPEAL from Steyn J.

The plaintiffs, Harbour Assurance Co. (U.K.) Ltd., claimed, inter alia, a declaration that certain insurance policies made by way of obligatory quota share retrocession, taking effect for the years 1980 to 1984, entered into with the six defendants, Kansa General International Insurance Co. Ltd., Tapiola International Insurance Co. Ltd., Keskinainen Vakuutusyhtio Autoilijat (a body corporate), Tyovaen Keskinainen Vakuutusyhtio Turva (a body corporate), Keskinainen Vakuutusyhtio Varma (a body corporate) and Finnish Industrial and General Insurance Co. Ltd., were void for illegality on the grounds, inter alia, that the defendants were not registered or approved to effect or carry on insurance or reinsurance business in Great Britain under the Insurance Companies Act of 1974 and 1981. The agreements contained an arbitration clause and the defendants applied for the action to be stayed under section 1 of the Arbitration Act 1975. On the trial of a preliminary issue Steyn J. [1992] 1 Lloyd's Rep. 81 ruled that he was compelled by authority to hold that the principle of separability of an arbitration clause from the contract in which it was contained, could not extend so as to enable the arbitrator to consider whether the contract itself was void ab initio for illegality, and dismissed the application.

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By a notice of appeal dated 18 November 1991 the first, third, fourth and fifth defendants appealed on the grounds, inter alia, that (1) the judge had erred in holding that it was part of the ratio decidendi of *Smith, Coney & Barrett v. Becker, Gray & Co.* [1916] 2 Ch. 86 and/or *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562 that an issue of illegality as to the primary contract could not be determined under an arbitration agreement; (2) the judge should have held, consistently with his findings as to the developments in the common law and by legislation, that an arbitration agreement, being a separate contract to the primary contract to which it referred, was capable of applying to a dispute of any nature, including initial invalidity of the primary contract, providing the arbitration agreement was sufficiently widely drafted, and (3) the judge, having correctly found that the arbitration agreement was sufficiently widely drafted as a matter of language to cover disputes as to the initial validity and/or illegality of the contracts of retrocession between the plaintiff and the first, third, fourth and fifth defendants, ought to have held that the disputes which were the subject of the action fell within the scope of the arbitration agreement and should therefore have ordered that the action be stayed pursuant to section 1 of the Arbitration Act 1975.

By a respondents' notice dated 6 December 1991 the plaintiffs contended that the judge's order should be affirmed on the additional grounds, inter alia, that (1) the judge, while correctly holding that arbitrators had no jurisdiction to determine disputes as to the illegality of a contract, had failed further to hold that the non-arbitrability of such disputes accorded with the decision and the reasoning of the majority of the House of Lords in *Heyman v. Darwins Ltd.* [1942] A.C. 356; (2) the judge had incorrectly held that a principle of the separability of the arbitration contract was inherent in the ratio decidendi of *Heyman v. Darwins Ltd.*; (3) the judge had erred in law in holding that disputes as to whether a contract was void or voidable for misrepresentation were arbitrable and (4) alternatively, the judge had erred in law in finding that the arbitration clause was drawn in sufficiently wide terms as to cover disputes as to the initial validity of the retrocession agreement or disputes as to illegality, as the clause was drawn in language not apt to cover such disputes.

The facts are stated in the judgment of Ralph Gibson L.J.

Sydney Kentridge Q.C. and *Stephen Ruttle* for the first, third, fourth and fifth defendants.

Andrew Longmore Q.C. and *Timothy Saloman* for the plaintiffs.

Cur. adv. vult.

28 January. The following judgments were handed down.

RALPH GIBSON L.J. This is an appeal, brought with the leave of Steyn J., by the first, third, fourth and fifth defendants against his order of 16 July 1991 in an action brought by Harbour Assurance Co. (U.K.) Ltd. By that order Steyn J. [1992] 1 Lloyd's Rep. 81 dismissed the application by the defendants for a stay of the action under section 1 of the Arbitration Act 1975.

This case raises the question whether in English law, under the principle of the separability or autonomy of the agreement expressed in an arbitration clause, which clause is contained in a written contract, the

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clause can give jurisdiction to the arbitrators under that clause to determine a dispute over the initial validity or invalidity of the written contract, upon the assumptions that upon its true construction the arbitration clause covers such a dispute and that the nature of the invalidity alleged does not attack the validity of the agreement expressed in the arbitration clause itself.

The orthodox view in English law has always been, it has been said for the plaintiffs, that if the contract in which the arbitration clause is contained is void ab initio, and therefore nothing, so also must be the arbitration clause in the contract. That is the proposition that nothing can come of nothing; ex nihil nil fit. It has also been called in this case the argument of logic.

In the action, commenced on 2 November 1989, the plaintiffs claim, inter alia, a declaration that certain insurance policies made by way of obligatory quota share retrocession, taking effect for the years 1980 to 1984, and entered into by the plaintiffs with the defendants, are void and that the plaintiffs are not liable in respect of them. Allegations are made against the defendants of non-disclosure of material facts and of misrepresentation by reason of which the plaintiffs say that they avoided the reinsurances by letter in 1989. With those allegations this court is not concerned. They will be for decision by the arbitrator if the appeal succeeds and if the contract is otherwise enforceable. In addition, however, the plaintiffs assert that in respect of the reinsurances for 1980, 1981 and 1982, the defendants were not registered or approved to effect or carry on insurance or reinsurance business in Great Britain by the Department of Trade under the Insurance Companies Acts 1974 and 1981, and that, therefore, the reinsurances for 1980, 1981 and 1982 are void for illegality. All the allegations of illegality are denied by the defendants.

The relevant reinsurance agreements between the plaintiffs and the defendants contain an arbitration clause. The relevant terms of the clause are:

> "All disputes or differences arising out of this agreement shall be submitted to the decision of two arbitrators one to be chosen by each party and in the event of the arbitrators failing to agree, to the decision of an umpire to be chosen by the arbitrators before entering upon the reference. The arbitrators and umpire shall be executive officials of insurance or reinsurance companies; or Lloyd's underwriters. If either of the parties fails to appoint an arbitrator within one month after being required by the other party in writing to do so or if the arbitrators fail to appoint an umpire within one month of their nomination, such arbitrators or umpire as the case may be shall at the request of either party be appointed by the chairman of the Reinsurance Offices Association. The arbitration proceedings shall take place in London."

The defendants applied for the action to be stayed under section 1 of the Act of 1975. On 11 February 1990 Gatehouse J. ordered that, pursuant to the applications of the defendants under section 1, a preliminary issue should be tried

> "whether the court is satisfied that, by reason of illegality, (i) the arbitration agreements contained in the retrocession agreements for the underwriting years 1980, 1981 and 1982 are null and void, inoperative or incapable of being performed; (ii) there is not in fact

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any dispute or difference between the parties within the meaning of the said arbitration agreements."

Pleadings were delivered in the preliminary issue. A procedural complication arose as described by Steyn J. [1992] 1 Lloyd's Rep. 81, 85. As a result of agreement between the parties the only issues considered by him were whether, as the defendants alleged, the arbitration clause was wide enough to cover the illegality issue, and whether there was no impediment in law to giving effect to the arbitration agreement.

For the reasons set out in his judgment, Steyn J. concluded that he was compelled by authority to hold that the principle of separability could not extend so as to enable the arbitrator to determine whether or not the contract, in which the arbitration clause is contained, is in fact void ab initio for illegality. He therefore dismissed the application for a stay of proceedings in which the plaintiffs seek to establish that illegality.

The appeal by the defendants was directed only to the last passages of the judgment by the judge, by which he held that he was required by authority to hold as he did. In all other respects the defendants adopted and supported the conclusions and reasoning of the judge.

Before dealing with the main issues in the appeal reference must be made to the issues of illegality. The issues were described briefly by Steyn J., at p. 84. In opening the appeal, Mr. Kentridge pointed to the allegations of the plaintiffs in their pleadings and noted that the plaintiffs themselves were authorised under the Acts of 1974 and 1981; and that if the allegations of fact as to where the defendants carried on their business were made out, the underlying reinsurances written by the defendants would be invalid and any rights of the defendants under the retrocession agreements between the plaintiffs and the defendants would be unenforceable. One consequence would be that if the underlying reinsurance contracts were invalid, the defendants would have no insurable interest in respect of which they could claim against the plaintiffs. That contention he said, would clearly be within the jurisdiction of the arbitrator, but, by making the allegation in the form that the retrocession agreements were rendered void, the plaintiffs were trying to remove from the arbitrators issues which the parties had agreed should be decided by them. That was relevant to one of the policy grounds considered by Steyn J. Hoffmann L.J. then raised the question whether the allegations of the plaintiffs did raise an issue as to the initial voidness of the retrocession agreements as contrasted with an issue as to their enforceability by the defendants.

The point raised seemed to me to be of substantial weight. Mr. Kentridge, however, said that he had not raised the point before the judge, and did not seek to raise it in this court. We proceed therefore on the same basis as that accepted by Steyn J.

In brief summary, the judge held as follows. (i) The principle of the separability of the arbitration clause or agreement from the contract in which it is contained exists in English law; and, provided that the arbitration clause itself is not directly impeached, the arbitration agreement is, as a matter of principled legal theory, capable of surviving the invalidity of the contract so that the arbitrators could have jurisdiction under the clause to determine the initial validity of the contract. Further, it would be consistent to hold that an issue as to the initial illegality of the contract is also capable of being referred to arbitration, provided that any initial illegality does not directly impeach the arbitration clause.

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A (ii) The illegality alleged in this case does not impeach the arbitration clause. (iii) The arbitration clause on its proper construction is wide enough to cover a dispute as to the initial illegality of the contract. (iv) To his evident regret, however, Steyn J. was driven to hold that the principle of separability could not apply when the alleged ground of invalidity of the contract was initial illegality. The decision of this court in *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562 B compelled him to hold that the separability principle does not extend to initial illegality.

For the defendants Mr. Kentridge submitted, as already indicated, that Steyn J. was right in holding as he did on points (i), (ii) and (iii) above for the reasons which he gave, but contended that the decision in the *Taylor* case did not bind the judge to hold that the principle of C separability could not apply so as to permit an arbitrator to decide an issue of initial illegality.

The contentions of the plaintiffs, in their respondents' notice, included the following. (i) The judge was wrong not to hold that the non-arbitrability of an issue of initial illegality was established by the reasoning of the majority in *Heyman v. Darwins Ltd.* [1942] A.C. 356. (ii) English law has adopted the principle of separability only so far as to D leave disputes as to initial validity or legality outside the jurisdiction of arbitrators. (iii) The logical ground for excluding the arbitrator's jurisdiction in cases of initial invalidity and initial illegality is ex nihil nihil fit, and it would be contrary to logic and principle to differentiate between cases of "direct" and "indirect" invalidity of the arbitration clause. (iv) Disputes as to the legality of the contract do impeach the E arbitration clause contained in the contract either directly or sufficiently directly to exclude the arbitrator's jurisdiction. (v) Lastly, this arbitration clause is not wide enough to cover disputes as to the initial validity of the retrocession agreement, or disputes as to illegality.

For my part, for the reasons which follow, I would uphold the reasoning and conclusions of Steyn J. on all aspects of his judgment, save for his final conclusion that he was bound by the decision in *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562 to hold as he F did. I would hold that this court can properly distinguish the decision in the *Taylor* case, and I would therefore allow this appeal.

As to the contention based upon *Heyman v. Darwins Ltd.* [1942] A.C. 356, the speeches in that case were examined again in this court in detailed argument. Mr. Longmore submitted that the ratio of the decision is that a distinction is to be drawn between a contract which is alleged to G have come to an end, and a contract which is alleged never to have been made and never to have been valid. Whereas an arbitration clause cannot apply to initial validity, that clause may apply to termination because it survives to deal with it. The statement of that to which an arbitration clause did not apply was as much part of the decision of their Lordships as the statement of that to which it did. I do not accept this submission, H and I can add nothing useful to the reasons given by Steyn J., with which I agree.

Mr. Longmore next relied upon the weight of opinion contained in the textbooks and in many dicta and decisions in support of the orthodox view, and from which he urged this court not to depart. Examples from textbooks were passages in *Mustill & Boyd, Commercial Arbitration*, 2nd ed. (1989), p. 113; *Halsbury's Laws of England*, 4th ed. (reissue), vol. 2 (1991), p. 337, para. 612 and *Chitty on Contracts*, 26th ed. (1989),

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pp. 639–640, para. 1068. The cases mentioned included *Smith, Coney & Barrett v. Becker, Gray & Co.* [1916] 2 Ch. 86; *Joe Lee Ltd. v. Lord Dalmeny* [1927] 1 Ch. 300; *Mackender v. Feldia A.G.* [1967] 2 Q.B. 590; *Prodexport State Co. for Foreign Trade v. E. D. & F. Man Ltd.* [1973] Q.B. 389 and *Dalmia Dairy Industries Ltd. v. National Bank of Pakistan* [1978] 2 Lloyd's Rep. 223.

Mr. Longmore also disputed the correctness of Steyn J.'s view that policy considerations were all clearly in favour of the incremental development of the principle of separability so as to extend to initial illegality. It was acknowledged that parties generally do not want to face two sets of proceedings, and that that consideration was properly taken into account in *Ashville Investments Ltd. v. Elmer Contractors Ltd.* [1989] Q.B. 488, in upholding the jurisdiction of the arbitrator under that clause to determine a claim to rectification under that contract.

The risk of two sets of proceedings, however, cannot be excluded, it was said, because it is common ground that if the attack on the initial validity of the contract must be taken to include an attack upon the validity of the arbitration clause as well, then the issue of validity must be for the court. Next, it could not be assumed that parties to commercial or other contracts with arbitration clauses would necessarily prefer or intend an issue as to original illegality to be decided by the arbitrator, particularly when the clause provides for the arbitrator to be from those engaged in a particular profession or branch of trade or commerce, as contrasted with a clause which permits the parties to appoint a lawyer, or person of other particular skills as so advised.

Further, it was submitted, there was little force in the reference by the judge to the preservation of the perceived neutrality of the arbitral process by not directing that an issue of initial illegality be removed from the arbitrator to the national court. In most cases, it was said, the parties, by the terms of the contract including the arbitration agreement, will have determined the proper law of the contract and the national court to which any issue will be referred. Contrary to the view of Steyn J. Mr. Longmore submitted that policy considerations should cause the court to favour reserving issues as to the initial validity of the contract for decision by the court.

The policy consideration which is of greatest weight, in my judgment, is what the judge called the imperative of giving effect to the wishes of the parties unless there are compelling reasons of principle why it is not possible to do so.

The first argument for the plaintiffs, that is, the orthodox view to which we are invited to adhere, is based on the logic of the proposition that nothing can come from nothing. Mr. Longmore's adherence to that logical proposition was, I think, less than fully constant because he, on occasion, referred to the proposition as applying to the "ordinary" arbitration clause. An example of what we are, I think, to understand as an "extraordinary" arbitration clause in this context is provided by article 8.4 of the rules of arbitration of the International Chamber of Commerce, which expressly provides that the arbitrator shall not cease to have jurisdiction by reason of any claim that the contract is null, void or inexistent, provided that he upholds the validity of the agreement to arbitrate. The logical proposition, however, upon which the orthodox view is based, does not depend upon the terms or construction of the arbitration clause. It asserts that if the containing contract is void ab initio, an arbitration clause contained within it is also void. It follows

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that if the logical argument is applied according to its terms, the intention of the parties could be thwarted even if, on its true construction, the clause shows, not only that the dispute is within those agreed to be referred, but also that the clause was intended to survive the validity of the contract.

Such a rule of law should in my judgment be rejected if this court can properly hold that it is not part of our law. Once that rule is removed, the parties remain free to exclude from the arbitrator's jurisdiction any issue which they prefer to leave to the court. That freedom will, I think, sufficiently answer the arguments of policy advanced by Mr. Longmore.

The reference to an extraordinary arbitration clause as possibly outside the logical proposition is in effect an argument that, for the principle of separability to be applied so as to save the clause from voidness by reason of the voidness of the containing contract, special words are needed. I do not accept this argument. An arbitration clause, in ordinary terms—that is to say, without special words to ensure survival—is usually, and has been held to be, a self-contained contract collateral to the containing contract. As with any other contract, it must be construed according to its terms in and with regard to the relevant factual situation. I see no reason to establish a principle of this nature which would require special words to be inserted in order to secure that which the parties would probably suppose was covered by the ordinary words.

For that reason, which is of course contained in Steyn J.'s judgment, it seems to me to be right for this court to be willing to abandon the orthodox view, if we are free to do so, notwithstanding the endorsement of it by so many authorities and judges.

Steyn J., if not prevented by authority, would have held that an issue as to initial illegality is capable of being within the jurisdiction of an arbitrator under a clause contained within that contract, provided that any initial illegality does not directly impeach the arbitration clause itself. He also held that the illegality alleged in this case does not impeach the arbitration clause. The concept of requiring direct impeachment was criticised in the respondents' notice, and it was asserted that this dispute as to the legality of the contract does sufficiently impeach the arbitration clause so as to require the issue to be decided by the court. As advanced in the notice it seems to me that these contentions are part of and dependent upon the argument of the logical proposition and fall with it.

Mr. Longmore however, as I understood him, also argued that, even if the logical proposition argument fails, problems remain as to when, and in what circumstances, an attack upon the initial validity of the contract must be taken to include an attack upon the initial validity of the separate but contained arbitration agreement. He criticised, for example, Steyn J.'s approach to questions of fraud. Steyn J. held that the inexorable logic of the decision in *Mackender v. Feldia A.G.* [1967] 2 Q.B. 590 required him to hold that a question of voidability for fraudulent misrepresentation is just as much capable of being referred to arbitration as an issue of avoidance for innocent misrepresentation.

Mr. Longmore pointed out that a party to a contract the making of which he says was induced by fraud, would be surprised to be told that he is bound to have the issue tried by an arbitrator appointed under a clause in that contract. He also pointed out that when such a party alleges that the contract is void for illegality, he might well be astonished

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to be told that the issue of that illegality is to be determined by an arbitrator appointed under it.

There is, I think, force in these comments, but I add that in my view they are no more than forceful comments. Steyn J. said that the question of fraud or initial illegality was *capable* of being referred to arbitration. He did not qualify the clearly stated principle that if the validity of the arbitration clause itself is attacked, the issue cannot be decided by the arbitrator. His reference to direct impeachment was, as I understand his judgment, to distinguish an attack upon the clause otherwise than by the logical proposition that the clause falls with the containing contract. When it is said that the contract was induced by fraud it may well be clear that, if it was, the making of the independent arbitration clause was also induced by the fraud. There is, further, the power of the court under section 24(2) of the Arbitration Act 1950, considered by Steyn J. [1992] 1 Lloyd's Rep. 81, 88.

Next, as to illegality, the question whether the particular form of illegality will, if proved, render void both the contract and the arbitration clause must depend upon the nature of the illegality and, as Hoffmann L.J. pointed out in the course of argument, when it is said to consist of acts prohibited by statute, upon the construction of the relevant provisions of the statute.

For example, the decision of Eve J. in *Joe Lee Ltd. v. Lord Dalmeny* [1927] 1 Ch. 300, in which he rejected the argument that an arbitration clause in a contract for betting was collateral to the betting transaction and therefore valid, might well I think be decided in the same way if the principle of separability is upheld by this court as far as Steyn J. thought it should extend.

I come now to the question of authority; to *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562. In that case the contract for the sale of canned meat was illegal under price control legislation. The umpire awarded damages for non-delivery to be paid by the sellers, although the indisputable illegality of the contract was pointed out to him. The motion by the sellers to set aside the award on the grounds that (i) the award was bad on its face and (ii) the umpire had misconducted himself in law in failing to take into account the illegality of the contract, was dismissed by Lord Goddard C.J.

On appeal to the Court of Appeal, the same two grounds were before the court. The first was dismissed and is irrelevant. On the second ground the appeal succeeded. Steyn J. noted that it was arguable that the *Taylor* case was decided on the basis that the arbitrator committed misconduct which warranted the setting aside of the award, and, if that was right, the decision is not authority for the proposition that an issue of illegality of the contract cannot be decided under an arbitration clause in that contract. On balance, however, he concluded that the decision could not be so distinguished at first instance. His comments upon the judgments of Singleton, Denning and Hodson L.JJ. are set out in his judgment [1992] 1 Lloyd's Rep. 81, 94.

I do not accept his view of the decision in the *Taylor* case [1953] 1 W.L.R. 562. It is clear that it was not argued, and the court did not address the proposition, that, although the contract was admittedly unlawful, the arbitrator did or did not have jurisdiction under an independent arbitration clause to determine whether it was unlawful. There would have been no point in such a contention. If he had jurisdiction to decide it, he could only lawfully decide it one way, and he

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had, in misconduct, chosen the other. The decision was not, in my judgment, a decision upon the point now before this court.

I will add that Denning L.J. did not, as I read his judgment, base his reasoning on a jurisdictional ground in any relevant sense. He rejected, at p. 570, the argument that the arbitrator could award what he thought it was fair to award, despite the illegality. He added, "If a contract is illegal, then arbitrators must decline to award upon it just as the court would do." If Denning L.J. had had in mind the point now in issue and intended to decide it as Mr. Longmore contends he did, he would have said, "If it is *alleged* that a contract is illegal, he must decline to consider whether it is" and he would not have said, "just as the court would do" because the court would not decline to give judgment but would decide whether it was illegal and give judgment accordingly. There is, in my judgment, no authority which requires the court to dismiss the appeal on jurisdiction.

The last point is the construction of the clause. The words are, "All disputes or differences arising out of this agreement shall be submitted to the decision of two arbitrators . . ." Mr. Longmore's submissions included the following. (i) The words "arising out of this agreement" envisage an existing valid agreement or contract. (ii) A dispute as to whether the contract was void at inception does not arise out of the contract. (iii) If an arbitration clause is capable in law of conferring jurisdiction on arbitrators to decide whether the contract is invalid "very clear language" is required to achieve such a result. Reference was made to the speech of Lord Porter in *Heyman v. Darwins Ltd.* [1942] A.C. 356, 392. (iv) In *Union of India v. E. B. Aaby's Rederi A/S* [1975] A.C. 797, Viscount Dilhorne, at p. 814, and Lord Salmon, at p. 817, indicated that there was no discernible difference in width of meaning between "arising out of a contract" and "under a contract."

In *Fillite (Runcorn) Ltd. v. Aqua-Lift (a firm)* (1989) 45 B.L.R. 27, the words of the clause were, "any dispute or difference arising under" the agreement. Nourse L.J. said, at p. 44:

> "The preposition 'under' presupposes that the noun which it governs already has some existence. It operates in time as well as in space. I think that it means 'as a result of and with reference to.' The disputes as to express or implied terms in the composite Peterborough contract arise both as a result of and with reference to that contract and are therefore with clause 14 of the heads of agreement. The disputes as to negligent misstatement, misrepresentation under the Act of 1967 and collateral warranty or contract, while they may in a loose sense be said to arise with reference to the contract, cannot be said to arise as a result of it. They all relate to matters which either preceded the contract or were at best contemporaneous with it. Those disputes are therefore outside clause 14. I agree with Slade L.J. that the material words are not wide enough to include disputes which do not concern obligations created by or incorporated in the contract."

It was then submitted that since the words in the present clause "arising out of" the contract are for this purpose no wider than "under" the contract (see *Union of India v. E. B. Aaby's Rederi A/S.* [1975] A.C. 797) then, as in *Fillite (Runcorn) Ltd. v. Aqua-Lift (a firm)* 45 B.L.R. 27, where the word was "under," the present clause presupposes that the

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contract was in existence and not void for illegality. The words do not apply to the issue as to whether the contract was in existence or void.

In my judgment, Steyn J. was right to hold that, as a matter of construction of the contract, the present clause covers the issue of illegality, and his conclusion does not conflict with the judgment of Nourse L.J. in the *Fillite* case with which Hollings J. there agreed.

In agreeing that "all disputes or differences arising out of this agreement shall be submitted to the decision of two arbitrators," the parties were indeed presupposing that "the agreement" had some relevant existence. For this purpose I think "this agreement" means the act of the parties recorded in the document which contains the mutual promises which they have made. The meaning and effect of those promises with references to their subsequent acts would be determined according to law and, if necessary, under the proviso for arbitration. The words must be construed by reference to any relevant facts (see *Prenn v. Simmonds* [1971] 1 W.L.R. 1381) but there has been no reliance on any particular circumstances for this purpose other than those evident from the making of the contract itself. The question whether all the promises contained in the agreement were rendered invalid and void at the time when the parties signed the documents by the illegality of the agreement, is, in my judgment, a dispute arising out of the agreement.

There was much material put before the court to which I have not referred. The material was provided to us before the hearing so that we were able to read it before the argument commenced. We are indeed grateful for this assistance. I have not referred to the authorities copied, to the extracts from textbooks and articles, and to the reports of decisions in the courts of the United States, Australia, Germany and Bermuda. In a case of this nature it was, I think, of importance that we be shown this material so that we should be instructed as to the development in this part of the law in other jurisdictions. The parties were not at one as to the precise direction and extent of such development. It is sufficient in my judgment to say that I have read much that has encouraged me to reach the conclusion expressed in this judgment, and nothing to suggest that in doing so I would be ignoring any substantial matter of policy or departing from any principle which should form part of the development of the common law.

I would allow this appeal.

LEGGATT L.J. The judge acceded to the submission that if he were to rule on the legality of the retrocession agreement, he would be deciding the very question which the arbitrator was supposed to determine. So the judge preferred to decide instead the question whether the arbitrator could determine whether or not the agreement was illegal ab initio. If he could not, then the judge would have to do so. But just as the court may decline to grant a stay under section 1 of the Arbitration Act 1975 on the ground that there is not in fact any dispute between the parties with regard to the matter agreed to be referred, so I should have thought that it would have been open to the judge to have concluded that, as Hoffmann L.J. suggested in argument, (a) performance of the retrocession agreement was not itself illegal, and (b) lack of an insurable interest would render it unenforceable, but not void. Upon that basis there would be no ground for arguing that the proceedings should be stayed.

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I am therefore chary of the assumption upon which we have been invited to proceed for purposes of this appeal that the retrocession agreement was itself illegal by reason of the assumed illegality of the underlying reinsurance agreements. But making that assumption, I agree with the judge's conclusion [1992] 1 Lloyd's Rep. 81, 93:

> "the separability principle, as applicable also to cases of the initial invalidity of the contract, is sound in legal theory. It is also in the public interest that the arbitral process, which is founded on party autonomy, should be effective. There are strong policy reasons in favour of holding that an arbitration clause is capable of surviving the initial invalidity of the contract. . . . As a matter of precedent it is therefore open to make a ruling such as I have indicated. In my judgment, the developments which have taken place, and the reasons for it, required me to make such a ruling. I do so."

I also agree that it would be consistent with his general approach to say that the initial illegality of the contract is capable of being referred to arbitration, provided that it does not impeach the arbitration clause itself; that supervening illegality can be so referred; and that an arbitrator appointed under a contemporaneous document separate from the contract can determine an issue as to initial illegality.

Mr. Longmore recognised that his best hope of stemming the tide running in favour of arbitral autonomy was to limit the scope of the principle of separability. Taking his stand as the last bastion of orthodoxy, Mr. Longmore bravely contended that it is part of the ratio decidendi of *Heyman v. Darwins Ltd.* [1942] A.C. 356 that, as Viscount Simon L.C. commented, at p. 366:

> "if one party to the alleged contract is contending that it is void ab initio (because, for example, the making of such a contract is illegal), the arbitration clause cannot operate, for on this view the clause itself also is void."

In my judgment, because Viscount Simon L.C.'s comment was not necessary to the decision, it formed no part of the ratio decidendi. The true ratio decidendi was expressed by Lord Macmillan in these words, at p. 374:

> "what is commonly called repudiation or total breach of a contract, whether acquiesced in by the other party or not, does not abrogate the contract, though it may relieve the injured party of the duty of further fulfilling the obligations which he has by the contract undertaken to the repudiating party. The contract is not put out of existence, though all further performance of the obligations undertaken by each party in favour of the other may cease. It survives for the purpose of measuring the claims arising out of the breach, and the arbitration clause survives for determining the mode of their settlement."

In more recent cases, beginning with *Bremer Vulcan Schiffbau und Maschinenfabrik v. South India Shipping Corporation Ltd.* [1981] A.C. 909, the House of Lords has explained the status of the arbitration clause. For example, Lord Diplock asserted in *Paal Wilson & Co. A/S v.*

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Partenreederei Hannah Blumenthal [1983] 1 A.C. 854, 917, that it was established in *Heyman v. Darwins Ltd.* [1942] A.C. 356 that

> "An arbitration clause is collateral to the main contract in which it is incorporated and it gives rise to collateral primary and secondary obligations of its own."

Mr. Longmore submits that the mere fact that the arbitration clause is collateral does not mean that the arbitrator can deal with initial invalidity. Aside from the question of construction, the argument in logic is that because there was, or is alleged to have been, no contract in the first place, the arbitration clause goes that was contained in it. The counter-argument is that because the arbitration agreement is separable from the contract containing it, it has a life of its own, which continues while the fate of the contract is being determined. Where the contract is alleged to have been invalidated by statute, the essential question must be whether the statute was intended to strike down the submission to arbitration.

Before examining the reason why the judge ultimately refrained from holding that the separability principle extends to initial illegality of a contract in which the arbitration clause is incorporated, it is convenient to consider the principle in the light of the comments of Judge Schwebel in the paper cited by Steyn J., "The Severability of the Arbitration Agreement," published in *International Arbitration: Three Salient Problems* (1987), pp. 1–60.

The arbitration agreement, if sufficiently widely drawn, is from its nature intended by the parties to govern any dispute that may arise between them, including a dispute about the initial illegality of the contract. There is no reason why the parties should have intended to exempt from the scope of the arbitration clause a dispute such as the plaintiffs saw fit to instigate here about whether the retrocession agreement was itself infected by illegality of the underlying insurance agreements. Otherwise it would put it in the power of one contracting party to prevent arbitration from taking place simply by alleging that the contract was void for initial illegality, though why in this case the plaintiffs should wish for more publicity than is necessary remains a mystery. It is worth noting, as Judge Schwebel has remarked, at p. 5 of his paper:

> "the courts of most countries will not review the holdings of an arbitrator on the substance of the case and accordingly will not challenge his holding with respect to the principal agreement which contains the arbitral clause."

Judge Schwebel concluded, at p. 60:

> "As a matter of practice, that principle [of the severability of an arbitration clause from the principal agreement which contains it] has been sustained by the terms and implications of arbitration conventions and rules, and by the case law, whether public international law, international commercial arbitration, or national arbitration."

The separability principle is seen in its simplest form in the United States Arbitration Act 1925, section 4 of which provides that

> "upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order . . ."

equivalent to a stay.

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In this case there is no dispute about the making of the retrocession agreement nor is it disputed that it contained an arbitration clause; and the objection to the arbitrator's jurisdiction did not constitute a failure to comply with the arbitration clause. Delivering the opinion of the majority of the Supreme Court of the United States in *Prima Paint Corporation v. Flood & Conklin Manufacturing Co.* (1967) 388 U.S. 395, 403–404, Fortas J. said:

> "Accordingly, if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally."

For present purposes it is unnecessary to consider the answer either to the question whether the contract was actually concluded or to the question whether the arbitration agreement itself was valid. Neither is in doubt here.

It was by *Smith, Coney & Barrett v. Becker, Gray & Co.* [1916] 2 Ch. 86; *Joe Lee Ltd. v. Lord Dalmeny* [1927] 1 Ch. 300 and *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562 that the judge felt inhibited from holding that an issue as to initial illegality of the contract is capable of being referred to arbitration. *Smith, Coney & Barrett v. Becker, Gray & Co.* [1916] 2 Ch. 86 related to a contract that was held not to be illegal, and the principle of separability was not mooted. *Joe Lee Ltd. v. Lord Dalmeny* [1927] 1 Ch. 300 was decided by Eve J. on the ground that he could not separate the arbitration agreement from the gaming or wagering contract of which it formed part. It therefore constituted an express rejection of the principle at a date before it had been considered by the House of Lords.

In *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562, one of the two grounds relied on by the seller's motion to set aside the award was that it was bad on the face of it, in that it incorporated by reference and purported to enforce a contract that was illegal. Singleton and Hodson L.JJ., in agreement with Lord Goddard C.J. at first instance, said, at pp. 569 and 571 respectively, that the award should not be set aside on that ground. Although Denning L.J. did not refer to it, it follows that the case was decided on the other ground relied on, namely that the umpire had misconducted himself in law in failing to take into account that the contract was illegal. Because the case was indisputably decided on that ground, all else that was said was obiter. The court's only alternative to setting aside the award was to remit or enforce it. Since the umpire had made his award, there was no question of a stay of proceedings in favour of arbitration: the judgments proceeded on the ground that the umpire was no more entitled than a judge would have been to uphold a contract that was ex facie illegal, and that the award should therefore be set aside. Singleton L.J., at p. 566, did cite the obiter dictum of Lord Cozens-Hardy M.R. in *Smith, Coney & Barrett v. Becker, Gray & Co.* [1916] 2 Ch. 86, 92, that if a contract was illegal by reason of war, any question of arbitration under the contract would fall with it. Since there was no reference to jurisdiction in the judgment of Singleton L.J. but only to misconduct, the dictum seems only to have served as an example of palpable illegality. Denning L.J., at p. 570, based himself not upon failure of the arbitration clause, but upon the proposition that "if a contract is illegal, then arbitrators must decline to

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award upon it just as the court would do." Both Singleton and Denning L.JJ., at pp. 569 and 570–571, contemplated that the award might be remitted, but took the view that it would be purposeless to do so, since there was only one conclusion to which the umpire could come.

Mr. Longmore sought to explain the possibility of remission, which, as the judge pointed out, presupposed a valid arbitration agreement, by suggesting that the voluntary appearance of both parties before the umpire might have constituted a submission to arbitration. Of that there is no sign in the report, but if correct it would mean that there could have been no question of the arbitration clause failing with the main contract. Hodson L.J., at p. 571, proceeded upon the ground relied on by the sellers that the umpire misconducted himself in failing to take into account the illegality of the contract. He regarded as applicable to arbitrations the principle enunciated by Lord Ellenborough C.J., in *Langton v. Hughes* (1813) 1 M. & S. 593, 596, that "what is done in contravention of the provisions of an Act of Parliament, cannot be made the subject matter of an action." In other words, this court set aside an award based on an illegal contract, not because of illegality had the effect of depriving the umpire of jurisdiction by avoiding the arbitration clause, but because the umpire was no more permitted than the court would have been to ignore the illegality of the contract.

All three cases cited by the judge in this context were decided before the House of Lords in *Bremer Vulcan Schiffbau und Maschinenfabrik v. South India Shipping Corporation Ltd.* [1981] A.C. 909 had explained the separability of the arbitration agreement. In my judgment none of those cases impels the conclusion that an arbitrator can have no jurisdiction to decide whether the contract in which the arbitration agreement is incorporated is void ab initio. If the judge was bound by the authority of *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562 to reach that conclusion, so are we. But I do not consider that he was. I do not find it necessary to refer to any of the other cases on which Mr. Longmore relied, because none of them was decisive, and I agree with Ralph Gibson L.J.'s observations about such of them as he has referred to.

In my judgment this court is not obliged by authority to prevent the arbitrator from determining the issue of initial illegality. The tide is flowing in favour of permitting the arbitrator to do so, and it is no more necessary on grounds of public policy for the courts to retain exclusive control over the determination of the initial legality of agreements than over their subsequent legality. In particular, it would ill become the courts of this country, by setting their face against this jurisdiction, to deprive those engaged in international commerce of the opportunity of entrusting such disputes to English commercial arbitrators without the need for arbitration clauses containing elaborate self-fulfilling formulae.

Mr. Longmore's final argument was that because more explicit words might have been used in the arbitration clause, such as are to be found in article 8.4 of the rules of arbitration of the International Chamber of Commerce, or in article 16 of the UNCITRAL Model Law, the words actually used do not provide the requisite clarity. But the fact that the clause might have been more explicit does not mean that it was not sufficient. Mr. Longmore argued that the arbitration clause was not apt, as a matter of construction, to apply to a dispute about the legality of the retrocession agreement in which it was contained, because a dispute "arising out of" an agreement presupposes an existing valid agreement.

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But there is no issue about the making of the arbitration agreement, and it is undoubtedly out of the retrocession agreement that, on account of the contention that it is void for lack of an insurable interest, the dispute between the parties arises. I discern no intention by the parties not to treat a dispute as arising out of the retrocession agreement if one of the parties contends that the intention of the other has the effect of avoiding it retrospectively.

It follows that I too would take the step from which the judge drew back. I therefore agree that the appeal should be allowed, and the stay granted.

HOFFMANN L.J. The plaintiffs, by their writ dated 2 November 1989, claimed a declaration that the retrocession agreements were void or alternatively that the plaintiffs were entitled to avoid them. The points of claim, dated 29 November 1989, alleged misrepresentations and failure to disclose material facts. The plaintiffs also alleged that in respect of the insurance written and retroceded in the years in question, the defendants were not registered or approved by the Department of Trade to carry on insurance business in Great Britain. This allegation, which is not disputed, formed the basis of a claim that the retrocession agreements were void.

Each of the agreements contained an arbitration clause by which "all disputes or differences arising out of this agreement" were to be submitted to arbitration. On 11 January 1990 the defendants issued their summons for a stay. On 20 February 1990 Gatehouse J. ordered by consent the trial of the following preliminary issue:

> "whether the court is satisfied that, by reason of illegality, (i) the arbitration agreements contained in the retrocession agreements for the underwriting years 1980, 1981 and 1982 are null and void, inoperative or incapable of being performed; (ii) there is not in fact any dispute or difference between the parties within the meaning of the said arbitration agreements."

Pursuant to the directions of Gatehouse J., the plaintiffs served points of claim on the preliminary issue. They alleged that the defendants, although not registered or approved to carry on insurance business in Great Britain, intended nevertheless at the time of each retrocession agreement to carry on such business and to retrocede insurance contracts which in law they were not entitled to effect. For the same reason, the contracts actually purported to be retroceded were void for illegality. From this it was alleged to follow that the retrocession agreements, including the arbitration clauses, were null and void or unenforceable. The plaintiffs were asked for further particulars of precisely how the retrocession agreements were said to be affected by the illegality of the underlying contracts. The answer was:

> "The quota share reinsurances are null and void and/or are intrinsically illegal by reason of the fact that the defendants had no insurable interest therein. Further or alternatively the primary contractual obligations are unenforceable by reason of illegality."

On the hearing of the preliminary issue, Steyn J. said that it could be divided into three subissues: (a) whether the arbitration clause could survive the alleged illegality of the retrocession agreements and was wide enough to cover the illegality issue; (b) whether there was in fact any

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dispute to justify a stay, and (c) "the substantive merits of the plaintiff's allegations of illegality."

Subissue (b) disappeared when the plaintiffs conceded that there was a "real live issue on illegality." On the application of the defendants, the judge deferred consideration of subissue (c) because otherwise, if he or a higher court decided subissue (a) in the defendants' favour, he would have decided a question within the province of the arbitrators. He therefore addressed himself solely to subissue (a).

This issue, as I have stated it above, involves two separate questions. The first is whether the arbitration clause would itself be struck down by the alleged illegality. The second is whether, as a matter of construction, it is wide enough to cover the illegality issue.

It is common ground that in English law an arbitrator cannot bind the parties by a ruling on his own jurisdiction, and therefore the validity of the arbitration clause is not an arbitrable issue. Mr. Longmore, for the plaintiffs, says that he is alleging that the entire retrocession agreement was void ab initio for illegality and that if this is right, the arbitration clause must also be void.

Both before Steyn J. and in this court, Mr. Kentridge, on behalf of the defendants, was content to argue the case on the footing that there was a genuine dispute, which, depending on the outcome of this appeal, the judge or arbitrator would have to determine, over whether the retrocession agreements were void ab initio for illegality. I too am content to proceed on this basis, but I must confess to considerable doubt as to whether the plaintiffs' pleadings on the preliminary issue disclose any arguable case for the agreements having been void ab initio.

The basis of the alleged illegality is the Insurance Companies Act 1974, of which the relevant provisions are:

> "2(1) No person shall carry on in Great Britain insurance business of a class relevant for the purposes of this Part of this Act . . . except—(*a*) a body corporate which is authorised under section 3 below to carry on business of that class; . . . 11(1) A person who carries on business in contravention of this Part of this Act shall be guilty of an offence."

Section 83 defines each of the relevant classes of business as "the effecting and carrying out contracts of insurance" of that class.

In *Phoenix General Insurance Co. of Greece S.A. v. Halvanon Insurance Co. Ltd.* [1988] Q.B. 216, this court decided, following *In re Mahmoud and Ispahani* [1921] 2 K.B. 716, that the effect of these provisions was impliedly to prohibit the effecting or carrying out of contracts of insurance by an unauthorised insurer. It followed that such contracts were void ab initio.

In this case, however, the plaintiffs as insurers under the retrocession agreements were authorised to carry on the relevant business. The defendants were not, but insuring oneself is not an activity which requires authorisation under the Act of 1974. The plaintiffs therefore do not allege that the *Phoenix* principle directly prohibited the effecting or carrying out of the retrocession agreements. The allegation is that the Act of 1974 prohibited and rendered void the underlying insurance contracts which the defendants intended and purported to retrocede.

I cannot understand how the way in which the retrocession agreements were performed, or the defendants' intentions on the subject, can have made them void ab initio. The agreements were not such that they could

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only be performed unlawfully. There was nothing to stop the defendants from conducting their business outside Great Britain, as they claim they did, or obtaining authorisation under the Act of 1974. The fact that the contracts retroceded were void may have avoided the composite contract constituted by the retrocession agreement and the retrocessions, but cannot, as it seems to me, have made the retrocession agreement itself void ab initio. Equally, it may be that the defendants intended to perform the retrocession agreements in an unlawful manner, but this would merely disentitle the defendants from enforcing its obligations. It would not make the agreement void.

I mention these doubts because I think there is a real possibility that the questions which both parties invite this court to decide are in fact moot. Nevertheless, since the questions have been fully argued, I think we should decide them.

Mr. Longmore's argument is extremely simple. He says that the question raised on the pleadings is whether the retrocession agreement was void ab initio. The arbitration clause formed part of the retrocession agreement. Therefore the issue must involve the validity of the arbitration clause itself.

Mr. Longmore calls this logic. I call it over-simplification. The flaw in the logic, as it seems to me, lies in the ambiguity of the proposition that the arbitration clause "formed part" of the retrocession agreement. In one sense of course it did. It was clause 12 of a longer document which also dealt with the substantive rights and duties of the parties. But parties can include more than one agreement in a single document. They may say in express words that two separate agreements are intended. Or the question of whether the document amounts to one agreement or two may have to be answered by reference to the kind of provisions it contains. In any case, it is always essential to have regard to the reason why the question is being asked. There is no single concept of "forming part" which will provide the answer in every case. For some purposes a clause may form part of an agreement and for other purposes it may constitute a separate agreement. One must in each case consider the terms and purpose of the rule which makes it necessary to ask the question.

Mr. Longmore's argument might have appealed to Lord Sumner who, in *Hirji Mulji v. Cheong Yue Steamship Co. Ltd.* [1926] A.C. 497, 505, said:

> "The arbitration clause is but part of the contract and, unless it is couched in such terms as will except it out of the results, which follow from frustration, generally, it will come to an end too."

But the reign of false logic came to an end with the decision of the House of Lords in *Heyman v. Darwins Ltd.* [1942] A.C. 356. This case decided that an accepted repudiation or frustration, while it might bring the contract to an end in the sense of discharging the parties from further performance of their primary obligations, did not affect the enforceability of an arbitration clause. The House of Lords arrived at this decision by looking at the purpose of the rule that accepted repudiation or frustration discharges the parties from further obligations and asking whether the arbitration clause should for this purpose be regarded as imposing an obligation. In one sense it obviously did. In the context of the repudiation or frustration rules, however, there was no reason to treat the obligation

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to submit to arbitration as discharged, and such a conclusion would have severely reduced the value of the clause.

In explaining why he refused to categorise an arbitration clause as a contractual obligation for the purposes of the repudiation or frustration rules, Lord Macmillan said, at pp. 373–374:

> "I venture to think that not enough attention has been directed to the true nature and function of an arbitration clause in a contract. It is quite distinct from the other clauses. The other clauses set out the obligations which the parties undertake towards each other hinc inde, but the arbitration clause does not impose on one of the parties an obligation in favour of the other. It embodies the agreement of both parties that, if any dispute arises with regard to the obligations which the one party has undertaken to the other, such dispute shall be settled by a tribunal of their own constitution."

Likewise Lord Wright said, at p. 377:

> "an arbitration agreement . . . is collateral to the substantial stipulations of the contract. It is merely procedural and ancillary, it is a mode of settling disputes, though the agreement to do so is itself subject to the discretion of the court. All this may be said of every agreement to arbitrate, even though not a separate bargain, but one incorporated in the general contract."

The proposition that at least for some purposes the arbitration clause may be treated as severable or separable or autonomous has become orthodox doctrine. In *Bremer Vulkan Schiffbau und Maschinenfabrik v. South India Shipping Corporation Ltd.* [1981] A.C. 909, 980, Lord Diplock was able to say without further explanation:

> "The arbitration clause constitutes a self-contained contract collateral or ancillary to the shipbuilding agreement itself: *Heyman v. Darwins Ltd.* [1942] A.C. 356."

Lord Scarman, citing the same authority, said at p. 998, that an arbitration clause in a contract was "in strict analysis, a separate contract, ancillary to the main contract."

Mr. Longmore therefore accepts, as he must, that for some purposes the arbitration clause is treated as severable and may survive the termination or even the avoidance with retrospective effect of all the other obligations under the contract: see *Mackender v. Feldia A.G.* [1967] 2 Q.B. 590. He submits, however, that the separability doctrine cannot apply to any rule which prevents the contract from coming into existence or makes it void ab initio. In particular, it does not apply to a statute or other rule of law which makes the contract void for illegality.

It seems to me impossible to accept so sweeping a proposition. There will obviously be cases in which a claim that no contract came into existence necessarily entails a denial that there was any agreement to arbitrate. Cases of non est factum or denial that there was a concluded agreement, or mistake as to the identity of the other contracting party suggest themselves as examples. But there is no reason why every case of initial invalidity should have this consequence. A curious contrary example is the decision of the Court of Appeal of Bermuda in *Sojuznefteexport v. Joc Oil Ltd.* (unreported), 7 July 1989; (1990) Yearbook of Commercial Arbitration 384 in which the signatory to an agreement containing an arbitration clause had no authority to bind the

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plaintiff to the substantive obligations but was authorised to sign an arbitration agreement. The court held that the arbitration clause was separable and binding. The decision was reached under Soviet law as the proper law of the contract, but I think that the answer in English law would have been the same.

In every case it seems to me that the logical question is not whether the issue goes to the validity of the contract but whether it goes to the validity of the arbitration clause. The one may entail the other but, as we have seen, it may not. When one comes to voidness for illegality, it is particularly necessary to have regard to the purpose and policy of the rule which invalidates the contract and to ask, as the House of Lords did in *Heyman v. Darwins Ltd.* [1942] A.C. 356, whether the rule strikes down the arbitration clause as well. There may be cases in which the policy of the rule is such that it would be liable to be defeated by allowing the issue to be determined by a tribunal chosen by the parties. This may be especially true of contrats d'adhésion in which the arbitrator is in practice the choice of the dominant party. Thus, saying that arbitration clauses, because separable, are never affected by the illegality of the principal contract is as much a case of false logic as saying that they must be. As Ralph Gibson L.J. has pointed out the same is true of allegations of fraud.

In deciding whether or not the rule of illegality also strikes down the arbitration clause, it is necessary to bear in mind the powerful commercial reasons for upholding arbitration clauses unless it is clear that this would offend the policy of the illegality rule. These are, first, the desirability of giving effect to the right of the parties to choose a tribunal to resolve their disputes and secondly, the practical advantages of one-stop adjudication, or in other words, the inconvenience of having one issue resolved by the court and then, contingently on the outcome of that decision, further issues decided by the arbitrator.

As the German Federal Supreme Court (Bundesgerichtshof) said in its landmark *Decision of 27 February 1970* (1990) Arbitration International, vol. 6, No. 1, p. 79:

> "There is every reason to presume that reasonable parties will wish to have the relationships created by their contract and the claims arising therefrom, irrespective of whether their contract is effective or not, decided by the same tribunal and not by two different tribunals . . . Experience shows that as soon as a dispute of any kind arises from a contract, objections are very often also raised against its validity."

As against these considerations, is there anything in the policy of the rule which is alleged to invalidate the retrocession agreements which requires that the arbitration clause should also be invalid? I have already expressed my doubts as to whether the rule had any effect upon the initial validity of the agreements at all. I shall assume, however, that one was dealing with an insurance contract which was alleged to fall within the scope of the implied prohibition in the Insurance Companies Act 1974. Is there anything in such a provision which would be undermined by allowing the issue of whether it applied to be determined by arbitration? Mr. Longmore submitted that as a matter of policy all questions of illegality were better determined by the court than by arbitration. For my part, I cannot see why this should be so. In any case, Mr. Longmore had to concede that any such policy was not applied when

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it came to allowing arbitrators to decide whether a contract had been frustrated by supervening illegality. Since *Heyman v. Darwins Ltd.* [1942] A.C. 356 there has been no doubt that they have jurisdiction to do so. As for the specific statutory provisions, Kerr L.J. in *Phoenix General Insurance Co. of Greece S.A. v. Halvanon Insurance Co. Ltd.* [1988] Q.B. 216 wrung his hands over the conclusion to which he felt obliged to come and said that the invalidity of the substantive agreement itself could not be justified on any sound grounds of public policy. In those circumstances, it seems to me unnecessary to carry the effect of the prohibition even further and hold that it also invalidates an agreement to arbitrate the question of whether it applies.

Mr. Longmore submitted that the rule for which he was contending, however illogical or inconvenient it might be, was established by authority binding upon this court. He relied in particular upon some remarks in *Heyman v. Darwins Ltd.* [1942] A.C. 356 by Viscount Simon L.C. and Lord Macmillan, with whose speech Lord Russell of Killowen agreed. Both speeches contain passages which contrast cases of accepted repudiation or frustration, with which the case was actually concerned, with cases of initial invalidity, with which it was not concerned. It seems to me that this contrast was understandable because the most common examples of cases in which the ground of invalidity of the substantive obligations of the contract also necessarily entails the invalidity of the arbitration clause are cases of initial invalidity, such as the absence of consensus ad idem, non est factum, mistake as to the person and so forth. There was no reason for their Lordships to go into the question of whether *every* ground for initial invalidity of the main contract necessarily entailed the invalidity of the arbitration clause and anything which appears to support this proposition must in my judgment have been an obiter dictum.

There are passages in subsequent cases cited by Mr. Longmore which treat the dicta about initial invalidity of the contract in *Heyman v. Darwins Ltd.* [1942] A.C. 356 as authority for the rule that an arbitration clause can never be the subject of a binding arbitration. Similar statements appear in textbooks. But none of these are binding authority. Steyn J. was however persuaded that *David Taylor & Son Ltd. v. Barnett Trading Co.* [1953] 1 W.L.R. 562, a decision of this court, was binding authority for the proposition that an arbitrator cannot have jurisdiction to decide whether the contract containing the arbitration clause is void for illegality. In my view the case did not address this question at all. First, the motion to set aside the award was based upon two grounds: error of law on the face of the award, which the court rejected, and misconduct by the arbitrator in wilfully failing to have regard to the fact that the contract was illegal. The motion did not impugn his jurisdiction. Secondly, the references to jurisdiction in the judgments were statements to the effect that an arbitrator did not have jurisdiction to award damages on an illegal contract. No one said that the arbitrator could not have jurisdiction to decide whether the contract was illegal in the first place. Thirdly, even if by some implication the case is treated as having decided that the arbitration clause was itself void for illegality, the case can only have decided that this was the effect of the relevant statutory instruments. It cannot have decided that every ground of illegality must necessarily invalidate an arbitration clause in the prohibited contract.

It follows that in my judgment the illegality pleaded by the plaintiffs does not affect the validity of the arbitration clause. This leaves the

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question of whether as a matter of construction the clause is wide enough to cover the illegality issue. In construing the contract, one is assisted by the presumption in favour of one-stop adjudication to which I have already referred. As Bingham L.J. said in *Ashville Investments Ltd. v. Elmer Contractors Ltd.* [1989] Q.B. 488, 517:

> "I would be very slow to attribute to reasonable parties an intention that there should in any foreseeable eventuality be two sets of proceedings."

In my judgment the words "all disputes or differences arising out of this agreement" apply without difficulty to a dispute over whether the agreement, which was admittedly concluded, gave rise to any enforceable obligations. The presumption merely reassures one that the natural meaning of the words produces a sensible and business-like result.

I therefore agree that the appeal should be allowed and the proceedings stayed.

Appeal allowed.
Leave to appeal refused.

Solicitors: Lovell White Durrant; Clifford Chance.

[Reported by JAMES KELLY Esq., Barrister]

[COURT OF APPEAL]

In re B. (MINORS) (TERMINATION OF CONTACT: PARAMOUNT CONSIDERATION)

1992 Dec. 9, 10; 17 Butler-Sloss and Kennedy L.JJ.

Children—Child in care—Parental contact—Local authority proposing to place children in care with prospective adopters—Order terminating contact between children and mother—No investigation of mother's potential as future carer of children—Whether court bound by local authority's long-term plans for children—Children Act 1989 (c. 41), ss. 1(1), 34(4)

In 1991 the local authority obtained care orders in respect of two girls born in 1988 and 1990 respectively. After giving birth to a boy in 1992 the mother, who hoped for the girls' eventual return to her care, had looked after the boy satisfactorily and had regularly taken the girls to her home for contact visits, which had been successful. The local authority applied, under section 34(4) of the Children Act 1989,[1] for an order authorising them to refuse to allow contact between the girls and the mother so as

[1] Children Act 1989, s. 1 (1): "When a court determines any question with respect to—(*a*) the upbringing of a child; . . . the child's welfare shall be the court's paramount consideration."
S. 34(4): see post, p. 68A.

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