

**SEPARABILITY AND COMPETENCE-COMPETENCE  
IN INTERNATIONAL ARBITRATION:  
EX NIHILO NIHIL FIT? OR CAN SOMETHING  
INDEED COME FROM NOTHING?**

ROBERT H. SMIT\*  
SIMPSON THACHER & BARTLETT LLP

MAY 7, 2003

American Bar Association  
Section of International Law and Practice  
Spring Meeting  
May 7-10, 2003, Washington, D.C.

*Précis: The doctrines of separability (under which an arbitration clause is separable from the contract containing it and thus may survive a successful challenge to the validity of the contract) and competence-competence (under which arbitrators have jurisdiction to decide challenges to the arbitration agreements upon which their own jurisdiction is based) have been called the conceptual cornerstones of international arbitration as an autonomous and effective form of contractual dispute resolution. The doctrines, taken together, ensure that the parties' intent to arbitrate any and all disputes that arise out of their international relationship is effectuated without undue court interference, notwithstanding a party's challenge to the validity of the parties' contract or the arbitration clause it contains. While U.S. courts have generally applied the doctrines to, and thus required arbitration of, claims that an existing contract containing an arbitration clause is "voidable," most courts have declined to apply the doctrines, and have thus themselves decided, claims that the underlying contract never came into existence or is otherwise "void". The reason given for this limitation on application of the doctrines: ex nihilo nihil fit (from nothing nothing comes) – in the words of one court, "something can be severed only from something else that exists. How can the Court 'sever' an arbitration clause from a non-existent [contract]?" The author submits that this void/voidable distinction is not a principled or practical basis on which to limit the separability and competence-competence doctrines, and that those doctrines can and*

---

\* Robert H. Smit is a Partner at Simpson Thacher & Bartlett.

*should, in fact, apply to, and require arbitration of, many if not most claims that challenge the existence of the underlying contract. The author proposes an alternative approach for determining whether and how to apply the doctrines to a claim that the parties' contract, and/or its arbitration clause, is non-existent or otherwise void that is more consistent with the premises and purposes of the doctrines as well as with the contractual origin and juridical function of international arbitration.*

## **I. OVERVIEW OF THE DOCTRINES OF SEPARABILITY AND COMPETENCE-COMPETENCE**

**A. The Doctrine of Separability:** Arbitration agreements are “separable” or “severable” from the underlying contracts in which they appear or to which they relate.

### **1. Consequences of Separability**

- a. The invalidity of the parties' underlying contract does not necessarily invalidate their arbitration agreement. As a result, a challenge to the validity of the underlying contract does not necessarily affect the arbitration agreement or deprive the arbitral tribunal of jurisdiction to hear the parties' dispute concerning the challenged contract.
  - For the same reason, the invalidity of the parties' underlying contract does not necessarily deprive an arbitral award of validity. If an arbitral tribunal or court concludes that the parties' underlying contract was invalid, that conclusion does not necessarily undermine the validity of an award rendered by the arbitral tribunal pursuant to parties' arbitration agreement.
- b. Conversely, invalidity of the parties' arbitration agreement does not necessarily invalidate the underlying contract. The underlying contract can continue to be enforced, generally in national courts, notwithstanding the unenforceability of the arbitration clause.
- c. The law, or substantive legal rules, governing the arbitration agreement may be different from the law, or substantive legal rules, governing the underlying contract.
- d. The arbitration clause may survive termination or expiration of the underlying contract, as long as the claims arise from conduct during the term of the agreement (or during the term of specific provisions that survived the agreement).

2. Rationales for Separability

- a. The parties' agreement to arbitrate is analytically separate, distinct and independent from the parties' agreement in the underlying contract insofar as it relates to the "procedural" issue of dispute resolution as opposed to the "substantive" issues of the parties' rights under the contract.
  - Stephen M. Schwebel, *The Severability of the Arbitration Agreement in International Arbitration: Three Salient Problems*, 1, 5 (1987): "When the parties to an agreement containing an arbitration clause enter into that agreement, they conclude not one but two agreements, the arbitral twin of which survives any birth defect or acquired disability of the principal agreement."
- b. The separability doctrine is consistent with the parties' implied or express intent that any and all disputes between them be arbitrated, including disputes about the validity of their underlying contract.
  - The parties' intent is *express* when they incorporate institutional arbitration rules in their arbitration clause that expressly provide that the arbitration clause is separable from the contract containing it.
- c. The separability doctrine is a practical necessity because, without it, a party to an arbitration agreement would be able to avoid arbitration merely by challenging the contract in which the arbitration agreement is found.
- d. The separability doctrine is necessary to address the needs of international commerce. Parties of different nationalities will not contract and do business unless their agreements to resolve disputes in a neutral, non-national forum are enforced notwithstanding challenges to the validity of their underlying contracts.

3. Criticisms of Separability

- a. The "procedural" dispute resolution provisions of a contract are interrelated with – not separate and distinct from – the "substantive" provisions of the contract that contain the arbitration clause.
  - In practice, the parties (and their counsel) to a transaction would be surprised to hear that they have concluded not one but two separate agreements, as Judge Schwebel suggests.

- b. If the contract is non-existent, invalid or unenforceable as a whole, then so must be all of its parts, including its arbitration clause.
- *Ex nihilo nihil fit* (From nothing nothing comes)
  - S. Schwebel, *supra*, at 11: “[I]f an agreement contains an obligation to arbitrate disputes arising under it, but the agreement is invalid or no longer in force, the obligation to arbitrate disappears with the agreement of which it is a part. If the agreement was never entered into at all, its arbitration clause never came into force. If the agreement was not validly entered into, then, prima facie, it is invalid as a whole, as must be all of its parts, including its arbitration clause.”

4. Sources of Separability

- a. The U.S. Federal Arbitration Act (FAA) and Case Law: Given the separability doctrine’s status as a cornerstone of modern arbitration law, it is curious to note how ambiguous are its statutory and case law roots in the United States.
- (i) The FAA is silent on separability. **[Tab 1]**
- FAA §4: Upon a petition to compel arbitration under FAA §4, “[t]he court shall hear the parties, and 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 directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . . If the making of the arbitration agreement or this failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.”
- (ii) *Prima Paint Corp. v. Flood and Conklin Mfg. Co.*, 388 U.S. 395 (1967): *Prima Paint* is generally credited with making the separability doctrine U.S. law, but it never expressly adopts the doctrine by name. Rather, the Supreme Court held only that under a broad arbitration clause to which the FAA applies, a claim of fraud in the inducement of a contract generally -- as opposed to a claim of fraud in the inducement of the arbitration clause itself -- must be referred to the arbitrators, rather than decided by the courts.

- The Court based its holding on the language of FAA §4 that requires a court, on a petition to compel arbitration, to refer the case to arbitration “upon being satisfied that the making of the agreement for arbitration is not in issue.” The implied logic underlying the Court’s reasoning is something like: “If all the court has to do in order to compel arbitration under FAA §4 is to verify that the arbitration agreement – as opposed to the whole contract – is not in issue, then the two must be separable and the arbitration clause can be enforced notwithstanding a challenge to the contract containing it.”
- b. Leading international arbitration rules [Tab 2]
- UNCITRAL Arbitration Rules, Art. 21(2)
  - ICC Arbitration Rules, Art. 6(4)
  - AAA International Arbitration Rules, Art. 15(2)
- c. Foreign arbitration legislation [Tab 1]
- UNCITRAL Model Law (1985), Art. 16(1)
  - Swiss Law on Private International Law (1987), Art. 178(3)
  - English Arbitration Act of 1996, Sec. 7
- d. New York Convention (1958) [Tab 1]
- Article II(3): “The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an [arbitration] agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said [arbitration] agreement is null and void, inoperative or incapable of being performed.”
  - Compare A. van den Berg, *The New York Convention of 1958* 145-46 (1981) (New York Convention is “indifferent” as to the existence of the separability doctrine) with S. Schwebel, *International Arbitration: Three Salient Problems* 22 (1987) (New York Convention adopts separability doctrine “by implication”).
- e. Doctrine [Tab 3 bibliography]
- B. The Doctrine of Competence-Competence (or *Kompetenz*):** Arbitrators have jurisdiction to decide challenges to their own jurisdiction - *i.e.*, arbitrators are

competent to determine challenges to the arbitration agreements on which their own authority to resolve the parties' disputes is based.

1. Consequences of Competence-Competence

- a. At a minimum, the competence-competence doctrine permits arbitrators to consider challenges to their jurisdiction and to proceed with the arbitration notwithstanding such challenges, subject to judicial review of the jurisdictional challenges at any time (whether after an award is rendered or when a motion is made to stay court proceedings or to compel arbitration).
- b. More broadly, the doctrine may be applied to grant arbitrators exclusive authority to rule in the first instance on challenges to their jurisdiction, subject to subsequent judicial review of their jurisdictional determination (be it an interim or final award) under otherwise applicable standards of review.
- c. Most broadly, the doctrine may be applied to grant arbitrators exclusive authority to decide challenges to their jurisdiction, subject to little (*e.g.*, highly deferential) or no subsequent judicial review.

2. Rationales for Competence-Competence

- a. The competence-competence doctrine (like the separability doctrine) is consistent with the parties' implied or express intent that any and all disputes arising out of their relationship be arbitrated, including disputes about their dispute resolution agreements.
  - This is particularly true with respect to parties in international transactions, where parties of different nationalities generally proceed with the understanding that any and all disputes about their contractual relationship, including disputes about their agreement to arbitrate, will be resolved in a neutral, non-national forum.
- b. The power to resolve jurisdictional disputes is inherent in all adjudicative bodies and is essential to their ability to function.
  - Indeed, the competence-competence doctrine (like the separability doctrine) is a practical necessity because, without it, a party to an arbitration agreement would be able to thwart the arbitration merely by challenging the parties' arbitration agreement.

3. Criticisms of Competence-Competence

- a. As a theoretical matter, there is no foundation for an arbitrator’s authority to decide his or her own jurisdiction because an arbitrator’s authority derives exclusively from the parties’ arbitration agreement. Arbitrators therefore lack authority to decide anything unless and until their authority under the parties’ arbitration agreement is established.
- *See Sphere Drake Insurance Ltd. v. All American Insurance Co.*, 256 F.3d 587, 591 (7<sup>th</sup> Cir. 2001): “Courts have jurisdiction to determine their jurisdiction not only out of necessity (how else would jurisdictional disputes be resolved?) but also because their authority depends on statutes rather than the parties’ permission. Arbitrators lack a comparable authority to determine their own authority because there is a non-circular alternative (the judiciary) and because the parties *do* control the existence and limits of an arbitrator’s power.”
- b. As a practical matter, it is unrealistic to expect arbitrators to rule objectively on challenges to their jurisdiction because they have a financial interest in sustaining their jurisdiction in order to earn fees for adjudicating the merits of the parties’ dispute.
- *See Ottley v. Sheepshead Nursing Home*, 688 F.2d 883, 898 (2d Cir. 1982) (Newman, J., dissenting): “Our deference to arbitrators has gone beyond the bounds of common sense. I cannot understand the process of reasoning by which any court can leave to the unfettered discretion of an arbitrator the determination of whether there is any duty to arbitrate. I am even more mystified that a court could permit such unrestrained power to be exercised by the very person who will profit by deciding that an obligation to arbitrate survives, thus ensuring his own business. It is too much to expect even the most fair-minded arbitrator to be impartial when it comes to determining the extent of his own profit. We do not let judges make decisions which fix the extent of their fees . . . . How, then, can we shut our eyes to the obvious self-interest of an arbitrator?”
  - *See also Trafalgar Shipping Co. v. Int’l Milling Co.*, 401 F.2d 568, 573 (2d Cir. 1968) (“Moreover, it is not likely that arbitrators can be altogether objective in deciding whether or not they ought to hear the merits. Once they have bitten into the enticing fruit of

controversy, they are not apt to stay the satisfying of their appetite after one bite”).

4. Sources of Competence-Competence

a. The FAA and U.S. Case Law: As they are with respect to separability, the statutory and case law roots of competence-competence in the United States are ambiguous and confused.

(i) The FAA is silent on competence-competence.

- FAA §4: “upon being satisfied that the making of the agreement for arbitration. . . is not an issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. . . .”

(ii) The General Rule under U.S. Case Law: While arbitrators have authority under the FAA to consider challenges to their jurisdiction, disputes over arbitration agreements -- on a motion to stay litigation, to compel or enjoin arbitration or to enforce or nullify an arbitration award -- are for independent judicial determination.

- *See AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649 (1968) (“the question of arbitrability -- whether [an] agreement creates a duty for the parties to arbitrate a particular grievance -- is undeniably an issue for judicial determination.”)

(iii) The Recently Articulated Exception: *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), holding that arbitrators have the “primary power to decide arbitrability”<sup>1</sup> where the parties have specifically agreed to confer such power upon them.

---

<sup>1</sup> The *First Options* Court confusingly used the term “arbitrability” to include both the question of what persons are bound by the arbitration clause and the question of what particular dispute the clause covers. The term “arbitrability” is also generally used to address the question of whether, under applicable law, a dispute is susceptible of arbitration at all -- *i.e.*, the validity or enforceability of the arbitration agreement as applied to a particular dispute.



- The “who decides arbitrability” question: “Just as the arbitrability of the merits of a dispute depends upon whether the parties agreed to arbitrate that dispute . . . , so the question “who has the primary power to decide arbitrability” turns upon what the parties agreed about *that* matter. Did the parties agree to submit the arbitrability question itself to arbitration? If so, then the court’s standard in reviewing the arbitrator’s decision about *that* matter should not differ from the standard courts apply when they review any other matter that parties have agreed to arbitrate. . . . That is to say, the court should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances. . . . If, on the other hand, the parties did *not* agree to submit the arbitrability question itself to arbitration, then the court should decide that question just as it would decide any other question that the parties did not submit to arbitration, namely independently. These two answers flow inexorably from the fact that arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes—but only those disputes—that the parties have agreed to submit to arbitration.”
- The applicable “presumption”: “Courts should not assume that the parties agreed to arbitrate arbitrability unless there is “clea[r] and unmistakabl[e]” evidence that they did so. . . . In this manner the law treats silence or ambiguity about the question “*who* (primarily) should decide arbitrability” differently from the way it treats silence or ambiguity about the question “*whether* a particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement” — for in respect to this latter questions the law reverses the presumption. . . . But this difference in treatment is understandable. The latter question arises when the parties have a contract that provides for arbitration of some issues. And, given the law’s permissive policies in respect to arbitration, one can understand why the law would insist upon clarity before concluding that the parties did *not* want to arbitrate a related matter. On the other hand, the former question—the “who (primarily) should decide arbitrability” question—is rather arcane. A party often might not focus upon that question or upon the significance of having arbitrators decide the scope of their own powers. And, given the principle that a party can be forced to arbitrate only those issues

it specifically has agreed to submit to arbitration, one can understand why courts might hesitate to interpret silence or ambiguity on the “who should decide arbitrability” point as giving the arbitrators that power, for doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide.”

- Criticisms of “presumption”: By its terms, the FAA requires enforcement of *all* agreements to arbitrate, which encompasses agreement to arbitrate issues of arbitrability without singling them out for less-preferential treatment. Moreover, it is inappropriate to import presumptions created in the domestic context -- like the *First Options* presumption that the parties intend to litigate issues of arbitrability unless they clearly and unequivocally express otherwise – into the international arena, where the presumption should be that the parties intended to arbitrate *everything*.

b. Leading international arbitration rules

- UNCITRAL Arbitration Rules, Art. 21(1)
- ICC Arbitration Rules, Art. 6(2)
- AAA International Arbitration Rules, Art. 15(1)

c. Foreign arbitration legislation

- UNCITRAL Model Law (1985), Art. 16(1)
- Swiss Law or Private International Law (1987), Art. 186(1)
- English Arbitration Act of 1996, Sec. 30

d. New York Convention (1958) [Tab 1]

- *See* Article II (3), *supra*
- As with the doctrine of separability, nothing in the New York Convention expressly addresses, incorporates or excludes arbitrators’ authority to determine their own jurisdiction. But Article II’s requirement that member state courts enforce arbitration agreements presumably applies to agreements to arbitrate questions of arbitrability as well.

e. Doctrine [Tab 3 bibliography]

**C. The Relationship Between Separability and Competence-Competence**

1. The separability and competence-competence doctrines have been described as “corollaries” of each other.
  - *See, e.g.*, Gary Born, International Commercial Arbitration in the United States, 68 (“The separability doctrine implies the arbitrator’s power to consider his own jurisdiction.”) and 87 (“if a party challenges an arbitrator’s jurisdiction, could the arbitrator decide whether he has jurisdiction even if the parties’ arbitration agreement is not separable?”)
  - Most international arbitration rules and foreign arbitration statutes address the two doctrines together in the same or adjacent articles.
  
2. But some leading commentators emphasize the difference between the two doctrines.
  - *See, e.g.*, William Park, *Determining Arbitral Jurisdiction: Allocation of Tasks Between Courts and Arbitrators*, 8 Am Rev. Int’l Arb. 133, 142-43 (1997): “Competence-Competence analysis should not be confused with the principle of ‘separability’ . . . , by which the validity of an arbitration clause is determined independently from the validity of the basic commercial contract in which it is encapsulated. . . . Separability . . . says nothing about the validity of the arbitration clause itself. The fact that an arbitration clause *might* be valid notwithstanding infirmities in other contract terms does not mean that the clause necessarily *will* be valid, or that an arbitrator’s erroneous decision on the clause’s validity will escape judicial scrutiny. Separability and competence-competence intersect only in the sense that arbitrators who rule on their own jurisdiction (like courts deciding whether to allow an arbitration to go forward) will look to the arbitration clause alone, not to the entirety of the contract.”
  
3. Some courts have (mistakenly) suggested that *First Options*, which dealt with competence-competence, implicitly overruled *Prima Paint*, which dealt with separability.
  - *See, e.g.*, *Aviall, Inc. v. Ryder System, Inc.*, 913 F. Supp. 826, 831 (S.D.N.Y. 1996) (reasoning that, unlike *Prima Paint*, which found that allegations that the contract generally -- as opposed to the

arbitration clause specifically -- was fraudulently procured could be decided only by the arbitrator, *First Options* generally held that “whether the parties agreed to arbitrate an issue is for the courts, not the arbitrator, to resolve unless the contract itself specifies otherwise . . . . That holding suggests that the related and antecedent issue of whether an agreement to arbitrate is a contract of adhesion, fraudulently induced, or otherwise revocable, is an issue for the court as well, because essential to the *First Options* inquiry is the assumption that an agreement to arbitrate was made voluntarily.”) *See also Maye v. Smith Barney, Inc.*, 897 F. Supp. 100, 106 n.3 (S.D.N.Y. 1995) (noting that the *Prima Paint* dichotomy between treatment of challenges to the contract generally and to the arbitration clause specifically may not survive *Prima Paint*).

## II. THE COURTS’ REFUSAL TO APPLY THE DOCTRINES TO CLAIMS THAT THE UNDERLYING CONTRACT NEVER CAME INTO EXISTENCE OR WAS VOID *AB INITIO*

A. **Application of the Doctrines to “Voidable” Contracts:** The separability doctrine of *Prima Paint* and the competence-competence doctrine of *First Options* have generally been applied to claims that an existing contract, which contains an arbitration clause, is “voidable.”

1. Definition of “voidable”: A voidable contract is an agreement that “[u]nless rescinded . . . imposes on the parties the same obligations as if it were not voidable.” Samuel Williston & Richard A. Lord, *A Treatise on the Law of Contract* §1:20, at 50 (4<sup>th</sup> ed. 1990).
2. Examples of challenges to the underlying contract to which the separability and competence-competence doctrines apply
  - Fraud in the inducement of underlying contract (*Prima Paint*)
  - Mistake in formation of underlying contract
  - Duress or undue influence in formation of underlying contract
  - Unconscionability of underlying contract

- B. The Courts’ Refusal to Apply the Doctrines to Allegedly Non-Existent or “Void” Contracts:** Most U.S. courts have held that the separability doctrine does not apply to claims that the underlying contract never came into existence or is “void.” Those courts have held that challenges to the very existence of the contract containing the arbitration clause must necessarily be decided by the courts on a motion to stay litigation or compel arbitration, rather than being referred to arbitration. Few courts have even considered how the competence-competence analysis of *First Options* might impact the issue of whether the courts or arbitrators should resolve challenges to the existence of the contract containing the arbitration clause.
1. Definition of “void”: A void contract is one that produces no legal effect; “[i]f an agreement is void, it cannot be a contract”. 1 Williston §1:20 at 49.
  2. Rationale for limitation on separability doctrine: “[S]omething can be severed only from something else that exists. How can the Court ‘sever’ an arbitration clause from a non-existent charter party?” *Pollux Marine Agencies v. Louis Dreyfus Corp.*, 455 F. Supp. 211, 219 (S.D.N.Y. 1978)
    - It is argued that challenge to the very existence of the contract containing the arbitration clause *necessarily* puts the “making of the agreement for arbitration . . . in issue” within the meaning of FAA §4, as construed by *Prima Paint*.
  3. Examples of challenges to allegedly non-existent/void contracts to which the separability doctrine has been held not to apply
    - Fraud in the factum of underlying contract (*e.g.*, forgery of party’s name on contract)
    - Lack of capacity or authority of signatory to enter into underlying contract (*e.g.*, purported agent lacked authority to bind party)
    - No “meeting of the minds” on essential terms of underlying contract
    - No consideration for underlying contract; illegality of contract
  4. Select cases holding the separability doctrine does not apply to non-existent/void contracts
    - *Canada Life Assurance Co. v. Guardian Life Insurance Co.*, 242 F. Supp. 2d 344 (S.D.N.Y. 2003) (“it is well settled that when the existence of the contract form which the obligation to arbitrate arises

is itself called into question, it is the obligation of the court, before a dispute is referred for arbitration, to determine, in the first instance, whether the contract itself is valid.”)

- *Sphere Drake Ins. Ltd. V. Clarendon Nat’l Ins. Co.*, 263 F.3d 26 (2d Cir. 2001) (“If a party alleges that a contract is void and provides some evidence in support, then the party need not specifically allege that the arbitration clause in that contract is void, and the party is entitled to a trial on the arbitrability issue pursuant to 9 U.S.C. §4 . . . . However, under the rule of *Prima Paint*, if a party merely alleges that a contract is voidable, then, for the party to receive a trial on the validity of the arbitration clause, the party must specifically allege that the arbitration clause is itself voidable.”)
- *Sphere Drake Ins. Ltd. V. All American Ins. Co.*, 256 F.3d 587 (7<sup>th</sup> Cir. 2001) (a claim that a purported agent lacked authority to bind a party “is not a defense to enforcement, as in *Prima Paint*; it is a situation in which no contract came into being; and as arbitration depends on a valid contract an argument that the contract does not exist can’t logically be resolved by the arbitrator . . . .”)
- *Burden v. Check Into Cash of Kentucky, LLC*, 267 F.3d 483 (6<sup>th</sup> Cir. 2001) (“*The void/voidable distinction is relevant for the Prima Paint analysis because a void contract, unlike a voidable contract, was never a contract at all . . . Prima Paint supports, rather than prohibits, excluding nonexistent contracts from the severability doctrine, because an allegation of a void contract raises exactly the same question as an allegation of a fraudulently induced arbitration agreement; whether the arbitrator has any power at all.*”)
- *Sandvik AB v. Advent Int’l Corp.*, 220 F.3d 99 (3d Cir. 2000) (*Prima Paint* “presumes an underlying, existent, agreement”; a valid arbitration agreement “cannot arise out of a broader contract if no broader contract ever existed.”)
- *Three Valleys Mun. Water Dist. V. E.F. Hutton & Co.*, 925 F.2d 1136 (9<sup>th</sup> Cir. 1991) (“we read *Prima Paint* as limited to challenges seeking to *avoid* or *rescind* a contract – not to challenges going to the very existence of a contract that a party claims never to have agreed to.”)

**C. Criticisms of the “Void/Voidable” Distinction**

1. The void/voidable distinction is inconsistent with the basic premise of the separability doctrine that the arbitration agreement and the underlying contract are separate and independent agreements. Because the arbitration agreement and their underlying contract are separate and independent agreements, one can come into existence without the other.
  - Different national laws may apply to the formation of each.
  - Different substantive rules of contract formation may apply to each.
  - Different facts may be relevant to the formation of each.
  - The void/voidable distinction fails to take into account that certain challenges to the existence of the underlying contract do not, in fact, necessarily place the “making of the arbitration agreement ... in issue” within the meaning of FAA § 4.
  
2. Prima Paint is not, by its terms, limited to “voidable,” as opposed to “void,” contracts. Indeed, Justice Black, in dissent in *Prima Paint*, observed that “[t]he Court here holds that [arbitration should be compelled] even though a court might after a fair trial, hold the entire contract – including the arbitration agreement – void...” (italics supplied)
  
3. The void/voidable distinction is not universally accepted.
  - The UNCITRAL Model Law as well as the leading international arbitration rules that incorporate the separability doctrine specifically provide that any claim or determination that the parties’ underlying contract is “non-existent,” “null” or “void” shall not render invalid the arbitration clause or deprive the arbitral tribunal of jurisdiction. See UNCITRAL Model Law, Art. 16(1); ICC Arbitration Rules, Art. 6(4); AAA International Arbitration Rules, Art. 15(2) [Tabs 1 and 2]
  - *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404 (9<sup>th</sup> Cir. 1990) (applying *Prima Paint* to refer issue as to whether the DRAFT constituted a final and binding contract to arbitration in the absence of “a challenge to the arbitration provision which is separate and distinct from any challenge to the underlying contract.”)
  - *Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469 (9<sup>th</sup> Cir. 1991) (applying *Prima Paint* to refer dispute arising out of

“Memorandum of Intent” to arbitration pursuant to its arbitration provisions notwithstanding claim, and the district court’s finding, that Memorandum of Intent did not constitute a binding contract and that contract “never existed at all.”)

- *Cf. Lawrence v. Comprehensive Bus Servs. Co.*, 833 F.2d 1159, 1162 (5<sup>th</sup> Cir. 1987) (*Prima Paint* applies even to contracts that are “void from . . . inception”)
4. The void/voidable distinction is inherently ambiguous and inappropriately ties application of the separability doctrine to the legal nature of the challenge leveled at contracts.
- *Cf. Sphere Drake v. Clarendon*, 236 F.3d at 31 (the void/voidable distinction has a “metaphysical ring”)
  - *Cf. Burden*, 267 F.3d at 489 (the void/voidable or fraud in the factum/fraud in the inducement distinctions “may more confound than clarify the dispositive issue and its resolution”)
5. The void/voidable distinction promotes procedural skirmishing in the courts and draws courts into the merits of issues properly subject to arbitration.
- For example, the Second Circuit’s requirement in *Sphere Drake v. Clarendon* that a party resisting enforcement of a purported contract and its arbitration clause on the ground that its purported agent lacked authority to bind it to both the contract and its arbitration clause must provide some evidence in support of its position inevitably will draw courts into consideration of the merits of disputes that should be arbitrated.
6. The limitation on the separability and competence-competence doctrines is inconsistent with the strong federal policy favoring arbitration in *international cases* in particular.
- The courts that have applied the void/voidable distinction in international cases falling under the New York Convention have blindly followed the precedent established in domestic cases under FAA §4 without taking into account the international nature of the dispute. *See, e.g., Sandvik*, 220 F.3d at 104-05 (relying on FAA §4 to interpret the New York Convention); *Sphere Drake v. Clarendon*, 263 F.3d at 30 n.2 (same).



- International commerce will be compromised if parties of different nationalities who have engaged in negotiations with the understanding that disputes arising out of their relationship would be arbitrated in a neutral, non-national forum, but who, for one reason or another are alleged not ultimately to have entered into a final and binding contract, find their disputes being resolved by national courts.
7. Finally, the cases limiting the doctrine of separability to “voidable” contracts have failed even to consider how the competence-competence analysis of *First Options* might impact the issue of who should resolve challenges to allegedly non-existent/void contracts.
- The doctrine of separability articulated in *Prima Paint* posits only that arbitrators can decide challenges to the underlying contract without undermining their jurisdiction under the arbitration clause; in framing the dichotomy between challenges to the contract generally and to the arbitration clause specifically, the *Prima Paint* Court confirmed that any challenges to the arbitration clause itself were reserved for judicial determination. In other words, *Prima Paint* articulated the separability doctrine in the context of the prevailing general rule in the United States that jurisdictional disputes over arbitration agreements raised before a court on a motion to stay litigation or compel arbitration are for the courts to decide, absent specific agreement otherwise. Thus, under *Prima Paint*, the analysis of who decides challenges to the underlying contract is complete as soon as it is determined that the challenge is not addressed to the arbitration clause specifically since challenges to the arbitration clause are properly for the courts to resolve.
  - Under *First Options*, however, the parties may specifically agree in their arbitration agreement to submit questions of arbitrability -- *i.e.*, challenges to the arbitration clause -- to the arbitrators. Where they have done so -- as in international transactions they usually do by virtue of their choice of a set of international arbitration rules (such as the ICC Rules) which expressly confer competence-competence on the arbitrators -- even challenges to the arbitration clause itself should generally be referred by the courts to arbitrators. Yet, the courts have rarely brought this “second tier” competence-competence analysis to bear on their consideration as to who should decide challenges to the parties’ contracts and arbitration clauses. *But see Appollo Computer, Inc. v. Berg*, 886 F.2d 469 (1<sup>st</sup> Cir. 1989)

(a pre-*First Options* cases holding that, under the ICC Rule referring issues of arbitrability to the arbitrators, it was for the arbitrators rather than the court to decide whether the arbitration clause applied to disputes between a party to the contract and a non-party assignee of rights under the contract).

### III. AN ALTERNATIVE APPROACH

- A. **The Proper Scope of the Separability Doctrine:** Application of the separability doctrine should not depend upon the existence or validity of the underlying contract because the doctrine is predicated on the notion that the arbitration agreement and underlying contract are *separate and distinct* agreements. The only limitation on the separability doctrine that is consistent with the premise of the doctrine itself are challenges to the existence of the underlying contract that, if well-founded, *necessarily* would also entail the inexistence of the arbitration agreement.
1. **The Appropriate Inquiry:** Separability does not presume an existing underlying contract, as most U.S. courts have held. Nor, however, is an arbitration clause always immune to challenges to the existence of the underlying contract. Rather, the appropriate inquiry is whether the particular challenge to the existence of the contract is such as to necessarily also put the existence of the arbitration agreement in issue. In other words, would the challenge to the existence of contract, if well-founded, also necessarily mean that the arbitration agreement could not exist.
  2. **As applied to recurring fact scenarios**
    - a. **Forgery:** The separability doctrine can not apply to an allegation that a party's signature on the underlying contract was forged because the alleged defect in the manifestation of assent to the contract necessarily also calls into question the party's assent to the arbitration clause in that contract.
      - *See, e.g., Chastain v. Robinson-Humphrey Co.*, 957 F.2d 851 (11<sup>th</sup> Cir. 1992) (a claim that the signature on a contract containing an arbitration clause was forged must be resolved by a court because a person whose signature was forged has never agreed to anything, including arbitration).
    - b. **Agency:** By contrast, not all claims that the contract is "void" because an agent lacked authority (or failed to comply with formal requirements) to bind a party to the underlying contract necessarily also call into question

the existence of the arbitration agreement. So long as the agent had authority to enter into the arbitration agreement, that agreement should be severed from the remainder of the contract regardless of whether the agent was authorized to enter into the contract.

- *See, e.g., Sojuznefteexport v. JOC Oil Co.*, 4 Mealey Int’l Arb. Rep. B1 (1989) (Court of Appeal of Bermuda 1989) (confirming that an arbitration clause was separable and enforceable from a contract that did not comply with requirement imposed by Russian law that two agents sign the contract and that therefore never came into existence under Russian law).
- c. “Meeting of the minds”: Similarly, the alleged failure of the parties’ pre-contractual negotiations to mature into a final and binding contract does not necessarily also imply a failure to reach agreement to arbitrate any disputes that may arise between them. For example, in cases involving a “battle of the forms,” the parties’ agreement to arbitrate any disputes may crystallize before the parties reach consensus on the substantive terms of their relationship, which consensus may never actually materialize. Where each party proposes its own set of terms and *both* propose the same arbitration clause, it may be appropriate to sever and enforce the arbitration clause notwithstanding that the underlying contract never came into existence.
- *See, e.g., Teledyne v. Kone, supra; Republic of Nicaragua v. Standard Fruit Co., supra.*
- d. Lack of consideration/illegality: While courts have held that a claim of missing consideration must be heard by a court rather than an arbitrator (*see, e.g., Gibson v. Neighborhood Health Clinics, Inc.*, 121 F.3d 1126 (7<sup>th</sup> Cir. 1997)), there is no reason why the arbitration clauses in such contracts should not be severed from their underlying contracts and enforced.
- *See Sphere Drake Insurance, Ltd., v. All American Insurance Co.*, 256 F.3d 587, 591 (7<sup>th</sup> Cir. 2001) (questioning cases that refuse to apply the separability doctrine to claims of lack of consideration because, unlike forgery and agency claims, “a contract without consideration represents an *agreement*.”).
  - *Harbour Assurance Co. (U.K.) Ltd. v. Kansa General Int’l Ins. Co.*, [1993] Q.B. 701, 708 (referring to arbitration a claim that the underlying contract is illegal and therefore void).

**B. The Relevance of Competence-Competence:** How is the analysis of who decides challenges to the existence of the underlying contract impacted if the parties have specifically agreed to submit questions of arbitrability to the arbitrators within the meaning of *First Options*, as they usually do in international transactions by virtue of their choice of a set of international arbitration rules that expressly incorporates the competence-competence principle?

- Relatively few cases have applied *First Options* to disputes about the formation of the underlying contract.
- In *Sphere Drake, supra*, the Seventh Circuit hinted at the issue in noting that every federal appellate court that has addressed whether a dispute about an agent’s authority to bind a principal to a contract is arbitrable has answered: “no, unless . . . The “unless” clause reflects that parties may agree separately to arbitrate disputes about whether they have agreed to the contract’s substantive promises.” Citing *First Options*.
- As noted above, the separability doctrine as articulated in *Prima Paint* posits only that challenges to the underlying contract can be referred to arbitration under a separable arbitration clause, but the court remains responsible for deciding any challenges to the arbitration clause specifically. Under competence-competence-- or the half-baked concept of that doctrine adopted in *First Options* -- the parties can agree to submit all challenges to the arbitration clause itself to the arbitrators. So while separability concerns only the issue of “who decides” challenges to the contract, competence-competence raises the second-tier issue of “who decides who decides” challenges to the contract.

**C. A Proposed Analysis for Determining “Who Decides Who Decides” Challenges to the Existence of the Contract and its Arbitration Clause Under the Doctrines of Separability and Competence-Competence:**

1. The “first tier” separability inquiry: Does the challenge to the existence of the contract necessarily place “in issue” (to use the language of FAA §4) the existence of the arbitration clause? Put differently, can the arbitration clause have come into existence even if the contract never did for the reasons alleged by the party challenging the contract?
  - If the alleged non-existence of the contract does not necessarily imply the non-existence of the arbitration clause, then the challenge to the contract should be referred to the arbitrators for decision in accordance with *Prima Paint* (regardless of whether the arbitration clause at issue confers competence-competence on the arbitrators).

- If the challenge to the existence of the contract necessarily places in issue the existence of the arbitration clause (and/or the existence of the arbitration clause is also specifically challenged), then the court should proceed to the “second tier” competence-competence inquiry.
2. The “second tier” competence-competence inquiry: Where the challenge to the existence of the contract necessarily places in issue the existence of the arbitration clause (and/or the existence of the arbitration clause is also specifically challenged), then the court should determine whether the arbitration clause at issue confers competence-competence on the arbitrators within the meaning of *First Options*. (Contrary to *First Options*, however, there should be a presumption in international cases in favor of competence-competence; in any event, the designation in the arbitration clause of a set of arbitration rules that provide for competence-competence should certainly constitute “clear and unmistakable evidence” of an agreement to submit questions of arbitrability to the arbitrators within the meaning of *First Options*.)
- a. If the arbitration clause at issue does not provide for competence-competence, then the court should itself decide the challenge to the existence of the contract and/or its arbitration clause.
  - b. If the arbitration clause at issue does provide for competence-competence, then the court should make a threshold determination as to whether there is a plausible argument or evidence that the arbitration agreement may have come into existence notwithstanding the challenge to the existence of the contract and/or the arbitration clause. This threshold determination would be akin to the “examen sommaire” applied by the Swiss Federal Tribunal (ATF 124 III 139 cons. 2b) or the “prima facie” determination made by the ICC Court under Article 6(2) of the ICC Rules than an arbitration agreement “may exist” before referring the case, including any jurisdiction challenges, to the arbitrators for decision.
    - (i) If the court finds as a threshold matter that there is a plausible argument or evidence that an arbitration agreement may exist, it should refer the dispute to arbitration for resolution both of the challenge to the existence of the arbitration agreement and, if an arbitration agreement is found to exist and thus confer jurisdiction on the arbitrators, of the challenge to the existence of the contract.
      - Importantly, the arbitrators’ award or determination on the existence of an arbitration agreement should be subject to subsequent independent judicial review -- *not* limited to the

threshold inquiry proposed for determining whether to refer the parties to arbitration in the first place -- as a check on the integrity of the arbitral process.

- (ii) If the court finds no plausible argument or evidence of an arbitration agreement between the parties, then the court should proceed to adjudicate the parties' dispute.