

Separability within the arbitration clause with special focus on U.S. jurisdictions

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Abstract

The past decades have witnessed an increased role of arbitration as an alternative means in commercial dispute resolution. Given its growing reach and impact, the need to discuss issues as separability within the arbitration agreement is very important since this doctrine helps in salvaging the arbitration clause -making thus arbitration functioning- when it incorporates unlawful, invalid or unenforceable provisions. Separability within the arbitration agreement consist of the process of deleting defective provisions from the arbitration clause, thus making the latter able to survive and able to be enforced. The aim of this thesis is to provide the reader with a deeper understanding of this doctrine and a general framework of how and based on what factors the separability applies. The thesis will firstly focus on the separability application and its related arguments on arbitration clauses incorporated in seafarer agreements and consumer contracts. Moreover, separability application on clauses yielding a nonfunctional arbitration scheme will also be discussed, followed by author's critical approach on the application of this doctrine in certain cases. The second part of the thesis will be devoted to the doctrine application on appeal mechanism designed by parties' agreement, specifically heightened judicial review clauses and waiver or limited judicial review clauses. This work will be of help to anybody interested in the topic, and it can be easily used for practical purposes since it systematically offers a diversity of cases, arguments and results. With regards to the methodology, the thesis employs a qualitative approach, resting mainly on the analysis of US case law which is selected in a way to provide a solid understanding of the doctrine and a clear picture of the problems that might emerge from its application. US jurisdiction is mostly discussed because it is precisely where this doctrine is more widely elaborated.

Introduction

“Separability within the arbitration agreement” means omitting clauses that are unenforceable, invalid or illegal from the arbitration agreement.¹ It should not be confused with the common notion of “separability”, which is one of the cornerstones of international arbitration that establishes the autonomous status of the arbitration agreement with respect to the container contract.² The latter means that when the container contract is attacked for invalidity, the validity of the arbitration agreement itself is not affected.³ It is necessary to start with this distinction in order to clarify the topic this thesis addresses. Hence, I will concentrate on the process that involves deleting provisions from the arbitration agreement to allow the remainder of the clause to be binding and enforceable for the parties. It is important to stress that the terms severance and severability hereinafter are used interchangeably in this work to refer to the same notion - separability *within* the arbitration agreement.

The scope of the thesis will be limited to commercial arbitration because it is one of the most preferred alternative dispute resolutions in business transactions. US jurisdictions will be mainly targeted, because that is where this doctrine is more widely elaborated. As arbitration is becoming increasingly dominant as a means of dispute resolution in commercial relations, the purpose of choosing this topic is to provide an overview of the application of this doctrine as well as the associated problems and benefits that might result from its usage. In terms of methodology, the thesis employs a qualitative approach, which consists in the examination and interpretation of case law selected in a way to provide a clear picture how

¹ Jeremy L. Zell, *Discerning the Validity of Arbitration Agreements Containing Heightened Judicial Review Clauses after Hall Street Associations, L.L.C. v. Mattel, Inc.*, 40 LOY. U. CHI. L. J. 959, 968 n.55 (2009).

² For the development of the principle of separability in international arbitration see GARY B. BORN, *INTERNATIONAL COMMERCIAL ARBITRATION* 311-409 (2009); FOUCHARD, GAILLARD, GOLDMAN, *ON INTERNATIONAL COMMERCIAL ARBITRATION* 198-204 (Emmanuel Gaillard & John Salvage eds., 1999).

³ See, e.g., *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-03 (1967); *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 445-46 (2006).

the doctrine is applied and of the complexity of the issue. This methodology aims to provide a balanced solution to implications that might result from the application of separability in practice.

Separability (within arbitration clause) is very instrumental in salvaging the arbitration agreement when the latter is badly drafted. Therefore its application will ensure the survival of the rest of the arbitration clause conserving thus the parties' agreement on contract terms. However there are cases where its application would be inappropriate. For example, when the arbitration clause contains so many unlawful provisions that if severability was applied, nothing would remain from the initial agreement; or when the clause is so fundamental for the parties' intent that it cannot be deleted because the purpose of the agreement would be frustrated.

Given these potential problems, the dilemma that any law student, judge or arbitrator will encounter when he/she deals with an imperfect arbitration clause, will be either to sever that invalid part or to invalidate *in toto* the arbitration agreement. Can an arbitration agreement survive the swiping of an invalid provision? What are the arguments supporting an affirmative or a negative answer of the latter question? Even if the separability (within arbitration clause) is upheld and somehow promoted in many case law, another question that arises is how far the judges and arbitrators should go in applying this doctrine. The purpose of this paper is to shed some light on these questions. There is little in the literature about this topic given that it is not widely and extensively discussed. Therefore my contribution will consist in setting up a framework that will provide guidance to the practical use of separability.

Although the focus of this thesis, as it is stated above, will be the application of this principle in commercial arbitration, it must be noted that this doctrine has also been applied in employment arbitration clauses. Therefore, I will initially provide a brief analysis of some

US landmark employment decisions to show how the courts came to an outcome regarding the severability issues. These cases will briefly demonstrate the reasoning provided by the courts on severing or not severing the invalid provisions. I would like to emphasize that separability applied in employment contracts is a very closely related issue to its application in commercial arbitration clauses for two reasons. The main one is that many employment court decisions have been cited in commercial decisions. Moreover, the policies applied in these decisions regarding the severance have also been applied in commercial disputes.

My discussion on the topic will continue with the analysis of two types of contracts – respectively, seafarer agreements⁴ and consumer contracts – and how severability has been applied in these cases. These two kinds of contracts offer a diversity of unlawful clauses and they provide a variety of arguments for the application of severability. Also, another area where the doctrine has been applied is related to stipulations yielding a non-functional arbitration scheme. The purpose here is to emphasize the implications that might emerge from the doctrine application by providing thus a critical approach to certain cases.

The second chapter will be devoted to the application of severability in the appeal mechanism designed by the parties' agreement, particularly in heightened judicial review clauses and limited or waiver judicial review clauses. The appeal mechanism is attributed to courts which exercise the state control on arbitral awards, and it is very important to be considered since the state control serves as a filter on arbitral awards to prevent the enforcement of those awards that do not comply with the law. Again, I am providing additional arguments and principles that stand for the application of the current doctrine.

Thus, this thesis does not only follow a comparative approach towards the application of the doctrine on different types of unlawful/unenforceable clauses, but it also serves as a basis for practitioners in the field of arbitration. This diversity of cases and severability

⁴ Also named as seamen contracts, are those agreements concluded by a seaman and his employer. A seaman is “a person who is attached to a navigating vessel as an employee below the rank of officer and contributes to the function of the vessel or the accomplishment of its mission”. BLACK’S LAW DICTIONARY 1468 (Bryan A. Garner ed., 9th ed. 2009).

related arguments will help them to have a practical approach towards the issue, by following and using certain arguments, in accordance with the nature of the cases.

Chapter 1 - Separability of unlawful and invalid provisions within the arbitration agreement

Separability is one of the remedies used by courts/arbitrators to save the arbitration agreement in case it contains unlawful, invalid or unenforceable provisions.⁵ This doctrine serves to sever the invalid portion rather than to impede the arbitration -the main aspect settled by the parties- by invalidating the whole arbitration clause. Despite offering a general overview of separability, this chapter focuses on the analysis and interpretation of relevant case law in relation to the application of severability in seafarer agreements, consumer contracts and stipulations yielding a non-functional arbitration scheme.

1.1 General overview of severability within the arbitration clause

Different types of unlawful provisions are frequently inserted in agreements where one party has a stronger bargaining power or/and is more experienced than the other party when entering in transaction (contracts of adhesion). Seafarer agreements and consumer contracts are two examples of these contracts, which best demonstrates the application of severability within the arbitration clause doctrine. “Arbitration clauses, more than most contract terms, are a type of contract provision meriting substantial judicial scrutiny as to fairness because of the inability of most laypersons to effectively assess ex ante the value they will ultimately place on judicial access or at least leverage as to shape of any alternative forum.”⁶ This expression implies that arbitration clauses should be subject of a very careful examination in order to prevent any insertion of misbalanced stipulations, which favor one party in the detriment of the other. Examples for one-sided provisions might be limitation-of-

⁵ Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1287 (2003).

⁶ Jeffrey W. Stempel, *Arbitration, Unconscionability, and Equilibrium: The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism*, 19 OHIO ST. J. ON DISP. RESOL. 757, 767 (2004).

remedies clauses such as the prohibition of punitive and compensatory damages, fee-splitting provisions, stipulations shortening statute of limitations, etc.⁷

However, the insertion of invalid provisions within arbitration agreement is not limited only to the contracts of adhesion. Even when the parties do have the same bargaining power, they may stipulate invalid provisions such as those yielding a non-functional arbitration scheme or those in respect to the expansion or limitation of the judicial review. Illustrations of these types of provisions and how severability has been applied are the focal points of the thesis and will be analyzed in the next chapter.

This section will provide the reader with a general framework of the application of severability by citing and analyzing briefly some US employment cases notwithstanding that they do not fall within the commercial realm. It is important to reassert that these cases are taken into consideration primarily because they are cited by courts in commercial arbitration decisions. In addition, the reasoning applied in these decisions in relation to severance has also been applied in commercial disputes. The policy arguments used by the courts in pro-severance and against-severance decisions at stake are respectively inspired mainly by two different rationales: one which is based on the strong policy favoring arbitration,⁸ whereas the

⁷ *Id.* at 804-806.

⁸ Adam Borstein, *Arbitrary Enforcement: When Arbitration Agreements Containing Unlawful Provisions*, 39 LOY. L.A. L. REV. 1259, 1260 (2006).

With the enactment of the Federal Arbitration Act in 1925 in which 9 U.S.C. § 2 provides that the arbitration agreements “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract,” and the issuance of many US court decisions reasserting the strong pro-arbitration policy, - *see, e.g.*, *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 221 (1985); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614 (1985); *Shearson/American Express v. McMahon*, 482 U.S. 220, (1987) - the arbitration agreements were given the same weight as other contracts by preempting also any state law that would make any difference regarding the enforceability between arbitration agreements and other civil contracts. *See also Cardegna* 546 U.S. at 443; *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (both cases treated equally the arbitration agreements with other contracts and favored the resolution of disputes through arbitration when the parties have provided for arbitration).

other is based on public policy reasons⁹ and arguments claiming that severance would create incentives to employers to stipulate unlawful provisions within arbitration clauses.¹⁰

The decision whether to apply severability or not is not an easy one. There are many points that the judges/arbitrators should look at. If the offending provision constitutes the main purpose of the agreement and it is not merely an auxiliary clause, it cannot be severed and the whole arbitration agreement should be invalidated.¹¹ Furthermore the courts have decided against severance when the arbitration agreement integrated multiple unlawful provisions because they reasoned that the main purpose of the agreement “was tainted by illegality.”¹² It must be noted that one of the strong elements that have supported the application of separability in most of the cases is the presence of a severance clause in the parties’ agreement.¹³ These clauses demonstrate the common intent of the parties to excise

⁹ See, e.g., *Graham Oil Co. v. ARCO Products Co.*, 43 F.3d 1244, 1249 (9th Cir. 1994) (holding an arbitration agreement as an “integrated scheme to contravene public policy” because it incorporated three unlawful provisions and consequently the entire arbitration clause was voided).

¹⁰ See, e.g., *Gannon v. Circuit City Stores Inc.*, 262 F.3d 677, 684 (8th Cir. 2001); *Perez v. Globe Airport Security Services, Inc.*, 253 F.3d 1280, 1287 (11th Cir. 2001).

¹¹ *Zechman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 742 F. Supp. 1359, 1364 (N.D. Ill. 1990).

¹² See, e.g., *Armendariz v. Foundation Health Psychcare Services, Inc.*, 99 Cal. Rptr. 2d 745, 775 (Cal. 2000); *Hooters of America, Inc. v. Phillips*, 173 F.3d 933, 938-940 (4th Cir. 1999) (holding that due to the presence of several illegal provisions (for ex. the arbitrators were to be appointed by the employer, and some other provisions which were completely one-sided and put the parties in an unequal position), the arbitration agreement was so infected by illegality that if severance would have been applied nothing would have been left from the arbitration agreement); *Alexander v. Anthony International* 341 F.3d 256, 263, 271 (3rd Cir. 2003) (denying severance by arguing that “numerous elements of illegality permeate the overall agreement to arbitrate” and the main purpose of arbitration agreement was tainted by illegality).

¹³ See, e.g., *Gannon* 262 F.3d at 681 (severing a limitation-of-liability clause by using as a key argument the presence of a severability clause stating that “any provisions in the contract which conflict with the applicable law shall be modified automatically to comply”); *Morrison v. Circuit City Stores Inc.*, 317 F.3d 646, 646 (6th Cir. 2003) (severing a limitation of liability and a cost-splitting clause (requiring the claimant to pay excessive fees to start arbitration proceedings) based on the severance provision by pointing out the pro-arbitration policy); *Booker v. Robert Half International, Inc.*, 413 F.3d 77, 83-84 (D.C. Cir., 2005) (severing a limitation-of-remedies provision, which prevented the arbitrator to award punitive damages based on the severance clause).

For a completely opposite approach in relation to the cases cited above, see *Circuit City Stores, Inc v. Adams*, 279 F.3d 889, 893 (9th Cir. 2002) (holding void the entire arbitration clause because it was found unconscionable). The unconscionability was based on the unfairness of the arbitration clause because it was so one-sided that stated that the employees had to raise claims only in arbitration, whereas the employers could raise claims either in courts or in arbitration. Moreover the clause stipulated that the employee had to split the fees of arbitrators with the employer. The court reasoned that the contract was procedurally unconscionable because it was drafted by the employer who had stronger bargaining power than the employee (adhesive contract) and it was also substantively unconscionable because it limited the employee to get relief only through arbitration whereas the employer was not required to arbitrate his claims and for moreover the arbitration agreement contained a cost-splitting clause. Because of these unconscionable terms the court concluded that it

unlawful, unenforceable or invalid provisions included in their contract and at the same time salvage the remainder of the arbitration clause. Moreover, the fact that deleting one part of the arbitration agreement did not disturb the remainder because the latter could be still operational even without the severed provision, has been another argument used by the courts endorsing severance.¹⁴

The separability has also been applied even in the absence of a severance provision. For instance, in *Hadnot v. Bay Ltd.*,¹⁵ the court decided to enforce the remainder of the arbitration agreement whilst holding unenforceable and severing the clause barring the award of punitive damages.¹⁶ In the decision reasoning, the court stated that the clause was unlawful,¹⁷ and severing this part helps the arbitration provision to achieve its intended function in compliance with the law.¹⁸ Moreover, the court held that the enforcement of the arbitration agreement is a product of a widely accepted pro-arbitration approach that was elaborated by US case law.¹⁹ In addition, it argued that the limitation-of-remedies provision was not so fundamental, and could be severed without affecting the parties' intent to arbitrate their dispute.

In *Hadnot*,²⁰ the court did not need the presence of a severability clause to decide on severance of unlawful provision.²¹ The main point in this case is that severance was proper even though the parties did not declare their intention to sever unlawful provisions by

could not sever them but rather the whole arbitration agreement had to be declared void. *See id.* at 893-94. For the meaning of procedural and substantive unconscionability see also *Fiser v. Dell Computer Corporation*, 188 P.3d 1215, 1221 (N.M., 2008).

¹⁴ *See, e.g., Gannon* 262 F.3d at 681.

¹⁵ *Hadnot v. Bay Ltd.*, 344 F.3d 474 (5th Cir. 2003).

¹⁶ *Id.* at 474.

¹⁷ The clause was contrary to Title VII of Civil Rights Act of 1964, which provides the claimant with the relief to seek for statutory punitive damages. *See Id.* at 478.

¹⁸ *Id.*

¹⁹ *Id.* (citing *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*, 473 U.S. 614 (1985)).

²⁰ *Hadnot*, 344 F.3d 474.

²¹ *See contra Wright v. Circuit Stores, Inc.*, 82 F. Supp.2d 1279 (N.D. Ala. 2000.); *Etokie v. Carmax Auto Superstores, Inc.*, 133 F. Supp. 2d 390 (D. Md. 2000) (in both cases, the presence of severability clauses, in parties contract, were the central arguments in applying severability instead of voiding the entire arbitration clause). Michael K. Daming, *To Sever or to Destroy: The Eighth Circuit Allows Invalid Provisions to Be Served from Otherwise Enforceable Arbitration Agreements*, 2002 J. DISP. RESOL. 425, 428.

inserting a severability provision.²² Also in *Graham Oil Co. v. ARCO Products Co.*,²³ the dissenting judge reasoned that even though the contract did not have a severance clause, the arbitration clause could still stand without the unlawful provisions.²⁴ According to him, the offending provisions were not integral for the arbitration agreement, therefore arbitration could still remain “attractive” despite the severance of those clauses.²⁵

Whereas, in *Shankle v. B-G Maintenance Management of Colorado, Inc.*²⁶, the fact that there was no severance clause in the contract, served as a primary argument for the court to void the entire arbitration agreement instead of only severing the clause requiring the claimant to pay excessive fees to start arbitration.²⁷ Also in *Perez v. Globe Airport Security Services, Inc.*,²⁸ the nonexistence of a severability provision was one of the reasons why the court declared the whole arbitration agreement void and did not sever the limitation-of-remedies clause.²⁹ However in the last case the most predominant argument against severance was the public policy issue, specifically the concern that severing unlawful provision would give incentives to employers to include unlawful provisions within arbitration clauses³⁰.

In view of the arguments above, the severance of unlawful provisions within the arbitration agreements or the voidance of the latter one, remains an open issue. To sum the

²² See also *Spinetti v. Service Corp. Intern.*, 240 F.Supp.2d 350, 357, (W.D. Pa.2001) where the same approach was followed. The court severed two provisions regarding the employee’s payment of attorneys’ fees and arbitration costs and enforced the remainder of the arbitration agreement, even though there was no severance clause in the contract. It was reasoned that the primary intent of the parties is to resolve their disputes through arbitration and the offending provisions could be severed without affecting the intent of the parties.

²³ *Graham Oil Co. v. ARCO Products Co.*, 43 F.3d 1244, (9th Cir. 1994).

²⁴ *Id.* at 1251 (Fernandez, J., dissenting). However in this case the majority decided for the voidance of the entire arbitration clause based on public policy argument. There were incorporated several provisions in the arbitration agreement that were contrary to Petroleum Marketing Practices Act. For instance the employee could not recover punitive damages and the period for filing claims was shorten from 1 year to 6 months. For this reasons the court argued that these illegal provisions violated public policy and could not be severed because otherwise the arbitration agreement would have been changed as intensively as it would be doubtful if it would corresponded with the initial intent of the parties. See *Id.*, at 1248.

²⁵ *Id.* at 1251.

²⁶ *Shankle v. B-G Maintenance Management of Colorado, Inc.*, 163 F.3d 1230 (10th Cir. 1999).

²⁷ *Id.* at 1235.

²⁸ *Perez v. Globe Airport Security Services, Inc.*, 253 F.3d 1280, (11th Cir. 2001).

²⁹ *Id.* at 1287.

³⁰ Michael K. Daming, *supra* note 21, at 430.

main points up, in pro-severability decisions the courts have based their outcome on the strong policy favoring the arbitration agreement and on the presence of severability clauses in employment contracts. It is important to note, however, the non-existence of severance clauses has not been an obstacle for courts to apply the doctrine of severability. In pro-severability decisions, additional arguments to support severance include, for example, one that states that the remainder of the arbitration agreement could still stand because the offending provisions do not represent an integral part of the agreement and therefore the initial intent of the parties could not be disturbed.

On the other hand, in anti-severability decisions the main argument used by the courts was that the arbitration agreements were contravening public policy. Moreover in most of the cases the courts have argued that the absence of a severance clause did not allow the courts to apply separability and they have also reasoned that severance would create incentive to employers to include illegal provisions within arbitration agreements. It is obvious that the severance clause is very important in applying severability. Therefore, if the parties want an incontestable arbitration agreement, it is recommended that they insert a severance provision which applies expressly to the arbitration agreement or to certain provisions within it.³¹ In those cases where the courts dealt with numerous unlawful provisions, they have held that the arbitration agreements were “infected” by illegality so that nothing could have been able to “survive” after the severance of so many clauses. Consequently, it was impossible to cure defects through severance.

Another issue of interest, with respect to severance, is the insertion of discriminatory provisions within the arbitration agreement. Some people are so influenced by their religious or racial affiliation that they appoint as arbitrators people who pertain to the same affinity

³¹ Liz Kramer, *Severability Squared: Can Invalid Provisions Within an Arbitration Agreement Be Severed?*, ARB NAT BLOG (Dec. 6, 2011), <http://arbitrationnation.com/severability-squared-can-invalid-provisions-within-an-arbitration-agreement-be-severed/> (last visited Mar. 1, 2014).

group. A current example is the *Jivraj v. Hashwani*³² case where the arbitration agreement provided that the arbitrators should have been "...members of Ismaili community". On one hand the parties' autonomy is a well established principle in arbitration. Hence the parties are free to confide their case to people who they think are the most appropriate for the settlement of their disputes. On the other hand, firstly, the inclusion of biased features within arbitration agreement is not very sustainable in international arbitration³³ and secondly, it might fall within the scope of anti-discriminatory laws.

The question that emerges in these situations is whether these discriminatory provisions can be severed if they are found unlawful so that the remainder of the arbitration agreement can be enforced. The matter of separability was not discussed extensively in *Jivraj*, since the UK Supreme Court held the discriminatory provision and consequently the arbitration agreement valid.³⁴ The Court of Appeal only stated that if the provision was found unlawful and invalid it could be severed, unless the application of severance would have substantially altered the initial arbitration agreement.³⁵

Let us assume an arbitration clause which provides that arbitrators must not be of a particular racial group or gender. These provisions respectively constitute racial and sex-based discrimination and violate the fundamental human rights which are protected in each and every country. The arbitration agreements by no means shall incorporate exclusionary

³² *Jivraj v. Hashwani* [2011] UKSC 40 (Eng.) in TIBOR VÁRADY, JOHN BARCELO, ARTHUR MEHREN, INTERNATIONAL COMMERCIAL ARBITRATION: A TRANSNATIONAL PRESPECTIVE 329 (West, 5th ed. 2012).

³³ Umar A. Oseni & Hunud Abia Kadouf, *The Discrimination Conundrum in the Appointment of Arbitrators in International Arbitration*, 29 (5) J. INT'L ARB. 519, 542 (2012).

³⁴ The main discussion in courts' proceedings was whether arbitrators could be considered as employees in the context of employment. If so, the discriminatory provision would have fallen within the scope of some Regulations which regulate the employment discrimination. However the UK Supreme Court qualified the agreement between the parties and arbitrators as a contract of service and not an employment contract since there is no subordination relationship between the parties (the arbitrator does not perform his duties under the orders or direction of the parties.) Given that the contract between arbitrators and the parties was not considered an employment one, the Regulations did not apply to arbitration, as the party attacking the discriminatory provision contended. Therefore the provision was not found unlawful. Várady, Barcelo, Mehren, *supra* note 32, at 339.

³⁵ *Id.* at 332-333.

provisions like excluding people from being arbitrators based on racial, religious, or other grounds.³⁶

When applying severability in these cases, the court must look at the intention of the parties. When the resolution of disputes through arbitration is the main aspect agreed by the parties, the court will easily delete the offending clause.³⁷ The presence of the discriminatory element is just an ancillary provision, whose severance does not affect the arbitration agreement itself, meaning that after this provision is excised there is no need for altering or rewriting the remainder of the agreement. Moreover, given the strong policy favoring arbitration, which is especially highly considered in US, every controversy in relation to a defective arbitration agreement should be settled in its favour.³⁸ Based on the above arguments, one might conclude that the presence of a discriminatory provision does not invalidate the whole arbitration agreement, but the doctrine of severability applies instead, making thus enforceable the remainder of the arbitration clause.

1.2 Application of separability in seafarer agreements and consumer contracts

These two kinds of agreements are of a wide interest, considering the fact that the doctrine of severability is specifically discussed. What is important is to give an overview of the arguments and court reasoning regarding the doctrine application. But that is not the only reason. Another one is to show the diversity of unlawful provisions that are inserted in these two types of adhesive contracts. These two contracts, as part of adhesive ones, contain standardized stipulations including arbitration agreements that are drafted by only one party of the agreement – and these arbitration agreements are offered to the other party only on a “take it or leave it” basis. The focus will be on the severability application and related

³⁶ Oseni & Kadouf, *supra* note 33, at 543.

³⁷ *Id.* at 540.

³⁸ *Id.* at 541.

arguments on these one-sided provisions incorporated in arbitration clauses. In addition, the case is chosen to demonstrate arguments not yet mentioned in the thesis.

1.2.1 Seafarer agreements

Seamen's employment contracts have been considered as commercial contracts by case law³⁹, therefore they need to be discussed. Being considered as commercial contracts, arbitration agreements incorporated in them are also subject to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards ⁴⁰ (if some conditions are fulfilled)⁴¹ and Federal Arbitration Act (FAA)⁴². The necessity of discussing this type of contract in the thesis remains on the fact that it has been subject of legal disputes where the severability was commonly applied.

In *Bogdan Dumitru v. Princess Cruise Lines, Ltd.*,⁴³ the seafarer contract integrated an arbitration agreement between the parties which had incorporated a Bermuda choice-of-law and choice-of-seat of arbitration.⁴⁴ The US District Court for the southern District of New York severed these two clauses and referred the parties to arbitration by enforcing the substance of the arbitration agreement. The court reasoned that the two offending provisions

³⁹ See, e.g., *Rogers v. Royal Caribbean Cruise Line*, 547 F.3d 1148, 1150 (C.D. Cal., 2008), in 34 Y.B. COM. ARB. 926 (Van den Berg ed., 2009); *Razo v. Nordic Empress Shipping Ltd.*, 362 Fed. Appx. 243, 245 (D.N.J. 2009), in 35 Y. B. COM. ARB. 490 (Van den Berg ed., 2010); *Princess Cruise Lines, Ltd. v. Christina Dean*, No. PS 009907 (Cal. Super. Ct., L.A. Cnty, Aug. 15, 2007) in 33 Y.B. COM. ARB. 1187 (Van den Berg ed., 2008); *Leslie Holmes v. Westport Shipyards, Inc.*, No. 03-60105-CIV-HUCK/TURNOFF (S.D. Fla., Jun.15, 2004) in 30 Y.B. COM. ARB. 850 (Van den Berg ed., 2005).

⁴⁰ Also called New York Convention, *hereinafter* NYC. It was adopted on 10 June 1958. Its main objective is to establish common standards on the recognition and enforcement of foreign arbitral awards and to ensure the enforcement of them in the same manner as domestic awards.

⁴¹ To be subject of NYC, the following four pronged test developed by US courts, must be satisfied : “(1) there is an agreement in writing to arbitrate the dispute; (2) the agreement provides for arbitration in the territory of a signatory of the Convention; (3) the agreement arises out of a legal relationship, whether contractual or not, that is considered commercial; and (4) one party to the agreement is not a United States citizen, or the commercial relationship at issue has some reasonable relation with a foreign state”. See *Bautista v. Star Cruises*, 396 F.3d 1289, 1294 (11th Cir. 2005).

⁴² Hereinafter FAA. It is enacted in 1925 and codified in United States Code (U.S.C). It regulates arbitration as another means of disputes' resolution.

⁴³ *Bogdan Dumitru v. Princess Cruise Lines, Ltd.*, No. 09 Civ. 4792 (NRB) /10 Civ. 1790 (NRB), (S.D.N.Y., Jul. 29, 2010) in 35 Y. B. COM. ARB., *supra* note 39, at 563.

⁴⁴ *Id.*

resulted in a waiver of employee's rights under the Jones Act⁴⁵ and therefore these clauses contravened public policy.⁴⁶ Moreover the court argued that because of a strong pro-arbitration international policy and the presence of a severability clause the illegal provisions could be severed and the core of the arbitration agreement should be enforced.⁴⁷

*Thomas v. Carnival Corp*⁴⁸ was one of the precedents that was mentioned as a key argument against severability in *Dimitru*, however, the court reached a different outcome in *Dimitru* case. In *Thomas*, the arbitration clause in the seafarer agreement provided for arbitration in Philippines under the Panamanian law - the law of the vessel's flag at the time when the cause of action occurred.⁴⁹ The plaintiff argued that compelling the parties to arbitration would have resulted in a waiver of his rights under the Seaman's Wage Act which itself amounted to a violation of public policy, as the Panamanian law does not provide for any equivalent rights to those existing in the Act at bench.⁵⁰ The court had to deliberate whether the arbitration agreement is null and void or the parties should be compelled to arbitration.⁵¹

Quoting *Vimar*,⁵² the court held that the application of Panamanian law would prohibit the plaintiff to exercise his statutorily rights under Seaman's Wage Act, without any possibility of review in the enforcement phase because under Panamanian law, Thomas would not have been awarded with any relief regarding his Seaman's Wage Act Claims.⁵³ In

⁴⁵ See BLACK'S LAW DICTIONARY, *supra* note 4, at 915 (defining Jones Act (enacted in 1920) as "[a] federal statute that allows a seaman injured during the course of employment to recover damages for the injuries in a negligence action against the employer").

⁴⁶ *Dumitru*, No. 09 Civ. 4792 (NRB) /10 Civ. 1790 (NRB), at 567.

⁴⁷ *Id.*

⁴⁸ *Thomas v. Carnival Corp.*, 573 F.3d 1113, (11th Cir. 2009) *in* 34 Y.B. COM. ARB., *supra* note 39 at 1136.

⁴⁹ The arbitration clause stated in part that "[the] Agreement [was to] be governed by . . . the laws of the flag of the vessel on which Seafarer is assigned at the time the cause of action accrues, without regard to principles of conflicts of laws thereunder". *Id.* at 1147.

⁵⁰ *Id.* at 1137.

⁵¹ The deliberation on the validity of the arbitration agreement had to be based on NYC, only if the four requirements for being subject of NYC set out in *Bautista* 396 F.3d 1289 were satisfied. *Id.* at 1136-1137.

⁵² *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528, at 540, (1995).

⁵³ *Id.* at 1148.

Thomas, the court instead of applying the severability doctrine, declared the whole arbitration clause null and void on the grounds that it found the agreement to be against public policy, because the employee was prohibited from vindicating his statutory rights.

In *Orozco v. Princess Cruise Line, LTD.*,⁵⁴ the court severed the choice-of-law clause relying on a severability provision⁵⁵, which was part of the seafarer agreement. The plaintiff, analogously with the above analyzed cases, alleged that the Bermudian choice-of-law deprived her from exercising her rights under the Jones Act. The court held that the enforcement of the arbitration agreements should be ensured in compliance with its terms, however in the presence of a severability clause, the court could delete an unlawful provision.⁵⁶

It is apparent that the outcomes are not uniform. Even though in some cases the factual findings were comparably similar, still the results at the end were different. This situation amounts to an unpredictability when it comes to the enforcement of an arbitration agreement incorporating an unlawful provision. However, as it is noted, the presence of a severance provision is a very important drafting point, because its existence has always been a key argument in applying severance.

⁵⁴ *Orozco v. Princess Cruise Line, LTD.*, No. 10-23276-CIV-KING, (S.D. Fla. 2010) in 36 Y.B. COM. ARB. 384 (Van den Berg ed., 2011).

⁵⁵ Article 15 of the Acceptance of the Terms and Conditions stated the following: “If any clause of these Terms is determined to be void or otherwise unenforceable by any court or tribunal of competent jurisdiction, then the remainder of the Terms shall stand in full force and effect.” *Id.* at 384.

⁵⁶ *Id.* at 386. *See also* *Cardoso v. Carnival Corp.*, No. 09-23442-CIV., (S.D. Fla. 2010) in 35 Y. B. COM. ARB., *supra* note 39, at 518; *Dockeray v. Carnival Corp.*, 724 F.Supp.2d 1216, 1225-26 (S.D.Fla. 2010) (both cases held severable the choice of law clauses based on the presence of a severability provision within parties’ contracts).

1.2.2 Consumer contracts

In this section the severability issues will be discussed in relation to provisions within arbitration clauses in consumer contracts which have been attacked for unconscionability and their effects preventing the consumers from vindicating their statutory rights. The first case discussed in this section is related to severability of unlawful provisions within arbitration clause in a health care service contract.⁵⁷ In *Beynon v. Garden Grove Medical Group*,⁵⁸ the court applied the severability within arbitration agreement containing a provision stating that the health care provider had the right to resubmit the dispute to a second panel of arbitrators in case it (service provider) rejected the first award given by the first panel.⁵⁹ The contract was found adhesive as it was concluded on a “take it or leave it” basis and the court concluded that the clause was so one-sided that it put the parties in an unequal position.⁶⁰ Moreover, the provision was held misleading due to the fact that the existence of such clause was not communicated to the subscriber of the health care service.⁶¹ For the reasons stated above the court severed the provision from the rest of the arbitration agreement, as the latter was valid and could stand without the unlawful clause.⁶² In addition, it was inserted by the court that the pro-severability decision is based also on the strong pro-arbitration policy.⁶³

The analysis will follow with the application of the severability within an arbitration clause in a margin agreement.⁶⁴ In point of fact the case at bench, *Richards v. Merrill Lynch*,

⁵⁷ See *Beynon v. Garden Grove Medical Group*, 100 Cal.App.3d 698 (Cal. Ct. App. 4th Dist. 1980).

⁵⁸ *Id.*

⁵⁹ An arisen dispute between the parties related to malpractice claims was resolved through arbitration. After the award was issued the defendants gave notice that they would proceed to the second arbitration. Then plaintiff filed suit in the court to confirm the award. She contended that she was unaware of the existence of that provision in the arbitration agreement and she alleged that it was unenforceable as it was contrary to the public policy. See *Id.* at 703-704.

⁶⁰ *Id.* at 705.

⁶¹ *Id.* at 709.

⁶² *Id.* at 713.

⁶³ *Id.*

⁶⁴ Margin agreement is “[a]n agreement between a brokerage and a client governing a margin account. The margin agreement enables the client to borrow from the brokerage in order to buy securities.” THE FREE

Pierce, Fenner & Smith, Inc.,⁶⁵ antedates *Beynon*,⁶⁶ and it was cited in the latter one to support the pro-severability arguments. The contract between the customer and the brokerage firm contained an arbitration agreement in which there was an incorporation by reference of arbitration rules of the New York Stock Exchange.⁶⁷ Under these rules the seat of arbitration was in New York, the arbitrators were to be appointed by the New York Stock Exchange, one of whose members was the defendant.⁶⁸ It is obvious that the arbitration agreement drafted in this way was unfair because it was advantageous to the defendant, who in contrast with the plaintiff had influence in the appointment of the arbitrators. As this situation would create a unequal position between the parties⁶⁹ in violation of due process, and referring to the strong pro-arbitration policy,⁷⁰ the court severed the invalid provision and compelled the parties to arbitration under the rest of the arbitration agreement.

In *Joseph P. Anders v. Hometown Mortgage Servs. Inc.*,⁷¹ the plaintiff entered in a mortgage agreement with the defendant, to be financed for the purchase of his home. The contract contained an arbitration clause which incorporated a restriction-of-remedies provision.⁷² In the presence of a severance clause and supported by the strong policy favoring arbitration, the court held the provision severable and unlawful as it prevented the plaintiff from seeking all the possible remedies provided by law.⁷³

DICTIONARY (2014), available at <http://financial-dictionary.thefreedictionary.com/Margin+Agreement> (last visited Feb. 12, 2014).

⁶⁵ *Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 64 Cal.App.3d 899 (1976).

⁶⁶ *Beynon*, 100 Cal.App.3d 698.

⁶⁷ *Richards*, 64 Cal.App.3d at 902.

⁶⁸ *Id.* at 903.

⁶⁹ The court held that the rules were not unfair per se, but there was a great potential for abuse when those rules are incorporated by reference as in our case. Because of the implications that arise due to the NYSE rules, they should have been called to the attention of the other party and the latter must have given his consent. So, according to the court the incorporation was not enough. *Id.* at 904.

⁷⁰ *Id.* at 906.

⁷¹ *Joseph P. Anders v. Hometown Mortgage Servs. Inc.*, No. 02-14448, (11th Cir. Sep. 25, 2003), available at <http://www.kluwerarbitration.com/CommonUI/document.aspx?id=ipn80243&query=content%3A%22severability%22> (last visited Feb. 12, 2014).

⁷² *See Id.* at I.

⁷³ *See Id.* at II.

Another issue of great relevance with regard to the topic of this thesis is related to the question of what would be the fate of an arbitration agreement containing a no-class-action provision in a consumer contract.⁷⁴ Some courts have held the entire arbitration agreement invalid, whereas some others have severed the class-action-waiver as being unconscionable, and enforced the remainder of the arbitration clause.⁷⁵

From the economic point of view, one of the purposes why these waivers are considered unconscionable and thus invalid is because suing on individual claims would be unattractive as the costs of starting proceedings would be greater than the amount that the consumer would recover.⁷⁶ This would make the consumers bear disproportionate costs and they would be discouraged to file suits on an individual basis. Therefore their rights would not be vindicated unless they use the class action mechanism. Moreover in some situations the usage of class-action-ban from businesses immune them from liability deriving from claims that cannot be individually raised.⁷⁷ Cases that represent both approaches shall be discussed in the following paragraphs.

In addition, there is a third approach holding valid class-action-waivers within arbitration clauses unless there is a mandatory law supporting class-wide actions and providing also for arbitration.⁷⁸ Scholars and judges that endorse the last approach⁷⁹ rely on

⁷⁴ The recent approach taken by the United States Supreme Court in *AT&T Mobility v. Concepcion*, 131 S.Ct. 1740, 1751, (U.S., 2011), was to allow class waivers in arbitration agreement. However the analysis of the cases dealing with this issue is important to demonstrate the courts' rationale in application of severability within arbitration agreements.

⁷⁵ Kathleen M. Scanlon, *Class Arbitration Waivers: The 'Severability' Doctrine and Its Consequences*, 62 DISP. RESOL. J. 40, 42 & 44 (2007).

⁷⁶ See *Dale v. Comcast Corp.*, 498 F.3d 1216, 1224 (11th Cir. 2007). For arguments supporting the unconscionability of the class actions waivers see moreover Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?*, 67 LAW & CONTEMP. PROBS. 75, 85, (2004), available at <http://scholarship.law.duke.edu/lcp/vol67/iss1/4> (last visited Mar.1, 2014).

⁷⁷ Christopher R. Drahozal, *"Unfair" Arbitration Clauses*, 2001 U. ILL. L. REV. 695, 712.

⁷⁸ See JEFF WAINCYMER, *PROCEDURE AND EVIDENCE IN INTERNATIONAL ARBITRATION* 583 (2012).

⁷⁹ See, e.g., *Med Center Cars, Inc. v. Smith*, 727 So.2d 9, 20 (Ala. 1998); *Rains v. Foundation Health Systems Life & Health*, 23 P.3d 1249, 1253 (Colo.App.2001); *Edelist v. MBNA America Bank*, 790 A.2d 1249, 1261

the strong policy favoring arbitration and on the argument that the arbitration agreement can be shaped as the parties wish, and if they want to narrow its scope by excluding class actions, there is nothing to be disallowed.⁸⁰

Coming to our main issue, as it is mentioned above, the courts' decisions are split between those endorsing the severability of class-action-waiver provisions, and those setting aside the entire arbitration agreement, thus referring the parties to courts. What is noticeable in some of cases representing the last approach and which are taken for analysis in this thesis is that the courts have held invalid all the arbitration clauses because they contained numerous unlawful provisions. So, the main idea of these decisions is that the entire arbitration agreements were permeated by illegality. This reasoning is exactly as the one provided in employment cases containing multiple unlawful provisions within arbitration clauses.⁸¹

Thus in *Luna v. Household Finance Corp. III*,⁸² the severance was denied, based on the reasoning that “the unconscionable provisions⁸³ [were] interrelated and each [served] to magnify the one-sidedness of the others. As such the Arbitration Rider [was] tainted with illegality”.⁸⁴ Exactly the same outcome has been reached in *Acorn v. Household Intern., Inc.*⁸⁵ In the same vein, in *Ingle v. Circuit City Stores, Inc.*⁸⁶ and *Eagle v. Fred Martin Motor*

(Del. Super. Ct. 2001); *Ranieri v. Bell Atlantic Mobile*, 759 N.Y.S.2d 448, 449 (N.Y. App. Div. 2003); *Walther v. Sovereign Bank*, 872 A.2d 735, 750 (Md. 2005).

⁸⁰ Philip Allen Lacovara, *Class Action Arbitrations – the Challenge for the Business Community*, 24 (4) Arb. Int'l 541, 550 & 556 (2008).

⁸¹ See cases cited *supra* notes 9, 12.

⁸² *Luna v. Household Finance Corp. III*, 236 F.Supp.2d 1166, (W. D. Wash., 2002).

⁸³ Despite the incorporation of class-action-waiver the arbitration agreement provided for a cost-splitting provision, a confidentiality requirement which favored the defendant and moreover, the latter had the alternative to sue the consumer either in court or in arbitration. *Id.* at 1178-1182.

⁸⁴ *Id.* at 1183

⁸⁵ *Acorn v. Household Intern., Inc.*, 211 F.Supp.2d 1160, 1174 (N. D. Cal., 2002) (citing *Armendariz v. Foundation Health Psychcare Services, Inc.*, 99 Cal. Rptr. 2d 745 (Cal. 2000)) (holding the invalidity of the entire arbitration clause due to the incorporation of other one sided provisions such as those dealing with the share of the costs of arbitration and confidentiality).

⁸⁶ *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1180 (9th Cir. 2003) (citing *Armendariz*, 99 Cal. Rptr. 2d 745; *Circuit City Stores, Inc v. Adams*, 279 F.3d 889, 893 (9th Cir. 2002)).

Co.⁸⁷ the court held that the arbitration scheme containing many one-sided provisions is so illegally contaminated that it should be thrown in the trash.⁸⁸

Based on other arguments compared to what the courts have held in cases discussed above, in *Fiser v. Dell*,⁸⁹ the Supreme Court of New Mexico invalidated the entire arbitration clause because of the presence of a class action arbitration ban. The latter was held substantively unconscionable as it prevented the consumer from class relief, which was a very effective way of recovering damages in case of contract's breach.⁹⁰ The Court held the arbitration clause itself unenforceable as being contrary to the public policy of New Mexico.⁹¹ Regarding the severability of class action ban, it was stated that it “*was central to mechanism for resolving disputes*” and therefore it could not be severed.⁹² So, the criteria applied in this case were the importance and the crucial impact that the class action ban had in the dispute resolution process, such as if it was held severable, the arbitration agreement would have been significantly different from the initial intent of the parties.

The fact that class action ban was so fundamental to the dispute resolution mechanism was in the center of the arguments also in *Kinkel v. Cingular Wireless LLC*,⁹³ however, the result was the opposite of the one in *Fiser*. In this case the court decided to sever the no-class-action provision based on the following reasons: the strong pro-arbitration policy, a

⁸⁷ *Eagle v. Fred Martin Motor Co.*, 809 N.E.2d 1161, 1185 (Ohio App. 9 Dist., 2004). *See also* *Comb v. Paypal, Inc.*, 218 F. Supp. 2d 1165, 1170-75 (N.D. Cal. 2002) (invalidating the entire arbitration clause because of the presence of multiple unlawful provisions). *But see* *Dale v. Comcast*, 498 F.3d 1216, 1219 (11th Cir. 2007) (holding invalid the whole arbitration clause but based on a provision stipulated in the contract which stated that in case the court would have found the waiver invalid, then all the arbitration agreement should have been declared unenforceable).

⁸⁸ Example of other cases where the entire arbitration clause was invalidated based in part on the preclusions of class actions are *Powertel, Inc. v. Bexley*, 743 So. 2d 570, 576-77 (Fla. Dist. Ct. App. 1999); *In re Knepp*, 229 B.R. 821, 842 (Bankr. N.D. Ala. 1999).

⁸⁹ *Fiser v. Dell Computer Corporation*, 144 N.M. 464, 188 P.3d 1215, (N.M. 2008).

⁹⁰ *Id.* at 470, 1221.

⁹¹ The court determined the New Mexico Law as the law governing the dispute even though the contract contained a Texas-choice-of-law clause. The latter was invalidated because Texas law allows the waiver of class action arbitration and this would violate the New Mexico public policy (NM law is the law that would have governed the contract in the absence of a choice-of-law provision). *See Id.* at 476, 1218.

⁹² *Id.* at 471, 1222.

⁹³ *Kinkel v. Cingular Wireless LLC*, 857 N.E.2d 250 (Ill., 2006).

severability clause which was part of the contract and on the fact that the defendant who was the drafter of the contract did not convince the court that the class action ban was so essential for arbitration that it required the court to invalidate the whole arbitration clause.⁹⁴

As it was indicated above, the no-class-action provision was held severable mainly in those cases when it was the only unlawful clause of the arbitration agreement. In *Kristian v. Comcast Corp.*,⁹⁵ the clause was held unenforceable for being against the public policy which disfavored the unfair commercial practices and for preventing the consumer from vindicating their rights.⁹⁶ Two pro-severance arguments mentioned by the court were the existence of a saving clause⁹⁷ based on which the court stated that the class action bar was not so fundamental for the arbitral proceedings, thus it could be severed⁹⁸ and the strong policy pro-arbitration.⁹⁹

Additionally, in *Szetela v. Discover Bank*¹⁰⁰ and *Cooper v. QC Fin.*,¹⁰¹ the no-class-action provisions went down for the main reason that the arbitration agreement could stand even without them (the class-action-waivers were the only deficiencies of the arbitration agreement), and because of the promotion of the policy favoring the arbitration.¹⁰² In contrast to *Kristian*, in both last cases there was no severability or saving clause.

As it can be seen from the analysis above, different policies stand behind the pro-severability and against-severability approaches. Pro-severability is supported by the strong policy favoring arbitration in those clauses containing only one unlawful provision consisting

⁹⁴ *Id.* at 278.

⁹⁵ *Kristian v. Comcast Corp.*, 446 F.3d 25, (1st Cir. 2006).

⁹⁶ *Id.* at 42, 47.

⁹⁷ The clause provided the following: “There shall be no right or authority for any claims to be arbitrated on a class action or consolidated basis . . . unless your state’s laws provide otherwise”. *Id.* at 61.

⁹⁸ *See also* *Mandel v. Household Bank Nat’l Ass’n* (Nev.), 129 Cal. Rptr. 2d 380, 385-86 (Cal. Ct. App. 4th Dist. 2003) (holding severable a ban of class action as being unconscionable and one-sided, based in part on the presence of a severance clause); *Ting v. AT&T*, 182 F. Supp. 2d 902, 927 (N.D. Cal. 2002) (holding severable a class-action-prohibition clause).

⁹⁹ *Id.* at 61-62.

¹⁰⁰ *Szetela v. Discover Bank*, 97 Cal.App.4th 1094, 1101-02, (Cal. Ct. App. 4th Dist. 2002).

¹⁰¹ *Cooper v. QC Fin.*, 503 F. Supp. 2d 1266, 1289– 1293, (D.Ariz. 2007).

¹⁰² *See Id.*

of class action. However the latter policy plays no role and it is disregarded in against-severability decisions where arbitration agreements contain multiple portions of illegality. As the disputes consist of business-to-consumer (B2C) relationships, I think the reasoning following the second approach stems from the essential purpose of consumer laws, which is the consumers' protection from the not individually negotiated standardized terms, including arbitration agreements. According to the courts as the whole arbitration agreement "is tainted by illegality," the severability was found inapplicable. I support this agreement among courts. The consumer is the weakest party in the transaction, and the examples above show how the stronger bargaining power of the trader may result in a lack of mutuality between the parties.

In my opinion this is a very sound choice in order to impede the incentive of inserting unlawful provisions in contracts of adhesion. The arbitration is a very effective way of settling the disputes, but it cannot be ill-used to create harsh consequences on the consumer side. The latter is usually unsophisticated and inexperienced compared with the trader. Additionally, there is also the possibility of lacking knowledge on consumer's part regarding the impacts of one-sided provisions on consumer's rights. Therefore because of the consumer's law unawareness, he probably would not vindicate his statutory rights that are excluded by the arbitration clauses drafted by the trader. As a result the "output" of the arbitration would have been in violation of due process and this alternative dispute resolution cannot be used as a tool to favor one party's position on the detriment of the other party's rights.

Another argument that I would like to add against severability, even though it lacked in courts' reasoning on consumer disputes, is that almost nothing would have remained from the arbitration agreement if the unlawful provisions had been severed. The severability is acceptable so long as it does not make the arbitration agreement incomprehensible.

To continue further, despite that arbitration agreement is product of parties' intent, the courts may intervene to fill gaps and reasonably interpret ambiguous clauses within arbitration agreement. However this is not the case. Considering that cases deal with numerous unlawful provisions, the application of severability would lead to the need of redrafting the arbitration agreement.¹⁰³ The court cannot interfere at this point because as it is mentioned above this issue is a matter of agreement between the parties and pertains only to them.¹⁰⁴ Taking also into account that generally the issue of severability emerges after the dispute is arisen between the parties, it would be very difficult if not impossible for the parties to reach another agreement under tensions.¹⁰⁵ To conclude, based on reasons stated above, the application of severability is inappropriate under these circumstances. The arguments stated above thoroughly demonstrate how far courts can go in applying the severability.

1.3 Separability of stipulations that yield a nonfunctional arbitration mechanism

This subchapter will deal with provisions within arbitration clauses that have been claimed to hamper the dispute resolution scheme adopted by the parties. Some of the examples analyzed below cover pathological clauses consisting of the incorporation of inexistent, misnamed arbitral institutions, or ones that have ceased to arbitrate and how the courts or arbitration tribunals have dealt with this issue. Given that the topic is about separability it is important to stress that the cases where the imperfections of arbitration agreements have been interpreted and not severed are excluded from the analysis of this thesis. The importance of this section remains on the fact that it will provide the reader with the author's critical approach related to the application of severability in certain cases.

¹⁰³ For a critical view of severability within the arbitration clause *see supra* note 12 and accompanying text.

¹⁰⁴ *See MCI Telecomms. Corp. v. Exalon Indus., Inc.*, 138 F.3d 426, 428–29 (1st Cir.1998).

¹⁰⁵ Várady, Barcelo, Mehren, *supra* note 32, at 99.

The following example is going to illustrate the problem where the arbitral institution does not exist. In *Austrian party v. Yugoslav party*,¹⁰⁶ the arbitration agreement provided the following:

All disputes, which may arise from this contract, shall be settled by way of mutual agreement. If it is not possible to settle the dispute amicably, respectively in the sense of para. 1 of this article, to will be decided by the Arbitration Court of the Federal Economic Chamber of Yugoslavia.

The next instance for the settlement of disputes is the competent international law court.¹⁰⁷

It seems apparent that the second paragraph of this agreement is so ambiguous that it is impossible to determine which institution should have had played the role of a second instance to settle the dispute. For this reason the arbitration court severed the second paragraph, retained jurisdiction and issued an award.¹⁰⁸ In enforcement proceedings the losing party challenged the award by alleging that the entire arbitration clause was invalid because it provided for a non existing second-instance-authority.¹⁰⁹ The Austrian Supreme Court held the equivocal provision invalid distinguishing the ‘real arbitration agreement’ from the ‘agreement on the arbitral procedure’ arguing that the latter was only a nonfunctional procedural arrangement which by no means could yield the invalidity of the entire arbitration clause.¹¹⁰

The debatable question was whether to arbitrate by severing the second provision or to refer them to the court holding invalid the entire clause. Professor Várady’s observation that the court’s arguments were probably not very convincing is accurate.¹¹¹ Moreover his view that a court made a sound decision in favor of a fast dispute resolution is also well

¹⁰⁶ *Austrian party v. Yugoslav party*, Oberster Gerichtshof [OGH] [Supreme Court] Sep.9, 1987, No. 8 (Austria) in 15 Y.B. COM. ARB. 367 (Van den Berg ed., 1990).

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ Tibor Várady, *Arbitration despite the parties?*, 39 NETH. INT’L L. REV. 351, 365 (1992).

founded,¹¹² since the intent of the parties to arbitrate is unequivocally expressed in the first paragraph. In addition, as long as the last paragraph deals with the second instance of the dispute resolution, it could be easily severed without affecting the arbitration proceedings. The court should have grounded its decision focusing more on the above mentioned points.

The severability of a non existing institution was also held in *Technological Application and Production Company (Tecapro), Hcmc-Vietnam v. Control Screening LLC*.¹¹³ The arbitration clause stated the following: “In the event all disputes are not resolved, the disputes shall be settled at International Arbitration Center of European countries for claim in the suing party's country under the rule of the Center. Decision of arbitration shall be final and binding [sic] both parties.”¹¹⁴ The court reasoned that the non-existing forum was agreed by mistake and it could be severed because the parties’ intent to arbitrate was sufficiently expressed as other provisions showing pro-arbitration consent were present.¹¹⁵

Furthermore the court affirmed the District Court decision to refer the parties to arbitration within its district based on 9 U.S.C. § 4 stating that the arbitration hearings and proceedings “shall be within the district in which the petition for an order directing such arbitration is filed”.¹¹⁶ This is a provision which is part of Chapter 1 of FAA regulating the domestic arbitration but given that 9 U.S.C. § 208 provides that “[t]o the extent that it does not conflict with Chapter 2, Chapter 1 of the FAA applies to international arbitration agreements”, the court concluded that 9 U.S.C. § 4 also applies to international arbitration provided that the arbitration agreement does not incorporate a forum selection clause.¹¹⁷

¹¹² *Id.*

¹¹³ *Technological Application and Production Company (Tecapro), Hcmc-Vietnam v. Control Screening LLC*, 687 F.3d 163, (3rd Cir. 2012).

¹¹⁴ *Id.* at 166.

¹¹⁵ For instance stipulations such as “[d]ecision of arbitration shall be final and binding [sic] both parties” and the “losing party shall bear “[a]ll expenses in connection with the arbitration”” enhanced the argument favoring the presence of parties willingness for arbitration. See *Id.* at 170.

¹¹⁶ *Id.* at 170.

¹¹⁷ *Id.* at 171.

In this case ultimately the arbitration agreement was considered as having no forum-selection-clause since the non-existent institution was held void. As a result, the court compelled arbitration to its own district. However the question remains as to whether the parties when agreeing on a forum had the *lex arbitri*¹¹⁸ in mind which was more favorable than the state law which was supposed to apply after the court decision. Put differently, it is an issue which the court should have been concerned about.

In addition, when choosing the seat, the parties might have also taken into account the expenses to afford arbitration proceedings, such as costs of travelling for instance. Therefore the forum-selection-clause is one of the most important components of the arbitration agreement that the parties should agree about. It takes time to negotiate it and, moreover, the formation of arbitration agreement sometimes fails due to lack of consensus on the forum.¹¹⁹ In conclusion, based on the above arguments and the factual circumstances of each and any case, severance might be sometimes inappropriate, and all the arbitration agreement should be held void.

The clear intention to arbitrate has been the key argument also in *Rosgoscirc ex rel. SOY/CPI Partnership v. Circus Show Corp*¹²⁰ and *Astra Footwear Industry v. Harwyn Intern., Inc.*¹²¹ The latter case is important because it indicates an example where the court went beyond its authority. The arbitration agreement stipulated the following:

12. Disputes : For all claims of disputes arising out of this agreement which could not be amicably settled between the parties, is competent the arbitrage for export trade at the Federal Chamber of Commerce in Beograd. (sic) In the case that the buyer is accused, the Chamber of Commerce in New York is competent.¹²²

¹¹⁸ *Lex arbitri* is the law dealing with procedural issues of arbitral proceedings. It would be the law of the seat of the arbitration unless agreed otherwise by the parties. Várady, Barcelo, Mehren, *supra* note 32, at 683.

¹¹⁹ GARY B. BORN, INTERNATIONAL ARBITRATION: CASES AND MATERIALS 643 (Kluwer Law Arbitration, 2001).

¹²⁰ See *Rosgoscirc ex rel. SOY/CPI Partnership v. Circus Show Corp.*, Nos. 92-CV-8498, 93-CV-1304 (JSM), 1993 WL 277333, at *4-5, (S.D.N.Y. Jul. 16, 1993) (severing a misnamed and non-existent forum-selection clause stipulating for “International Arbitration in Hague”, based on the clear intent of the parties to arbitrate).

¹²¹ *Astra Footwear Industry v. Harwyn Intern., Inc.*, 442 F.Supp. 907, (S.D.N.Y. 1978) in Várady, Barcelo, Mehren, *supra* note 32, at 237.

¹²² *Id.*

The plaintiff (seller) moved to compel arbitration arguing that if the buyer was sued, the parties would be referred to the International Chamber of Commerce¹²³ with the seat in New York, but the District Court construed the last provision as parties intended arbitration to take place in New York Chamber of Commerce.¹²⁴ Furthermore, the New York Chamber of Commerce had ceased to arbitrate before the parties concluded the agreement, and since the arbitration was impossible according to the scheme designated by the parties, the court severed the corresponding clause from the arbitration agreement.¹²⁵ The pro-arbitration policy and the undisputable intent of the parties to arbitrate were the arguments which upheld the application of severability and relying on 9 U.S.C. 5 (1970) the court decided ad hoc arbitration.¹²⁶ The reliance on this provision was unfounded, because the provision was extended to include the court's appointment of the arbitral institution by the court when the latter could not perform its tasks¹²⁷, whereas nowhere this element appeared in 9 U.S.C. 5.¹²⁸

Apparently the conspicuous existence of parties' intent towards arbitration is the bar set by the courts in ruling in favor of the severance of the invalid clause. Whereas in those cases where it was non-ascertainable whether the parties wanted arbitration or not, the court

¹²³ *Hereinafter* ICC.

¹²⁴ *See* Várady, Barcelo, Mehren, *supra* note 32, at 237, 239.

¹²⁵ *Id.* at 239. *See also* Delma Engineering Corp. v. K & L Construction Co., 6 A.D.2d 710, rev'd , 174 N.Y.S.2d 620, 710 (N.Y.A.D. 1958) . In this case the court severed from the arbitration agreement an institution that no longer arbitrated, reasoning that the parties' intent to arbitrate was dominant. It further stated that the court had the discretion to appoint three arbitrators that used to be part of arbitrators' list of the institution that no longer arbitrated. These arbitrators would have the authority to resolve the dispute.

¹²⁶ *See* Várady, Barcelo, Mehren, *supra* note 32, at 239-240.

¹²⁷ Várady, *supra* note 111, at 364.

¹²⁸ Várady, Barcelo, Mehren, *supra* note 32, at 239. 9 U.S.C. 5 (1970) provides as follows:

If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement the arbitration shall be by a single arbitrator.

has decided against severance. For instance, in *X Holding AG et al. v. Y Investments NV*,¹²⁹ the clause stated that the parties could submit their dispute either to American Arbitration Association¹³⁰ under the rules of ICC or in any other US court.¹³¹ The Federal Supreme Court held the whole arbitration agreement invalid because based on the wording the intention to arbitrate could not be determined.¹³²

In my opinion in cases when it is debatable whether the parties opted for arbitration or for litigation, even the policy favoring arbitration would not be of help. For example, if the judge refers parties to arbitration and thus severing the litigation clause, he undermines the fact that parties might have had equal inclination toward both arbitration and litigation.¹³³ On the other hand, invalidating the entire arbitration clause is neither a sound choice because it will be contrary to equal treatment of dispute resolution mechanisms.¹³⁴ Therefore the judge should give equal weight to both clauses and opt for the most appropriate forum which does not necessarily have to be arbitration.¹³⁵ This is an issue that has to be ascertained in a case-by-case analysis and must be based as much as possible on the wording of parties' agreement.¹³⁶ Consequently it is recommended that the parties should pay attention to the wording of text while drafting, meaning that if they want arbitration they should make it clear, to avoid any future controversies related to the means of dispute resolution.¹³⁷

It is also important to add that, had the clause stipulated the settlement of the disputes through AAA under the ICC Rules, then there would have been no dispute regarding the

¹²⁹ *X Holding AG et al. v. Y Investments NV*, Bundesgerichtshof [BGer] [Federal Supreme Court] Oct. 25, 2010, No. 43 (Switz.) in 36 Y. B. COM. ARB., *supra* note 54, at 343.

¹³⁰ Hereinafter AAA.

¹³¹ See 36 Y. B. COM. ARB., *supra* note 54, at 343.

¹³² *Id.* at 343-344.

¹³³ Richard Garnett, *Coexisting and Conflicting Jurisdiction and Arbitration Clauses*, 9 J. PRIV. INT. L. 361, 372 (2013).

¹³⁴ *Id.* at 370.

¹³⁵ *Id.* at 373.

¹³⁶ *Id.* at 362.

¹³⁷ Daniel Girsberger and Pascal J. Ruch, *Pathological Arbitration Clauses: Another Lawyers' Nightmare comes true*, in INTERNATIONAL ARBITRATION AND INTERNATIONAL COMMERCIAL LAW: SYNERGY, CONVERGENCE AND EVOLUTION 123 (Stefan Michael Kröll, Loukas A. Mistelis, et al. eds., 2011).

intent to arbitrate. Therefore it is conceivable that if the parties would have been referred to AAA, the latter would have severed the ICC-Rules-clause, resulting thus in applying its own rules.¹³⁸ Nevertheless, it is still debatable if the severability would have been appropriate even in this case. The reference to one institution under another institution's rules makes it difficult to discern which is the intended arbitral institution designated by the parties for the settlement of the disputes.¹³⁹

An issue with important relevance in this chapter is related to dilemmas that a court might come across regarding the fate of an arbitration agreement in case a change of circumstances occurs. It further boils down to the question whether a choice-of-*situs* clause can be severed from the arbitration agreement when there is a risk that the proceedings will not result in an effective legal protection. So in other words can the *forum non conveniens*¹⁴⁰ doctrine apply in arbitration proceedings leading to the application of the separability within the arbitration agreement?

A relevant case on this issue is *National Iranian Oil Company v. Ashland Oil, Inc.*¹⁴¹ Due to the hostage taking of some members of US Embassy during the Islamic Revolution in Iran, the diplomatic ties between these two countries were totally broken and their

¹³⁸ See, e.g., *Wünsche Handelsgesellschaft v. Coop. S. Maria srl*, Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 2, 1982, No. E7 (Ger.) in *Várady, Barcelo, Mehren*, *supra* note 32, at 95. The arbitration clause concluded by the parties stated "Hamburg Friendly Arbitration according to the rules of the Commodity Trade Association of the Hamburg Exchange." The arbitral tribunal did not decline jurisdiction, but it decided the case by applying its own rules. Thus it disregarded the stipulation made by the parties referring to the rules of Commodity Trade Association of the Hamburg Exchange. Nevertheless when the case reached the Supreme Court of Germany due to a motion for setting aside the award, it annulled the award arguing that it was unclear in which arbitral institution the parties intended to settle their disputes.

¹³⁹ See *Id.*

¹⁴⁰ Regarding the application of this doctrine in arbitration see Andrew Rogers, *Forum Non Conveniens in Arbitration*, 4 (3) ARB. INT'L 240, (1988). It is important to stress that party's contention that a *situs* is inconvenient because he/she would bare unreasonable costs on arbitration proceedings has been unsuccessful. The outcome is based on the fact that parties know before entering in the arbitration agreement that they would give up their courtroom rights, therefore the pre-conclusion phase of the contract is the time to think about either opting for arbitration or for a traditional court. Thus, it would be hard to hold severable a choice-of-*situs* clause in an arm's length contract, based only on the argument that arbitration in the chosen forum would impose high/unreasonable costs on one of the parties. See e.g. *Reisfeld & Son Import v. S.A. Eleco*, 530 F. 2d. 679 (5th Cir. 1976) & *USM Corporation v. GKN Fastener Ltd.*, 574 2d 17 (1978).

¹⁴¹ *National Iranian Oil Company v. Ashland Oil, Inc.*, 817 F.2d 326 (5th Cir. 1987) in Rogers, *supra* note 140, at 244.

relationship was characterized by hostility.¹⁴² A valid arbitration agreement was entered between the parties, incorporating a Teheran forum selection clause. When the dispute arose due to the failure of payment by the US party, the latter refused to appoint its arbitrator because of the mistrust of arbitration proceedings taking place in Tehran.¹⁴³

The Iranian party filed suit in US court for an order to refer the parties in arbitration in Mississippi, arguing that the forum selection clause should be severed as being impracticable and impossible because of the war in Tehran.¹⁴⁴ The court held that the argument on impossibility and impracticability is groundless at this point because it was unconceivable that the Iranian party, being part of the revolutionary country, could not have foreseen the coming of that political atmosphere that would have been an obstacle for the US party to arbitrate.¹⁴⁵

However, the court added that even if Tehran had been found non convenient on grounds of impossibility, the choice-of-forum clause could not be severed so long that the surrounding circumstances and the language of the entire arbitration agreement inferred that the *situs* was not merely an “ancillary” component of the arbitration agreement.¹⁴⁶ As the court reasoned, the clause was found fundamental because “the contract's provision that arbitration was to be in Tehran “unless otherwise agreed” suggests that, were Iran to become inconvenient or unacceptable to one or both parties, no other forum was to be available unless mutually agreed upon.”¹⁴⁷ Moreover the arbitration clause provided the contract to be

¹⁴² See Rogers, *supra* note 140, at 244.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* at 245. The doctrine of the impossibility applies when the parties do not take into account the possibility of happening of the supervening event when they conclude the contract and when such event is not a consequence of party's actions.

¹⁴⁶ *National Iranian Oil Company*, 817 F.2d at 334.

¹⁴⁷ *Id.*

governed by Iranian Law and moreover that the President of the Appeal Court of Tehran was the appointing authority in case of failure to appoint the second or the third arbitrator.¹⁴⁸

To conclude, the court paid attention to the language of the contract which demonstrated that *situs* was a very essential part of the arbitration agreement because it could be disregarded only with the parties' agreement. Moreover, two other clauses, those relating to the applicable law and the appointing authority, strongly demonstrated the fundamental nature of the *situs*. This case is an example where the wording of the arbitration agreement plays an important role in discerning the parties' intent in respect with the essential nature of choice-of-*situs* clause, which on the other hand constitutes a determinative factor in deciding whether severability applies.

¹⁴⁸ *Id.*

Chapter 2 - Separability within the arbitration clause as a doctrine applied in appeal mechanism designed by the parties' agreement

Given the contractual nature of arbitration agreement, the parties occasionally endeavored not only to designate the rules and procedures that regulate the arbitration itself but they went further by defining also the rules related to the judicial review mechanism. For instance, they have done so by either stipulating an extended judicial review clause which authorizes the courts to scrutinize the arbitral awards on grounds that go beyond the review standards provided by law, or by incorporating clauses that limit or totally remove the judicial review. An example of the former clauses are stipulations that provide a review on errors of law or arbitrator's factual findings, whereas an example of contractual limitation of judicial review clauses are provisions seeking to establish the conclusiveness and finality of the arbitral awards.

The courts are split with regard to the enforceability of contractual expansion or limitation of judicial review clauses. Some of them advocate the principle of enforceability of the arbitration agreements according to their terms, which considers these clauses valid. Conversely, other courts that have endorsed the opposite approach, declare judicial review related clauses as invalid based mainly on the argument that judicial review grounds are regulated by law provisions and the latter cannot be subject to parties' agreement. This chapter will focus on the second approach and will spot specifically the application of separability and its supporting arguments on those clauses which set out the parties' own regime on judicial review of arbitral awards.

2.1 Separability application in heightened judicial review clauses

Due to harmonization of international commercial arbitration, the arbitral awards are today subject of state control which can be exercised either by an action of setting aside or objection to recognition and enforcement.¹⁴⁹ While the grounds for refusal of enforcement and recognition are harmonized by New York Convention,¹⁵⁰ there is no international agreement regarding setting aside action. However recently, national legislations have adopted similar grounds as on refusing the enforcement and recognition in NYC.¹⁵¹ So put differently, the national arbitration acts do specify the grounds on which an action to set aside can be filed.¹⁵² The question is whether the parties can provide in their arbitration agreement grounds other than those stated by law, such as review on arbitrators' factual findings or application of law.¹⁵³

Shaping the judicial review as parties wish and thus going beyond what law stipulates results in an expanded judicial review. Before providing an outlook of separability analysis in heightened judicial review clauses, I will briefly discuss two opposing approaches embraced by scholars and judges regarding the allowance or not of the extended judicial review.

These two opposing approaches have been in the center of many discussions and subject to courts' interpretation since in most of the state arbitration acts there is no legal framework regulating this matter.¹⁵⁴ But there are also statutes which explicitly allow the

¹⁴⁹ Várady, Barcelo, Mehren, *supra* note 32, at 815.

¹⁵⁰ See Article V of NYC (enumerating the grounds on which a court may refuse the enforcement and recognition of arbitral awards).

¹⁵¹ Várady, Barcelo, Mehren, *supra* note 32, at 815.

¹⁵² It is worth it to mention that in most of the jurisdictions the setting aside proceedings are not equal to appeal because there is no reexamination of evidence and merits on which the arbitral award was based. See UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, UNCITRAL 2012 DIGEST OF CASE LAW ON THE MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 134 (2012).

¹⁵³ Várady, Barcelo, Mehren, *supra* note 32, at 877.

¹⁵⁴ See Tibor Várady, *On the Option of a Contractual Extension of Judicial Review of Arbitral Awards—What Is Actually Pro-Arbitration?*, 56 Zbornik Pravnog fakulteta u Zagrebu 455, 461-62 (2006).

Even in the same case, courts' decisions of different instances have reached opposing outcomes. For instance, in *LaPine Technology Corp. v. Kyocera Corp.* the District Court arguing against extension of judicial review held that statutorily grounds for appeal are matters of public policy and cannot be changed by parties' agreement.

expansion of judicial review if the parties agree so, such as the arbitration acts of California and New Jersey.¹⁵⁵ However it is of particular interest to discuss different expanded judicial review related arguments in those cases where the law is silent, to illustrate how the courts reason on this matter. What is interesting is that both approaches stem out from the strong pro-arbitration policy. Thus, those who endorse the extension give prevalence to the fundamental principle that arbitration agreements should be enforced according to their terms (parties' autonomy in shaping the arbitration agreement as they wish),¹⁵⁶ whereas those who argue against it, assert that most important features of arbitration are speed and finality.¹⁵⁷

The position of the thesis is closer to disallowing the expanded judicial review for the following reasons. It is clear that parties' autonomy in shaping the arbitration agreement is one of the cornerstones of international arbitration.¹⁵⁸ They can agree on everything within the arbitration process such as the number of and the appointment mechanism of arbitrators, seat of arbitration, applicable law, *lex arbitri*, etc.¹⁵⁹ However, grounds for judicial review are part of statutory provisions of arbitration acts and do not fall within arbitration process itself. They fall within the scope of public policy which should not be touched by parties' agreement.¹⁶⁰

Whereas the Court of Appeals favored extension of judicial review, asserting that arbitration agreements should be enforced according to their terms. The final decision on this case was to sever the expanded judicial review clause, but however this issue will be discussed more deeply below. *See* LaPine Technology Corp. v. Kyocera Corp., 909 F.Supp. 697, 706 (N.D.Cal., 1995), *rev'd*, 130 F. 3d 884, 888 (9th Cir. 1997), *rev'd en banc*, 341 F.3d 987, 1000 (9th Cir. 2003).

¹⁵⁵ John J. Barceló III, *Expanded Judicial Review of Awards After Hall Street and in Comparative Perspective 7* (Cornell Law Faculty Working Papers, Paper No. 67, 2009), *available at* http://scholarship.law.cornell.edu/clsops_papers/67 (last visited Mar. 1, 2014).

¹⁵⁶ *See, e.g.*, Not indicated v. Not indicated, Bundesgerichtshof [BGH] [Federal Court of Justice] Mar. 1, 2007, No. III ZB 7/06 (Ger) (holding valid the expanded judicial review clause by arguing that parties can shape the arbitration agreement as they wish), *available at* <http://www.kluwerarbitration.com/CommonUI/document.aspx?id=ipn80858> (last visited Mar. 1, 2014).

¹⁵⁷ *See* Várady, *supra* note 154, at 462-63 & n. 20.

¹⁵⁸ Várady, Barceló, Mehren, *supra* note 32, at 533.

¹⁵⁹ *Kyocera*, 130 F. 3d at 891. *See also* United Nations Commission on International Trade Law, *supra* note 152, at 58-59.

¹⁶⁰ *See Kyocera*, 909 F.Supp., at 706. *See also* Bowen v. Amoco Pipeline Co., 254 F.3d 925, 934-36 (10th Cir. 2001).

Moreover, one of the principles of arbitration is the finality of the awards, meaning that arbitral awards are excluded from the appeal on merits in almost all countries.¹⁶¹ The parties particularly opt for arbitration instead of litigation particularly because their disputes get a faster resolution than in traditional courts. In support to this principle even UNICITRAL Model Law,¹⁶² serving as a guide for national arbitration acts, has adopted limited grounds for setting aside which are similar to article V of NYC.¹⁶³ Therefore extension of the judicial review of arbitral awards hinders the benefits of arbitration such as speed in settling the disputes.¹⁶⁴

After discussing two approaches on expanded judicial review, it is important to stress out that in US, the debate on it has come to an end after the 2008 US Supreme Court decision in *Hall Street Associates, L.L.C. v. Mattel, Inc.*¹⁶⁵ The court held that the grounds of judicial review in Federal Arbitration Act are exclusive and cannot be extended by parties' contract.¹⁶⁶ However this decision left open the issue of severability of heightened judicial review clause. Is the arbitration clause still binding on the parties by holding unenforceable the extended judicial review, or the latter renders it invalid *in toto*?

The practice till now (excluding case law in favor of heightened judicial review) has shown that courts have endorsed either the severance or invalidation of the whole arbitration agreement. Those which have embraced the first approach argued in favor of the policy

¹⁶¹ This principle however is not universally applicable because there are national arbitration laws such as English Arbitration Act 1996, which provide an appeal on merits. See Rowan Platt, *The Appeal Mechanisms in International Arbitration: Fairness over Finality?*, 30 (5) J. INT'L ARB. 531, 531 (2013).

¹⁶² UNICITRAL Model Law on International Commercial Arbitration, lastly amended in 2006 is designed as a guide for all states willing to adopt and amend their national arbitration laws in accordance with the needs of international commercial arbitration. See United Nations Commission on International Trade Law, *supra* note 152, at vii.

¹⁶³ See *Id.* at 134-135. See also Várady, Barcelo, Mehren, *supra* note 32, at 815.

¹⁶⁴ Cynthia A. Murray, *Contractual Expansion of the Scope of Judicial Review of Arbitration Awards Under the Federal Arbitration Act*, 76 (3) ST. JOHN'S L. REV. 633, 634 (2002).

¹⁶⁵ *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 128 S. Ct. 1396, (U.S., 2008).

¹⁶⁶ *Id.* at 1404. It is important to stress that this ruling applies for the arbitration agreements that are controlled by FAA.

favoring the enforcement of the arbitration clauses¹⁶⁷ and have often stated that the remainder of arbitration agreement could stand without the offending provision.¹⁶⁸ Another fact that has enhanced the courts' decision has been the incorporation of a severance clause within parties' contract.¹⁶⁹ Based on this provisions it is easier to delete expanded judicial review clauses by asserting that the intent of the parties is pro striking down the judicial review clause when the latter has been found invalid.

In cases in which the whole arbitration agreement was declared invalid the argument was based on the premise that heightened judicial review was so fundamental that its severance would have resulted in a very significant change of arbitration agreed by the parties.¹⁷⁰ The attempt to find the main purpose of parties' agreement decided the question of indispensability of judicial review clause in *Carr & Brookside Farm Trust Ltd. v. Gallaway Cook Allan*.¹⁷¹ In essence the court tries to figure out whether the parties would have entered the agreement absent to judicial review clause.¹⁷² If the answer is affirmative it implies that expanded judicial review is not crucial and does not vitiate the agreement's main purpose. In such a case the severance is justifiable.

In *Gallaway* the court concluded that the "right of appeal on law and facts" was important because the parties used italics writing in the text, in order to emphasize the

¹⁶⁷ See, e.g., *SI V, LLC v. FMC Corp.*, 223 F.Supp.2d 1059, 1063, (N.D.Cal. 2002); *Oakland-Alameda County Coliseum Authority v. CC Partners*, 101 Cal.App.4th 635 at 647, 124 Cal.Rptr.2d 363 at 372, (Cal. Ct. App. 1st Dist., 2002).

¹⁶⁸ See, e.g., *LaPine Technology Corp. v. Kyocera Corp.*, 341 F.3d 987, 1001(9th Cir. 2003) (*en banc*).

¹⁶⁹ See, e.g., *CC Partners*, 101 Cal.App.4th at 646; *SI V, LLC*, 223 F.Supp.2d at 1063; *Cable Connection, Inc. v. DIRECTV, Inc.*, 49 Cal.Rptr.3d 187, 206 (Cal. Ct. App. 2nd Dist., 2006); *Ignazio v. Clear Channel Broadcasting, Inc.*, 865 N.E.2d 18, 21 (Ohio, 2007).

¹⁷⁰ See *Société de Diseno v. Société Mendes*, Paris Court d'Appel [CA] [Paris Court of Appeal] Oct. 27, 1994, (Fr.) in *Várady*, *supra* note 154, at 467; *Crowell v. Downey Community Hospital Foundation*, 115 Cal. Rptr. 2d 810, 817 (Cal. Ct. App. 2002).

¹⁷¹ *Carr & Brookside Farm Trust Ltd. v. Gallaway Cook Allan*, [2012] NZHC 1537 (HC), available at [\(http://www.kluwerarbitration.com/CommonUI/document.aspx?id=KLI-KA-1232570&query=AND\(content%3A%22severability%22,content%3A%22of%22,content%3A%22arbitration%22,content%3A%22clause%22\)\)](http://www.kluwerarbitration.com/CommonUI/document.aspx?id=KLI-KA-1232570&query=AND(content%3A%22severability%22,content%3A%22of%22,content%3A%22arbitration%22,content%3A%22clause%22)) (last visited Mar. 1, 2014)

While the Arbitration Act of 1996 permits appeals only on questions of law, the arbitration agreement between the parties provided appeal for both questions on facts and law. See *Id.* at 1.

¹⁷² *Id.* at 16.

importance of the terms highlighted.¹⁷³ Moreover, in the pre-contractual phase an exchange of correspondence evidenced that the possibility of inclusion of appeal on facts was largely negotiated.¹⁷⁴ The court reached its outcome based on the evidence provided by the parties and it concluded that the arbitration agreement was coherent even without the judicial review provision, but the latter could not be severed because it “formed a fundamental part of the exchange of promises between the parties.”¹⁷⁵

As it can be seen from the analysis of the cases above, the courts have applied different tests so as to decide on the appropriateness of the severability. For instance the judges examined whether the arbitration could stand without the offending provision, or whether there was a severance clause stipulated in the contract, and whether the parties would have entered in the agreement absent to that clause. In addition they also invoked the policy favoring arbitration to justify the severance. Given that a variety of reasons have been applied in support to courts’ arguments, I would say that it gives rise to unpredictability since there is no clear cut test on the application of separability.

One of the tests applied was whether the arbitration agreement would stand absent that provision. So in this case the courts examine the degree that invalid provision is interwoven with other parts of arbitration agreement.¹⁷⁶ Hence the review clause can be severed provided it is not interconnected with other provisions of the agreement.¹⁷⁷ The latter argument is not very persuasive, or at least it should be combined with the test whether the parties would have entered in the agreement absent to that provision.

For instance, let us assume the heightened judicial review clause is a *conditio sine qua non* for parties in order to proceed with arbitration. The fact that invalid provision does not

¹⁷³ *Id.*

¹⁷⁴ *Id.* at 17.

¹⁷⁵ *Id.*

¹⁷⁶ Zell, *supra* note 1, at 969.

¹⁷⁷ See LaPine Technology Corp. v. Kyocera Corp., 341 F.3d 987, 1001-1002 (9th Cir. 2003) (*en banc*).

permeate other provisions, in other words the arbitration agreement can still stand without it, does not mean that severance is appropriate. Therefore the application of this test might lead to superficial conclusions, undermining thus parties' intent to enter in arbitration agreement only if the award would be extensively scrutinized by courts.

The most appropriate applicable method should consist of determining whether the parties would have concluded the agreement absent to that clause, meaning that the focus of the attention should be directed towards parties' intent.¹⁷⁸ This test was not applied in *Kyocera*¹⁷⁹ for example. The court merely held that the judicial review clause was not fundamental for the parties' agreement, but it did not provide reasons why it reached this conclusion.¹⁸⁰ Therefore one might think that the outcome of this case has been superficial and the intent of the parties might have been ignored.

Due to these implications I highly suggest that courts should target parties' intent by answering the question whether the parties would have entered in the agreement absent to heightened judicial review clause. That said, the courts should collect evidence in order to reach a conclusion. As it happened in *Gallaway*, the parties can provide evidence to the court such as their pre-contractual correspondence that shows the negotiation on expanded judicial review.¹⁸¹ However two problems might arise from this situation. Firstly the evidence is subject to judges' discretion on interpretation¹⁸² and secondly it might be difficult to collect the necessary evidence especially ones that relate to negotiation phase.¹⁸³

¹⁷⁸ Zell, *supra* note 1, at 979.

¹⁷⁹ LaPine Technology Corp. v. Kyocera Corp., 341 F.3d 987, (9th Cir. 2003) (*en banc*).

¹⁸⁰ Margaret L. Moses, *Can Parties Tell Court What to Do? Expanded Judicial Review of Arbitral Awards*, 52 U. KAN. L. REV. 429, 448 (2004).

¹⁸¹ See *supra* note 174 and accompanying text.

¹⁸² Tibor Várady, *The Elusive Pro-Arbitration Priority in Contemporary Court Scrutiny of Arbitral Awards*, in 2 COLLECTED COURSES OF THE XIAMEN ACADEMY OF INTERNATIONAL LAW 393 (Xiamen Academy of International Law ed. 2009).

¹⁸³ See Zell, *supra* note 1, at 980.

As Jeremy L. Zell suggests one solution of this problem might be to treat the heightened judicial review clause as a fundamental part of parties' agreement, considering it thus as a rebuttable presumption.¹⁸⁴ In other words, the incorporation of the heightened judicial review clause would invalidate the whole arbitration agreement unless the party who has the burden of proof evidences sufficiently that the provision constitutes only an ancillary component of the arbitration clause. Nevertheless, this suggestion might not satisfy every judge and arbitrator, leading thus to an uncertainty on the fate of arbitration agreement in case it incorporates a heightened judicial review clause. Therefore, I strongly advise the parties who are aware of the impact that a judicial review clause might have on the arbitration agreement to stipulate either a severability or non-severability clause, which will be the result of their common consent.¹⁸⁵

To conclude severability is a very important tool which serves the survival of the arbitration clause, provided that the extension of the judicial review is an auxiliary and not a fundamental component of the arbitration agreement. Accordingly, its application preserves the parties' fundamental consent to arbitrate their disputes. Moreover it is especially very useful in those cases where the arbitral award has already been rendered, because as professor Várady states, invalidating the whole arbitration agreement in a post-award procedure would not only be financially but also psychologically burdensome since the parties have already paid large proceedings related sums and dedicated a lot of time, effort and energy to this dispute resolution.¹⁸⁶ For instance the fact that the case in *Kyocera*¹⁸⁷ lasted for years, was one of the factors that motivated the court to opt for severance.¹⁸⁸

¹⁸⁴ *Id.* at 979.

¹⁸⁵ Barceló, *supra* note 155, at 3.

¹⁸⁶ See Várady, *supra* note 182, at 377.

¹⁸⁷ *LaPine Technology Corp. v. Kyocera Corp.*, 341 F.3d 987, (9th Cir. 2003) (*en banc*).

¹⁸⁸ See Barceló, *supra* note 155, at 3.

The last issue I would like to mention about the application of severability is related to another potential problem that might arise in the enforcement phase of an arbitral award.¹⁸⁹ Let us assume that the winning party seeks recognition and enforcement in a country different from that in which the award was rendered. As professor Várady has accurately noted, the losing party based on NYC can invoke two defenses which are set out under article V.¹⁹⁰ Hence, under art. V (1) (a) the court may refuse the recognition of an award if the “arbitration agreement was not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made.”¹⁹¹ Hence according to this provision, if the court/arbitral tribunal strikes the judicial review clause, the question that arises is whether holding invalid a portion of arbitration agreement also implies the invalidity of all arbitration agreement within the meaning of art. V (1) (a).¹⁹²

Additionally, under art. V (1) (d), the court may refuse recognition if “the arbitral procedure is not in accordance with the agreement of the parties.”¹⁹³ Therefore based on this ground, the enforcement of the arbitral award might be refused because while severing the expanded judicial review clause, the arbitral procedure agreed by the parties was not respected.¹⁹⁴ The result of all this discussion is that even if *prima facie* it may seem that severability salvages the arbitration agreement, the situation might be reversed in the enforcement phase in which the court can refuse the recognition and enforcement.

¹⁸⁹ It must be clear that this analysis does not refer to domestic arbitration, but rather the international one, in which the NYC for Recognition and Enforcement of Arbitral Awards comes into play.

¹⁹⁰ See Várady, *supra* note 182, at 389.

¹⁹¹ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. V (1) (a) (1958).

¹⁹² Várady, *supra* note 182, at 389.

¹⁹³ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. V (1) (d) (1958).

¹⁹⁴ Várady, *supra* note 182, at 389.

2.2 Application of separability in narrow or total waiver judicial review clauses

As in the expanded appeal mechanism, there is no reconciliation concerning the allowance or not of the limitation of judicial review of arbitral awards by parties' agreement. There is no unanimity among judges regarding the enforceability of limitation provisions, therefore there are arguments favoring both sides. Given that the focus of this thesis is separability, those cases that opt for the allowance of limitation will be briefly discussed below in order to give an overview of the reasons that support this approach. This section will aim attention at decisions that have applied the separability on limitation of judicial review clauses and the reasons sustaining this approach. Furthermore, it is important to note that cases where the courts have held that the non-appealability provisions should be understood as the parties intended to eliminate only the review on merits and not to forbid the right to seek review based on grounds provided by law,¹⁹⁵ are excluded from the discussion. Again, the aim of this thesis is to provide an analysis on the application of severability on contractual limitation of judicial review, thus the case law where these clauses have been interpreted by the courts will remain outside the scope of attention and consideration.

Limitation of judicial can have different forms. For instance in *MACTEC, Inc. v. Gorelick*,¹⁹⁶ the parties jointly agreed to relinquish any review that goes beyond the control exercised by the court of first instance.¹⁹⁷ In this case the court ruled in favor of limitation by arguing that the omission of the appellate review was in line with one of the principles of

¹⁹⁵ See, e.g., *Tabas v. Tabas*, 47 F.3d 1280, 1288 (3d Cir. 1995); *Rollins, Inc. v. Black*, 167 F. App'x 798, 799 n.1 (11th Cir. 2006); *Dean v. Sullivan*, 118 F.3d 1170, 1171 (7th Cir. 1997); *Southco, Inc. v. Reell Precision Mfg. Corp.*, 331 F. App'x 925, 927–28 (3d Cir. 2009); *Silicon Power v. General Elec. Zenith Controls*, 661 F. Supp. 2d 524 (E.D. Pa. 2009).

¹⁹⁶ *MACTEC, Inc. v. Gorelick*, 427 F.3d 821, (10th Cir. 2005).

¹⁹⁷ The arbitration clause provided that the "[j]udgment upon the award rendered by the arbitrator shall be final and non appealable and may be entered in any court having jurisdiction thereof." *Id.* at 827.

arbitration which is rapid and low costs proceedings.¹⁹⁸ Moreover, it was argued that generally the case law has held admissible the clear and unambiguous parties' agreements that provide for the exclusion of appellate review without differentiating between cases involving arbitration and those involving litigation.¹⁹⁹ Put differently, the court used the case law holding acceptable the limitation of judicial review in litigation, even though the case at stake was in relation with arbitration.²⁰⁰

Alike the ruling in *MACTEC*,²⁰¹ even when the parties opted for total waiver of judicial review some courts have rendered the clauses enforceable. Therefore in *Roadway Package System, Inc. v. Kayser*,²⁰² it was concluded "that [the] parties may opt out of the FAA's off-the-rack vacatur standards and fashion their own"²⁰³ because the "statute's ultimate purpose is to enforce the terms of private arbitration agreements."²⁰⁴

To sum up, those who endorse the validity of limitation of judicial review advocate the principle of freedom of contract, meaning that the arbitration agreements should be enforced according to their terms.²⁰⁵ Additional arguments, such as waiver leads to rapid and low cost procedures, have enhanced their position. On the other hand courts that have declared void the limitation of judicial review clauses have applied the doctrine of severability. How and based on what arguments these provisions have been severed from the arbitration agreement shall be analyzed below.

¹⁹⁸ Thomas S. Meriwether, *Comment: Limiting Judicial Review of Arbitral Awards Under the Federal Arbitration Act: striking The Right Balance*, 44 HOUS. L. REV. 739, 763 (2007).

¹⁹⁹ *Id.* at 764.

²⁰⁰ Exactly the same outcome has been reached in *Van Duren v. Rzasa-Ormes*, 926 A.2d 372, 374 (N.J. Super. Ct. App. Div. 2007), *noted in* Michael S. Oberman, *'The Other Shoe': Are Agreements Narrowing Judicial Review Enforceable?*, 31 ALTERNATIVES TO THE HIGH COST OF LITIGATION, May. 5, 2013, at 73.

²⁰¹ *MACTEC*, 427 F.3d 821.

²⁰² *Roadway Package System, Inc. v. Kayser*, 257 F.3d 287, (3d Cir. 2001).

²⁰³ *Id.* at 293.

²⁰⁴ *Id.* at 292.

²⁰⁵ With regard to the freedom of contract principle and its effects on restriction of judicial review see generally Kenneth M. Curtin, *An Examination of Contractual Expansion and Limitation of Judicial Review of Arbitral Awards*, 15 OHIO ST. J. ON DISP. RESOL. 337, (2000) (advocating the allowance of contractual limitation of judicial review as one of the best methods that result in a rapid dispute resolution).

In *Hoelt v. MVL Grp. Inc.*,²⁰⁶ the court denied the enforceability of contractual restriction of judicial review. The arbitration clause provided that the award “[was not] subject to any type of review or appeal whatsoever.”²⁰⁷ The court argued that the parties cannot contract out the safeguards that the law provided to ensure that the arbitration is not tainted by corruption, unfairness, partiality, etc.²⁰⁸ Hence, the aim of limited grounds for judicial review is to warrant that due process principle is respected in arbitration proceedings. It was concluded that “judicial standards of review . . . are not the property of private litigants,”²⁰⁹ therefore the parties cannot intervene in the courts’ authority conferred by law to scrutinize the arbitral awards. In this case the court disregarded the provision, in other words severed it, nonetheless no technical argument was provided for the application of the severability.²¹⁰

The same rationale was applied also in *In Re Wal-Mart*,²¹¹ where the court severed the non-appealability clause. It held that the text of FAA compels that the grounds for vacatur cannot be contracted out by parties’ agreement, otherwise the parties would have remained without any protection against an unjust arbitration process.²¹² The court supported its arguments by citing *Hall Street Associates*,²¹³ stating that while the court has held in the latter mentioned case that the grounds for judicial review cannot be extended through parties’ contract, the conclusion that these grounds are neither waivable can be also implied.²¹⁴

²⁰⁶ *Hoelt v. MVL Grp. Inc.*, 343 F. 3d 57, 63 (2d Cir. 2003).

²⁰⁷ *Id.* at 63.

²⁰⁸ *Id.* at 64.

²⁰⁹ *Id.* at 65.

²¹⁰ Other examples where there were provided no reasons for the application of severability on stipulations giving finality and conclusiveness to arbitral awards are *Grissom v. Greener & Sumner Const., Inc.* 676 S.W.2d 709, 711-12 (Tex. App. 1984); *Barsness v. Scott*, 126 S.W. 3d 232, 238 (Tex. App. 2003); *Union Construction Co. (P) Ltd. v. Chief Engineer, Eastern Command, Lucknow & Anr.*, A.I.R. 1960 All 72 (India), available at <http://indiankanoon.org/doc/308877/> (last visited Mar. 1, 2014).

²¹¹ *In Re Wal-Mart*, No. 11-17718, (9th Cir. Oct. 8, 2013), available at <http://cdn.ca9.uscourts.gov/datastore/opinions/2013/12/17/11-17718.pdf> (last visited Mar. 1, 2014).

²¹² *Id.* at 12.

²¹³ *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 585 (U.S. 2008).

²¹⁴ *In Re Wal-Mart*, No. 11-17718, at 11.

Shin Satellite Public Co. Ltd. v. Jain Studios Ltd.,²¹⁵ is an Indian Supreme Court decision which specifically tackled the issue whether the waiver of judicial review clause can be severed or the whole arbitration agreement should be rendered null and void. The arbitration agreement at bench provided that the arbitral award was “final and binding between the parties’ and the parties had waived ‘all rights of appeal or objection in any jurisdiction’”.²¹⁶ In order to reach a conclusion, the court applied the test whether the parties would have entered the agreement absent to the waiver of judicial review. The court held that the intention of the parties to settle the disputes through arbitration was straightforward and unambiguous.²¹⁷ A severance clause was incorporated in the contract, and given the presence of this clause, it was clear that if any portion of the agreement was held invalid, the lawful remainder part would have been enforced.²¹⁸ The court looked at the “independence” of the said provision, arguing that relinquishment of judicial review stands autonomously from the arbitration process itself, therefore it can be easily severed without perplexing the arbitration agreement.²¹⁹

To conclude, the severance or the enforceability of the waiver of judicial review clauses depends on the language of the provision. For instance the phrase such as “non-reviewable” and “non-appealable” has been interpreted as the parties intent is unambiguous and clear to exclude the judicial review.²²⁰ Thus some of the clauses incorporating this language have been enforced. On the other hand the phrase “final and binding” has not been

²¹⁵ *Shin Satellite Public Co. Ltd. v. Jain Studios Ltd.*, (2006) 2 SSC 628 (India).

²¹⁶ *Id.* at 2.

²¹⁷ *Id.* at 6.

²¹⁸ *Id.* at 7. *See also* Strom v. First Am. Prof. Real Estate Servs. Inc., 2009 WL 2244211 (W.D. Okla. July 24, 2009), (severing a limited-judicial-review clause based mainly on the stipulation of a severability clause within parties’ contract), *noted in* Michael S. Oberman, *supra* note 200, at 73.

²¹⁹ The court concluded that a provision can be severed only if severability can be done by blue pencil, meaning that after the portion is deleted, the reminder can be enforced without making any alterations in the arbitration agreement. *See Shin Satellite Public Co. Ltd. v. Jain Studios Ltd.*, 2 SSC 628 at 9-10.

²²⁰ John R. Schleppebach & Howard S. Suskin, *Courts Split on Contractual Waiver of Judicial Review of Arbitration Awards*, 33 (11) WESTLAW J. ASBESTOS, Mar. 18, 2011, at 3, *available at* http://jenner.com/system/assets/publications/92/original/Courts_Split_on_Contractual_Waiver.pdf?1319808306 (last visited Mar. 16, 2014).

held as satisfactory as to show an indubitable intent of the parties to eliminate the judicial review.²²¹ In these cases these clauses has been disregarded and the remainder of the arbitration agreement has been enforced.

This thesis supports the argument that the limited grounds of judicial review on arbitral awards provided by law, should not be carved out by parties' agreement, notwithstanding the language used in the contract. The aim of judicial review is to preserve the integrity of arbitration and protect the parties from an unfair process. In cases when the arbitration agreement provides for a restriction of judicial review, separability is a very effective tool to ensure that due process principle has been respected during the arbitral proceedings. The doctrine is easily applied since the judicial review process is distinct and separate from the arbitration process itself so that after striking the limited judicial review clause down, the remainder of the arbitration clause can be enforced. The intent of the parties is an important factor that courts take into consideration while they decide on severance. Concerning this, it is unconceivable that a party would wish to enforce a limited judicial review clause after the arbitral award has been issued, knowing that his/her rights have not been respected during the arbitral proceedings.

²²¹ *Id.*

Conclusions

As commercial arbitration is being widely practiced, the need to clarify issues as severability *within* the arbitration clause, serves not only to law students but also young lawyers and everybody interested in this field. This thesis provides not only a comparative approach among arguments, cases and results, but it can be also used as a reference for practical purposes. It helps by giving guidance which way to follow and where to search, since it integrates a diversity of cases and courts' severability related arguments. Given that the literature offers little elaborated analysis on the issue, the thesis provides a systematic framework which can be used later on as a basis for severability application.

With respect to severability application I addressed the following questions. Can an arbitration agreement survive the swiping of an invalid provision? What are the arguments supporting an affirmative or a negative answer of the former question? Even if the separability (within arbitration clause) is upheld and somehow promoted in many case law, the subsequent question that arises is how far the judges and arbitrators should go in applying this doctrine.

Firstly it is important to reassert that severability within the arbitration agreement is of great importance since it is a flexible tool to make arbitration function by preventing the destruction of the arbitration clause in its entirety when it is defective. The same way the separability doctrine makes it possible for the arbitration clause to have an autonomous status from the container contract, the separability within the arbitration clause doctrine gives an autonomous status to the remainder and enforceable part of the arbitration agreement. The autonomy of the remainder of the arbitration clause itself refers to the fact that an arbitration agreement can be saved and enforced after the invalid portions have been severed.

So, to support the ideas given above, I will provide a summary of the arguments given in the first and second chapter – arguments that support the application of the doctrine.

Before considering the factors, it is essential to mention that one of the reasons why courts apply severability is due to a strong policy favoring arbitration. With regard to the arguments, first of all, the courts look at the intent of the parties. If the arbitration is the main agreed point between the parties, they opt for the application of the doctrine. For the intent to be determined, evidence and the wording of the arbitration agreement itself are examined.

For instance, the case *X Holding AG et al. v. Y Investments NV*, best demonstrates how the doctrine was not applied, because it was not certain whether the parties had chosen litigation or arbitration. In cases when the dispute resolution clause does not make it clear whether the parties opted for arbitration instead of litigation, the application of severance over the litigation clause does not necessarily apply. For example if the judge refers parties to arbitration and thus severing the litigation clause, he undermines the fact that parties might have had equal inclination toward both arbitration and litigation. On the other hand, invalidating the entire arbitration clause is not a sound choice, either, because it will be contrary to the equal treatment of dispute resolution mechanisms. Thus, it is important to strike a balance between both clauses and refer the parties to the most appropriate forum. The appropriateness itself stands to the fact that it must be based on the wording of the arbitration agreement and the evidence.

There are other factors that have been considered by courts endorsing severance. Severability is appropriate when after it is applied the remainder of the arbitration agreement is still operational and the court does not have to intervene to reword it – the arbitration agreement must be a product of the parties' intent. The stipulation of a severability clause in parties' contract has played an important role on the application of separability. In cases like that, the court reasons that it is precisely the intent of parties to strike down the invalid and unenforceable provisions.

Another one is when the offending provision does not constitute the fundamental portion of the agreement but it is merely an ancillary provision. This factor has been highly considered in application of severability on expanded judicial review clauses. The most appropriate test to be applied in order to determine the fundament of expanded judicial review is to answer the question whether the parties would have entered in the agreement absent to the heightened judicial review clause.

Another test has been applied, of course, such as whether the arbitration agreement could still stand without the offending provision. But this one is not considered to be a main or determinative one; instead, it might be accessory to the first test. The reason is that its application can undermine the intent of the parties that they would have entered in the agreement only if the arbitral award would have been extensively scrutinized by the courts. So, to answer the first test – which I think is the most determinative one – we turn again to the issue of evidence, which can be very difficult to be provided. Therefore, it is strongly advised that parties who are aware of the impact that a heightened judicial review clause might have on the arbitration agreement, to stipulate either a severability or non-severability clause, which will be the result of their common consent.

The separability has also been applied in limitation of judicial review clauses and it is considered to be an effective tool to ensure that due process principle has been respected during the arbitral proceedings. The doctrine is easily applied since the judicial review process is distinct and separate from the arbitration process itself so that after striking the limited judicial review clause down, the remainder of the arbitration clause can be enforced. In addition, when discussing the intent – which is one of the factors courts consider, while deciding on severance - it is unconceivable that one of the parties would wish to comply with the limited judicial review clause, being aware of the fact that his/her rights have been disregarded during the arbitral proceedings.

On the other hand, the doctrine might lead to some implications related specifically to two issues, one which has to do with its application on heightened judicial review clauses and the other has to do with its application on forum selection clauses. In the first one, the problem lies in the fact that in the enforcement phase the court might refuse to enforce an arbitral award, based on Article V (1) (d) of NYC, arguing that the arbitral procedure has not been followed according to the parties' agreement. Even though the severability doctrine has been applied with the main intent to save the arbitration itself, at the end the result might be an unenforceable arbitral award, which renders the process of arbitration itself worthless.

The second issue, related to the application on forum selection clauses might cause a problem when the forum selection clause is substituted with a new one, by court's order. For instance, in US, 9 U.S.C. § 4 authorizes the court to compel the parties to arbitration within its own district, when *an order directing such arbitration is filed*. In *Technological Application and Production Company (Tecapro), Hcmc-Vietnam v. Control Screening LLC.*, given that the forum selection clause was found invalid and was severed – because a non-existing arbitral institution was stipulated- the arbitration agreement was considered to have no forum selection clause, and the court referred the parties to a new forum, the one within its own district. Because of changes in the seat of arbitration, there might be also other changes concerning the expenses of arbitral process. That is why, one of the most important components is the forum selection clause, which takes time to negotiate and sometimes fails due to the lack of consensus. Therefore due to the fundamental nature of this, sometimes severability might not be appropriate.

But there are also cases when the courts do not apply severability. Besides the times when the above-mentioned factors have not been fulfilled, other arguments have been used for its non-application. For instance, as it is demonstrated in the thesis, when the arbitration agreement incorporates multiple unlawful clauses the whole agreement is invalidated. This

practice is mainly noted in consumer contracts and it is sensible since in the adhesive contracts, the weakest party is less experienced and he/she is often unaware of the statutory rights excluded from arbitration clauses drafted by the trader, therefore he/she needs a stronger protection.

Due to the lack of awareness, the weakest party might not vindicate his/her rights and therefore the arbitration would produce unfair results where the parties are not treated equally. By invalidating the entire arbitration clause, the incentives of stipulating unlawful provisions would be decreased in contracts of adhesion. Moreover, if severability applies on many unlawful provisions, almost nothing would remain from the arbitration. Consequently, it would be necessary to redraft the arbitration agreement again, and this action remains outside court's authority. The arguments and cases presented in this thesis thoroughly demonstrate how far courts can go in applying the severability has been answered.

Having in mind that the application of severability within the arbitration agreement depends on the fulfillment of the above mentioned factors, which themselves are dependent on the evidence provided by the parties and the court's interpretation, I will lastly recommend two points that parties should have in mind while drafting. Firstly, the parties should pay attention to the wording of the arbitration agreement by avoiding any ambiguousness and insertion of invalid provisions. Secondly, I would recommend the stipulation of a severance provision which applies expressly to the arbitration agreement or to certain provisions within it. Both of these suggestions will help in having an uncontestable arbitration clause, by avoiding any future controversies in relation to the invalidity *in toto* of the arbitration agreement.

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