

# The Inefficacy of Termination and Nullification of the Main Contract on Contractual Stipulations as a Consequence of the Principle of Autonomy of Arbitration Agreement from the Main Contract

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## Abstract

One of the most important results and effects of the principle of **autonomy** of arbitration agreement from the main contract is the inefficacy of termination and nullification of the main contract. It might be stated that with the termination or nullification of the main contract, the arbitration agreement, either as an arbitration condition in the terms of the main contract or as a separate agreement which is nonetheless related to the main contract, would not be localized in any instance, and thus it cannot be considered as an independent legal institution. The nullification of the terms based on the termination of main contract is justified by the principle implying the compliance of terms with the main contract, yet this rule is not universal. In some instances, based on the rule of autonomy and also the tacit agreement of parties, and considering the deviation of objectives in terms and the main contract, the principle may not be implied. By this argument, not only the acceptance of the doctrine of the autonomy of arbitration from the main contract becomes legitimate in our law, but it can also be argued that one of the most important consequences here is the autonomy of inefficacy of main contract on the arbitration agreement in Iranian law.

**Keywords:** Rule of Compliance of Condition, Principle of Autonomy of Condition, inefficacy of termination of contract on arbitration clause

## Introduction

Derogation from the jurisdiction of the courts is either in accordance with the law or pursuant to a mutual agreement which is applied as a separate agreement or a stipulation. One of the consequences of accepting the doctrine of the autonomy of arbitration agreements is that in case of nullification/termination of the main contract, arbitration clause or agreement is not nullified as well. Although this concept is rather employed for arbitration provisions and not arbitration agreements, with the acceptance of the autonomy of arbitration from the main contract, specially the arbitration condition, the following two achievements are derived.

In regards to the arbitration agreement being autonomy from the main contract, it is argued by some scholars (Nikbakht, 1997) that this is not the case, and there is no need for the principle of autonomy of arbitration conditions from the main contract, as they are autonomy in reality, while the nullification of the main contract may introduce the nullification of arbitration contract pursuant to the Article 765 of civil laws, which expresses that: reconciliation of claim based on a void contract is invalid, but the reconciliation of a claim based on the nullification of the contract is valid. In any circumstance, one of the most important consequences of the aforementioned principle is the inefficacy of nullification and termination of the main contract on the arbitration agreement which is annexed to the main contract as an arbitration clause. Although this topic may be perceived to belong to the principle of autonomy, it is in fact the consequence of the aforementioned principle. The remaining question is that whether these consequences are legitimate in our jurisprudence and jurisdiction. In contrast to other relevant articles of the field, this paper explores the differences of nullification and termination and its influence on contractual stipulations.

## 1. Inefficacy of the termination of the main contract on arbitration agreement:

There is no argue that until the termination of the main contract, due to its validity and application, it has its general effect, and until the contract is terminated, parties should not only be bound to its contents, but its stipulations as well. In this section, these issues are first considered in civil laws and then in the field of arbitration regulations. The inefficacy of the termination of the main contract is investigated separately from the inefficacy of nullification.

### 1.1. Definition of Termination

Termination is literal translation of the word «Termination». In Persian, this term is used as a synonym for separation of bonds. The termination of a contract occurs only after a valid agreement has been entered by the corresponding parties, in which the application of the contract for subsequent provisions is discarded, but yet

stays in effect for antecedent provisions. Annulment or termination refers to the dissolution of the contract with parties' consent. Revocation refers the same process through the exercise of a single party's authority. Cancellation is achieved through the expiry of the term of contract or through the termination provisions. Annulment is effected for subsequent acts. As stated by the Article 238 of Civil laws: After the conclusion of the deal, parties to the deal can nullify or annul the contract on mutual consent, and according the Article 287, which provides that benefits and interests since the annulment of the transaction that occurs belongs to the party that has rightfully acquired it by the contract, it can be argued that annulments are effective for future purposes and not for prior acts. Voluntary termination of either spot or continuous contract is highly similar to annulment. In general, cancellation with retrospective effects is not common in Iranian law, but these provisions are prevalent in French law, as annulments in France have retrospective effects and nullify the contract since its conclusion. In other words, the parties to the contract are obliged to return whatever they have obtained from the contract and their consequent gains, as the legal possessions in the period between the conclusion of the agreement and its annulment lack legitimacy (Safai et al., 2008). But in most of the jurisdictions, annulments are prospective (Chengwei, 2005). In the provisions of the Convention on the International Sale of Goods, terminations have retrogressive effects, as customers and vendors are required to return all the interests of the sale pursuant to the contract following its conclusion. (Honnold, 1999. Vilus, 1986)

In respect to the final result in law of Iran, if any contract is either nullified, revoked, terminated or cancelled, it remains in effect for any prior provisions and thus the termination lacks retrogressive effect.

#### **1.1.2. Retention of arbitration agreement after the termination of the mine contract**

In civil laws, termination of the contract though annulment or revocation follows the principle of compliance of the condition with contract and the assumption of the annulment can be deployed in various ways. According to the Article 246 of civil laws if the contract is cancelled as a result of termination or nullification, all terms and conditions are nullified as well, and the party bound to these condition may charge the other party for committed conditions.

In this regard, it has been stated that according to the principle of compliance of condition with contract, the clause pertaining to reference to arbitration is only legally binding when the main contract is still valid, and disputes regarding the validity of contract cannot be referred for arbitration (Katuzian, 1989). However, Legal experts and jurists do not consider the principle of compliance of condition with contract to be universal, and in some cases, such as conditions that are triggered specifically by the termination of contract, stipulation cannot be considered to be nullified and are thus binding. The content of the Article 246 should be implemented in cases where the conditions is specified within the scope of the contract, and as previously stated, conditions that are triggered specifically by the termination of contract cannot be considered ineffective after the nullification of the contract. Furthermore, in some cases of civil law regulations, it is observed that the remittance is not neutralized by the nullification or termination of the contract. Article 733 of civil law expresses that if in a sales agreement the seller has transferred the right to customer pending the price, or the customer has made a remittance for the seller to receive the good for someone else and the nullification of the sale is then discovered, the remittance should be rendered ineffective and it should be extradited, but if the sale agreement is cancelled trough termination or revocation, the remittance stays effective. The contents of this article is applicable to other commitments as well. It should be stated that according to the most of the jurists, the transferor is not liable against the transferee (Imami,1998). Hence, the inefficacy of the termination of the main contract on the conditions, either arbitration or other provisions is not against the law and it is even common in some cases. Nonetheless it might be expressed that according to article 461 of Civil Judicial Procedure, not only the inefficacy of termination of contract is not applied on the arbitration, but also it is not recognized in the Iranian law (Seifi, 2009). Article 461 of civil judicial Procedure provides that, in case there is a dispute regarding the main contract or the arbitration agreement, the court addresses it firsthand.

The advisory theory is introduced in line with the arguments. This theory is provided according to the principle of compliance of condition with the main contract, without considering the real intention of parties in dispute resolution even in respect to the main contract. Citing Article 461 is illogical, as this article is not universal and only refers to cases where parties have not nominated their arbitrators in the contract, and thus attend the court to determine the arbitrator instead of the refuser. If any dispute arises regarding the main contract or the arbitration agreement, it is logical for the court to determine the arbitrator instead of the neutral party after verifying the transaction and contract. However, if the parties have already nominated their arbitrators, or the dispute regarding the integrity of the contract arises after the nomination of arbitrators by the court, the aforementioned provision is not applicable (Saffai, 1998).

Hence, this assumption is more consistent with general and analytic principles in civil laws. Regardless of what has been stated, if the principle of independence of arbitration clause from the main contract is accepted in absolute terms, the aforementioned reasoning is easily acceptable. Content of Article 461 are considered as exceptions in the field of civil law.

Although the International Commercial Arbitration Law has not expressly provided for the termination of

the main contract and the survival of the condition of arbitration. In this regard, the nullification of the main contract and Survival of the condition of arbitration is accepted in some way in Iranian Law. Furthermore, the Article 16 of International Commercial Arbitration Law provides that the arbitration clause which is a part of the contract, is to be enforced as a separate agreement.

## **2. Inefficacy of the nullification of the main contract in the arbitration agreement:**

As according to the principle of autonomy of the arbitration clause from the main contract, the dissolution of the main contract has no influence on the arbitration condition, this section studies the inefficacy of the null contract on the arbitration condition. As the definition and implications of nullification are different from those of termination, this issue should be studied separately. Almost all the authors of international arbitration study this issue as a whole and without discretion, and achieve a single outcome with a single common reasoning.

While this single outcome doesn't justify the lack of separation, as a null contract is null from the beginning, if it is discussed that the relation between the condition and the contract relies on the Article of Civil Law (Ibid), the condition cannot be considered as an autonomous entity, while in termination, stipulations are at least effective until the moment of termination, and thus its implementation as current or prospective condition is undeniable. It is clear that the lack of separation of discussions lead to illogical outcomes. As a result, the issues of nullification of the main contract and termination of the main contract are studied separately.

To analyze the inefficacy of the nullification of the contract on the arbitration clause, first the definition of an invalid contract and the effect of the main contract on stipulations, and more specifically arbitration conditions, is studied.

### **2.1. Definition of nullification**

The term nullification is the opposite of integrity. A nullified contract is an invalid contract, and semantic-wise it is synonym to terms like vanity, meaningless and unjust (Moein, 1999). A nullified legal provision is a provision which lacks legal validity and effect expected from a valid one (JafariLangroudi, 2013). In jurisprudence, nullification usually refers to the infectivity of the contract (Al-Najafi, Bitá, vol. 12: 125).

According to the current regulations there three types of contract defined in Iranian Law. A Valid Contract is a contract which is free of deficiencies and error and has all the material for the integrity of the contract. Nullified contract: as previously stated, a nullified contract is a contract where some components are missing and thus is invalid and has no effect. It is evident that such contract would not be correct by the means of modification. For example, a contract where parties to it have no intention is nullified.

Unenforceable contract: Any contract which is neither valid nor nullified such as unauthorized transactions, unwilling contracts and contracts entered to by minors and natural fools.

Unenforceable contract may become valid by the means of modification. Thus, until an enforceable contract is not modified, there is no consequence to it. Therefore, some clerics consider the unenforceable contract without consent to be null according to the verse "O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent." It should be nonetheless stated that such contract is not nullified by draft, but lack of consent renders it unenforceable. Considering that the exemption in the verse is discrete and not consistent, there is no relation between the exception and the case, and therefore it should be noted that any agreement with consent is not only and invalid agreement (Asadi-Nejad, 2011:). Nullification can be classified in two types: Absolute nullification and partial nullification.

The concept of partial termination in French law is to some extent similar to the unenforceable contract. There are two types of nullification in the French law: absolute nullification and partial nullification. In Absolute nullification, there is no way to troubleshoot and modify the contract, and thus it is rendered illegitimate. But in the case of partial nullification, the party with the right to nullify the contract can modify the provision or the contract. Furthermore, in absolute nullification, every stakeholder can refer to it; but in partial nullification, only the stakeholder supported by the legislator refers to it (Safai, 1989). However, unenforceable contract is a contract in Iranian law that can be modified. By paying close attention, it becomes clear that the above classification is based on legal private or public interests: for example, the sale of a product which is not in the benefit of the legal commerce is nullified due to the adherence to the public interest (Taheri, 1991). The opposite is true for public interests. Thus a nullification is absolute when a principle in favor of the public interest is breached, such as contracts which encompasses provisions that are against social or ethical norms or breach the requirements for commercial security. In some cases, the compliance with nullification is justified by the benefit of the public order. But this issue is the case when the breached principle has a main property

#### **2.1.2. the effect of nullification of legal provision on its stipulations**

As previously stated, it is possible for the stipulations of the sale contract to be exempted from the errors of the contract. In this case, it should be witnessed whether the nullification of the contract results in the nullification of the conditions as well. As stated, stipulations are generally dependent on the contract (Katuzyan, 2000). All the while, it should be noted that the dependence of the stipulations is originated from the intention of the parties to

the sale agreement (Bagheri, 2011). So if it is exceptionally proved that the intention of the parties was for the condition to be autonomy, discussing the compliance of the condition from the sale agreement is irrelevant. As a result, if the condition in the assumption is legitimate regardless of the contract, the nullification of the contract has no effect on it (Ghanavati, 2003). Of the implication in this regard is the condition of discouragement or escalation of security against fault in title. It might be assumed that since the sale agreement is nullified in the assumption of belonging the object of sale to others the discouragement or escalation of security against fault in title is also nullified. Thus this assumption is not acceptable since according to the aforementioned contents and as the jurists have rightfully stated, the intention of parties is this contract is to regulate their own contract. In fact, the parties want the condition to be not a part of the contract (Heydari, 2008). One of the causes of the inefficacy of the nullification of the main contract is a law in civil laws. Legal provisions are dividable into two contracts as to their capacity to decompose (Taheri, 1991). As some jurists have argued in line with clerics, if a contract has two parties and its subject is single, the contract is inseparable. Hence, if the parties to a contract are more than two, or its subject is made up of several component and is decomposed, in such way that every part is independently accounted for, the sale contract may be decomposed to several contracts. The aforementioned argument is discussed as the principle of dissolution of single component in to several components in Iranian law (Mirzaie, 2010). The fitness of this discussion is in the fact that in decomposable contracts, nullification cannot be applied to only a part of the contract. In other words, nullification due errors in some components of the sale contract is generalized to the whole contract, and nullifies the whole structure of the contract. Hence, in decomposable contracts, it is observed that due to the disturbing of components of the agreement, some part of the contract is nullified while the other part is free of error (Bagheri, 1390). In this case, it seems that the nullification of a contract in part is not Generalizable to its whole. A clear example of this principle in the Iranian law, is the issue of belonging the product to others. In this case, the contract is nullified in regards to the part where the product is belonging to someone else. But the other part if the contract which observed the product of the seller is considered legitimate. In this assumption, the contract is effectively divided into two contract, one of which is considered nullified due to application to the belonging of other, and the other one which is free of controversy stands still (Yazdi, 2010). Of course, in this case, the legislator of Iran has bestowed him the Option of nullifying the recent Sale. Article 434 of civil law expresses that “if it is approved the subject of sale is priceless, the sale is nullified, either partially or completely, and the customer has the option of sales unfulfilled in part.” Article 441 of civil law states that “The option of sales unfulfilled in part may be applied when the sales agreement is nullified as a result. In this case, the customer has the right to nullify the contract or accept the part where the sale is legitimate and extradite the part where the contract is nullified.” But, according to the Article 443 of the civil laws “The option of sales unfulfilled in part is only applied when the buyer was not informed during the sale” In French law, nullifying a part of a legal provision is an example of partial nullification. Note that the partial nullity in this legal system nullification of part of the provision. In regards to the nullification of a part of a legal provision, some French jurists express that nullification of inseparable contract applies to the whole of the contract. According to them, however, the determination of partial and complete nullification depends on the intention of the parties and requirements of public order (Ghanbarpour, 2013).

Thus, the separation of the condition and ruling in favor of the legitimacy and integrity of the condition in spite of ruling for the nullification of the contract has legitimacy in law. If we consider the condition as a provision or a separate agreement, the nullification of contract has no influence on the condition. The theory of capacity, which is introduced by some scholars, is applied in this regard. In this theory, some provisions are subject to other provisions (Khomeini, Al-bei’, Vol. 1, p. 88, Vol 5, p. 204). According to this theory, the existence of the contract is not subject to conditions and, in some cases, vice versa.

### **2.1.3. Inefficacy of nullification of the main contract on the arbitration clause:**

As previously argued, it is possible to separate stipulations from their main contract in our law, and this act is not in contrast with principle of compliance of conditions with the main contract, as the mentioned provision is a general advice and not universal. If the nullification is due to Absence of validity conditions, the nullification of contract results in the absolute nullification of the stipulation. Examples of these situation include cases where the parties did not intend to draft any contract. Nonetheless, in cases where the integrity of the contract is not under question, there are stipulation that can be subject of autonomy commitments; such conditions are not nullified pursuant to the main contract. If we consider these conditions to be retrospective after the nullification of the main contract, such conditions are considered to be legally binding. Furthermore, as the subject and purposes of these conditions are different from those of the main contract, the implied intention of parties to enter separate agreements is concluded. In fact, one of the implications in this field pertains to the agreement of dispute resolution regarding an agreement by an arbitrator which is predicted as a condition of agreement in sales agreement. Agreements that are entered regarding dispute resolution through arbitrator are either manifested as an stand-alone agreement or as contractual stipulations. The first assumption is out of the scope of this paper. In regards to the second assumption, as described by researchers of law, the independence of this stipulation was

first accepted in judicial processes of France, and has been implemented in various rulings of international arbitration (MohagheghDamad, 2003).

While the issue was studied in regards to the dissolution of the main contract, yet due to the differences in meanings and effects, it seemed necessary to discuss the issue of nullification separately from dissolution. It is evident that to simply put the principle of compliance of terms with the main contract in forefront of our discussion yields trivial results, which clearly implies that contractual stipulations are considered nullified as a result of the nullification of the main contract. Hence, as the arbitration clause which is inserted as a stipulation is nullified, disputes as to the validity and invalidity of the main contract may not be commissioned for arbitration. Article 461 of Civil Procedure Code has been interpreted in this regard (Katuzian, 1989). This article, however, had been stated to not imply a general rule, and this provision is provided for instances where a party has not nominated its arbitral body and the other party goes to court to determine the arbitrator. In this case, whenever a dispute arises regarding the main contract or the arbitration agreement, it is logical for the court to appoint an arbitrator instead of the abstainer after establishing the validity of the transaction. In contrast to this theory, it is argued that by accepting this differentiation, that an arbitration clause may lead to different conclusions if the dispute arising from the main contract is referred to an arbitrator or a judge. In the first assumption the nullification of the transaction maintains the application of the arbitration clause, but in the second assumption, the nullification of the main contract causes the arbitration clause to be nullified as well (Eskini, 2004). As a counter argument, it should be stated that the aforementioned article is applied only when the scope of authority of the arbitrator is not specified, which means that the arbitrator is intended to address the disputes generally. However, if the subject of Dispute Settlement is expressly determined and is included in the scope of arbitration, it is out of the scope of Article 461 of the Code of Criminal Procedure. In other words, the article is introduced only when there is no such expression and the authority of the arbitrator is not specified (Mohaghegh) and the article in fact interprets the intention of the parties. Hence, it can be argued that the Governance and the intention of parties is all that matters. If the parties decide to refer the issue to the arbitrator firsthand, and in case of being provided in the arbitration agreement, investigating the validity or invalidity of the agreement is in the arbitrator's hand, and thus referring to the discretion of the judge is not necessary. Above all, even in cases where there is an arbitration agreement, and one of the parties brings the dispute to court, the court may reroute them to arbitration *prima facie*, and study the agreement generally (and not specifically) and then refer it to arbitration.

### Conclusion

Considering the unique definitions of termination and nullification, and the fact that dissolution has prospective effects in our system while nullification has retrospective effects as well, the importance of the effect of dissolution on arbitration agreements cannot be ignored. This paper proved that the principle of compliance of conditions with the main contract is not universal, and in some cases of jurisprudence and civil rights, due to the differences in purposes of the main contract and stipulations such as the arbitration agreement, the arbitration clause will remain effective in either case of dissolution and nullification. Hence, two instances of consequences and achievement are legitimate in Iranian civil rights and jurisprudence before being a result of mentioned principle. Hence, contrary to the belief of researchers of Civil Judicial processes law, the Article 461 of which states that the body responsible for determining validity and invalidity of contract is the court, and in case of invalidity the arbitration is nullified as well, the regulations are pursuant to the potential purposes of the parties. If it is to be believed in good faith that the common implied intention of the parties is to maintain existence of the arbitration agreement, the mentioned provision is not valid.

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