THE CRITICAL IMPORTANCE OF CAREFULLY DRAFTING ARBITRATION CLAUSES

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INTRODUCTION

Of the many judgments handed down by the Australian courts every week, there always seem to be at least one or two relating to arbitration. Indeed, in the last part of this journal alone, two articles in the 'Recent Developments' section related to court decisions arising out of arbitrations in Tasmania and Victoria.[1] Arbitration is supposed to be an alternative to litigation. Users of arbitration choose it instead of going to court. So why, when parties have elected for arbitration, do their disputes still turn up before the courts?

Most arbitration-related cases before the courts are there for one of two reasons. First, there are constant attempts at appealing against arbitral awards. Australian courts now allow appeals with far greater reluctance than might once have been the case. In international arbitrations under the *International Arbitration Act* 1974 (Cth) (IAA) there is generally no appeal possible against an arbitral award[2].

In domestic arbitrations under the uniform *Commercial Arbitration Acts* (CAAs) of the States and Territories, there is an extremely limited right of appeal with leave on a point of law[3]. But this does not stop parties trying to appeal against awards. *Qenos v Mobil Oil Australia*[4], considered in the last part of this journal, is an example of an unsuccessful application for leave to appeal.

Secondly, there are frequent examples of a party applying to the court to stay court proceedings commenced against it by the other party despite the existence of an agreement between them to resolve disputes by arbitration. These stay applications are often straightforward. The other case considered in the last part of this journal, *Origin Energy v Benaris*[5], is an example of such an application, but one which was not so straightforward.

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1 *Origin Energy v Benaris International; Woodside Energy v Benaris International* [2002] TASSC 50, discussed in (2003) 22 ARELJ at p 26; *Qenos v Mobil Oil Australia* [2002] VSC 379, discussed in (2003) 22 ARELJ at p 28.

2 See Articles 5, 34 of the United Nations Commission on International Trade Law (UNCITRAL) Model Law, applicable by virtue of the IAA.

3 Section 38 of the *Commercial Arbitration Act* 1985 (WA) and equivalent sections of the CAAs of the other states and territories. Before it will grant leave the court must be satisfied that (a) having regard to all the circumstances, the determination of the question of law concerned could substantially affect the rights of one or more parties to the arbitration agreement; and (b) there is (i) a manifest error of law on the face of the award; or (ii) strong evidence that the arbitrator made an error of law and that the determination of the question may add, or may be likely to add, substantially to the certainty of commercial law. See *State of Victoria v Seal Rocks Victoria (Australia) Pty Ltd* [2003] VSC 84; BC 200301900 at paras 12-21 for a summary of the principles applied by the courts in deciding whether to grant leave to appeal against an arbitral award.

4 [2002] VSC 379, discussed in (2003) 22 ARELJ at p 28.

5 [2002] TASSC 50, discussed in (2003) 22 ARELJ at p 26.

At around the same time, another stay application was made to the Supreme Court of New South Wales in *ACD Tridon v Tridon Australia*[6]. That application was not straightforward either.

These decisions can be viewed as cautionary tales of how jurisdictional arguments can end up hijacking the arbitration process, but the real lesson is that careful drafting of arbitration clauses is the best way of avoiding such adventures.

After briefly discussing the law relevant to obtaining a stay of court proceedings in favour of arbitration, this comment will consider briefly the *Tridon* and *Origin Energy* decisions specifically in the context of the arbitration agreements that existed between the parties, before suggesting a brief practical guide to the basic elements that should be contained in every arbitration agreement.

AUSTRALIAN LAW RELEVANT TO STAY APPLICATIONS

If a party attempts to litigate a dispute that is within the scope of an arbitration agreement, the court will usually grant the other party's application for a stay.

Under the IAA, where proceedings instituted by a party to an arbitration agreement against another party to the agreement are pending in a court, and the proceedings involve the determination of a matter that, in pursuance of the agreement, is capable of settlement by arbitration, then on the application of a party to the agreement, the court *shall*, by order, stay the proceedings or so much of them as involve the determination of that matter, and refer the parties to arbitration in respect of that matter.[7]

So in the context of an international arbitration the court has no discretion: it *must* stay proceedings to the extent that they relate to a matter capable of settlement by arbitration.

This will be the position unless the arbitration agreement is 'null and void, inoperative or incapable of being performed'.[8]

In domestic arbitration, where the IAA does not apply, there is discretion for Australian courts to grant a stay of proceedings in favour of an arbitration agreement, both at common law[9] and under the uniform CAAs of the States and Territories.[10]

It used to be quite straightforward to ignore an arbitration clause and litigate a dispute in the face of it, because Australian courts were traditionally reluctant to embrace commercial arbitration[11]. More recently, however, commercial arbitration has received judicial endorsement[12]. The position

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6 [2002] NSWSC 896.

7 Section 7(2) of the IAA. This is likely to apply to most arbitration agreements with international aspects: see s 7(1), and Garnett R 'the current status of international arbitration agreements in Australia' (1999) 15 *Journal of Contract Law* 29, 31.

8 Ibid, s 7(5).

9 See eg *Joy Manufacturing Co Ltd v AF Goodwin* (1969) 91 WN (NSW) 671.

10 See s 53 *Commercial Arbitration Act* 1985 (WA) and equivalent sections in the CAAs of the other states.

11 See for example the comments of Barwick CJ in *Tuta Products v Hutcherson Bros* (1972) 127 CLR 253 at 257, and of McGarvie J in *State Transport Authority v Apex Quarries* (unreported, Sup Ct Vic, 5 February 1986), cited in *Jacobs*, Commercial Arbitration Law and Practice, Lawbook Company looseleaf version, para [1.100].

12 See for example *Qantas Airways Ltd v Dillingham Corporation* (1985) 4 NSWLR 113 at 118, per Rogers J.

now is that it is recognised as a genuine and viable alternative to litigation as a method of dispute resolution of last resort.

Under the CAAs there is a presumption in favour of arbitration unless a party demonstrates the superiority of judicial determination in the circumstances.[13]

However, judicial adjudication may be more appropriate where there is a real prospect of multiplicity of proceedings, with increased legal costs and the prospect of inconsistent results.[14]

Thus where there are multiple parties in a dispute, a court will sometimes allow court proceedings to take place ahead of arbitration between only two of those parties.

The existence of claims that are outside the arbitration agreement, and unable to be stayed, may also prevent a stay of confined ambit being granted due to the unnecessary multiplicity of proceedings and risk of inconsistent findings of fact.[15]

THE *TRIDON* CASE[16]

The disputes between the parties in this case concerned a shareholders agreement and a distribution agreement.

The shareholders agreement provided for arbitration of 'all disputes or differences between the parties hereto touching and concerning the construction or effect of this Agreement or the rights and liabilities hereunder…'.

The distribution agreement contained a clause requiring arbitration of 'any dispute, difference or question which may arise… with respect to the true construction of this Agreement or the rights and liabilities of the parties hereto…'.

The plaintiff commenced court proceedings despite the arbitration clauses. Three of the four defendants applied to the court to have the proceedings stayed pursuant to s 7(2) of the IAA.

The plaintiff's claims against the defendants were for a number of alleged breaches of various provisions of the *Corporations Act*, and seeking various categories of relief available under that Act. Faced with the defendants' stay application, the plaintiff submitted that these statutory claims were not capable of settlement by arbitration for the purposes of s 7(2) of the IAA, and that accordingly its court proceedings should not be stayed.

Austin J of the Supreme Court of New South Wales confirmed that if an arbitration clause is drafted in appropriately wide language, it is legally effective to refer statutory claims to arbitration. He took the approach of Gleeson CJ of the Full Court in *Francis Travel Marketing v Virgin Atlantic Airways*[17]:

> 'When the parties to a commercial contract agree, at the time of making the contract, and before any disputes have yet arisen, to refer to arbitration any dispute or difference arising

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13 See *PMT Partners Pty Ltd (in liquidation) v Australian National Parks and Wildlife Service* (1995) 18 CLR 301.

14 See *Abigroup Contractors Pty Ltd v Transfield Pty Ltd and Obayashi Corporation and Ors* (1998) VSC 103 BC9805944 at para 151, 158 per Gillard J; *Beaufort Ltd v Gilbert-Ash Ltd* (1998) 2 All ER 778.

15 *BTR Engineering (Australia) Ltd v Dana Corp* [2000] VSC 246; BC200003389 per Warren J at para 24-25.

16 *ACD Tridon v Tridon Australia* [2002] NSWSC 896.

17 [1996] 39 NSWLR 160.

> out of the agreement, their agreement should not be construed narrowly. They are unlikely to have intended that different disputes should be resolved before different tribunals, or that the appropriate tribunal should be determined by fine shades of difference in the legal character of individual issues, or by the ingenuity of lawyers in developing points of argument.'[18]

After carefully reviewing many of the decided cases in which Australian courts have grappled with whether a variety of non-contractual claims are within the scope of arbitration agreements, Austin J turned to the particular arbitration clauses before him, and decided that they were not wide enough to cover all the disputes between the parties. Many of the statutory claims could not be said to *touch and concern the construction or effect of the shareholders agreement or the rights and liabilities thereunder*, or to *arise with respect to the true construction of the distribution agreement or the rights and liabilities of the parties thereto*. These claims were not capable of settlement by arbitration.

And yet, because the arbitration was international and s 7(2) of the IAA applied, those claims that *did* fall within the scope of the arbitration agreements *had to be referred to arbitration*. The court had no discretion in this regard.

In *Tridon*, the court decided that the most just and practical way of resolving this dilemma was for the whole of the proceedings to be referred to a referee under Part 72 of the *Rules of the New South Wales Supreme Court*.

Under those Rules, a dispute may be referred to a referee who, subject to any directions made by the court, may conduct the proceedings as he thinks fit and is not bound by the rules of evidence. The referee then submits a report to the court, and the court decides whether to adopt, reject or remit the referee's report back to the referee. The award of the referee is then equivalent to a jury verdict, unless set aside by the court or judge.

Subsequently, the parties consented to the dismissal of the stay applications and the referral of the whole of the dispute to a referee under Part 72 of the Rules. The person appointed as a referee had previously been appointed as an arbitrator to determine a separate ongoing arbitration between one of the defendants and the plaintiff.

The decision of Austin J in *Tridon* is an example of a court doing its best to bring about the most cost effective and efficient method of dispute resolution possible in the face of a potential multiplicity of proceedings. This took some doing, given the lack of discretion under s 7(2) of the IAA. What enabled the court to invoke the referee procedure, was what the court took to be the implied consent of the parties that the arbitrable disputes be referred to a referee instead of an arbitrator. This possibility had been put forward as a fallback position by the plaintiff and was taken up by the defendants before the court.[19]

So although a lot of time and costs were spent dealing with the stay application, it may be that even more time and costs were saved by reason of the parties being able to consent to the referee procedure in this case. In that respect the parties were perhaps fortunate.

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[18] Ibid at 165.

[19] Although a reference to a referee can be made under the Rules without the consent of the parties, this would result in part of the proceedings being determined by arbitration and the remainder of the proceedings being determined by a referee whose report would not be binding unless and until it was adopted by the court.

But the key to avoiding the jurisdictional arguments lay in the negotiation of wider, more straightforward and identical arbitration clauses in the parties' agreements, referring to arbitration, for example, "all disputes *arising out of or in connection with*" the agreement. There is no magic to such language; it is found in the recommended standard clauses of most international arbitral institutions. Such wording has a better chance of covering tortious, equitable, restitutionary or statutory claims than more limitative wording such as "arising from" or "under"[20].

THE *ORIGIN ENERGY* CASE

In the *Origin Energy* case the problem was not so much the wording of the arbitration agreement, which was wide in scope (similar to that suggested immediately above), but rather the contractual involvement of a third party subsequent to that agreement, without further agreement being reached in relation to resolution of disputes. The facts of this case are dealt with in more detail in the article in the last part of this journal.

The Farmin Agreement between Origin and Benaris, by which Benaris transferred to Origin an 80% interest in its exploration permit, provided for the resolution by arbitration in Singapore of 'any dispute, controversy or claim arising out of or relating to this Agreement, or the breach, termination or invalidity thereof'.[21]

The subsequent assignment agreement, by which Origin transferred a 50% interest in the permit to Woodside, in return for Woodside acting as drilling sub-contractor in relation to the exploration, did not contain an arbitration clause.

Slicer J in the Supreme Court of Tasmania considered that the arbitration clause in the Farmin Agreement provided 'an extremely wide ambit of the type, or category, of matter to be settled by arbitration[22]. Further, given that Benaris was a foreign company, the IAA applied so there was no discretion for the court: it had to order a stay of the proceedings in respect of matters capable of arbitration. But the matter was complicated by the appearance of Woodside as a co-defendant in Origin's claim against Benaris, and as a plaintiff in its own proceeding against Origin and Benaris.

Therefore, notwithstanding the wide scope of the arbitration agreement, there were inevitably disputes that it could not cover, not least because Woodside was not a party to the arbitration agreement at all. Slicer J declined to stay the Woodside proceedings (he could do little else in the absence of an arbitration agreement binding Woodside), and invited Origin and Benaris to try to agree on which of their particular disputes were referable to arbitration. Origin and Benaris could not agree, and so Slicer J had to decide the matter a few months later[23].

Benaris contended that all matters in dispute must be referred to arbitration, whereas Origin argued that the ultimate issue, namely the forfeiture and re-assignment of the interest in the exploration permit, was not capable of settlement by arbitration because of Woodside's equitable interest.

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20 For example, claims under s 52 of the *Trade Practices Act* 1974 (Cth), negligent misrepresentation and collateral warranties have been held not to fall within a clause requiring arbitration of 'any dispute arising from' the contract: see *Hi-Fert v Kiukiang Maritime Carriers* (1998) 159 ALR 142.

21 Farmin Agreement, clause 19, cited at [2002] TASSC 50 para 7.

22 [2002] TASSC 50 para 26, following *Ashville Investments Ltd v Elmer Ltd* [1989] 1 QB 488; *Ethiopian Oil Seeds v Rio Del Mar Foods Inc* [1990] 1 Lloyd's Rep 136; *IBM Australia v National Distribution Services Ltd* (1991) 22 NSWLR 466.

23 [2002] TASSC 104.

The court ultimately inclined to Origin's argument, having identified from the pleadings the issues between the parties and the remedies being sought and decided whether each was capable of settlement by arbitration. Essentially, given Woodside's lack of standing in any arbitration, equitable issues which affected Woodside's position were held not to be capable of settlement by arbitration between Origin and Benaris.

Therefore, the parties' disputes will have to be resolved in three sets of proceedings: one arbitration and two court proceedings. As indicated above, the problem here was not so much the drafting of the arbitration clause, which was very wide, but the subsequent involvement of Woodside without amendment to the arbitration clause.

When Woodside's involvement was being negotiated the dispute resolution provisions in the various contracts between Origin and Woodside could have been made consistent with each other, ensuring a single forum for the resolution of disputes involving any of the parties, or perhaps a separate, tripartite dispute resolution agreement could have been prepared, dealing with all disputes arising out of or in connection with any of the agreements between the parties.

THE IMPORTANCE OF THE ARBITRATION CLAUSE, AND WHAT IT MUST COVER

The jurisdictional quagmire encountered by the parties in the cases discussed above prove the importance of focusing on the drafting of the arbitration clause during contractual negotiations, however unpalatable it may be to think about dispute scenarios while negotiating a commercial deal.

With this in mind, the following is offered as a basic guide to the elements that every arbitration clause should cover.

The scope of matters to be referred to arbitration

As shown above, it is generally desirable to make the scope of the arbitration clause as broad as possible.

Place of arbitration

It is vital in international arbitration to specify the place of arbitration because, as a general rule, the procedural law of the country in which the place is located will govern the procedure of the arbitration.

A country with a favourable legal environment should therefore be chosen. That is, a country with a sound legal system, a good quality arbitration law without too much intervention from the courts, and which has signed the New York Convention[24]. An arbitral award rendered in a signatory country is enforceable in any signatory country around the world. The wide international enforceability of arbitral awards, compared to the often difficult enforcement of judgments abroad, helps makes arbitration the dispute resolution method of choice in the international context.

The most popular places of arbitration include Geneva, Paris and London, and in the Asia-Pacific region Hong Kong and Singapore. Any Australian city would also be suitable although if the contract is between an Australian and non-Australian party the latter may not be content with this agreement.

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[24] As at 9 June 2003, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, New York, 1958 has been ratified or acceded to by 133 countries, including by Australia in 1975. (See statistics at the website of UNCITRAL: www.uncitral.org).

Institutional or ad hoc arbitration

An arbitration is institutional if conducted under the auspices of one of a number of international arbitral institutions, adopting their arbitration rules. Well established arbitral institutions include the International Court of Arbitration of the International Chamber of Commerce (the ICC), the London Court of International Arbitration (LCIA), the Singapore International Arbitration Centre and the Hong Kong International Arbitration Centre.

Arbitrations that are not institutional are *ad hoc*, using rules specifically drafted by the parties to take account of the particular contract or dispute, or adopting rules of procedure specially developed for *ad hoc* arbitration, such as the UNCITRAL Arbitration Rules.

In international transactions institutional arbitration is generally preferred because the rules of the well-established institutions are tried and tested, and the institutions provide trained staff and a governing body to administer the arbitration and advise users. Fees are payable for the institution's services (in addition to the fees payable to the arbitrators).

The arbitrators are usually appointed more quickly in an institutional arbitration than in an ad hoc arbitration because of the strict time limits for the initial stages of the arbitration under most institutional rules.

Number of arbitrators

The arbitration agreement should specify the number of arbitrators. The number should be one or three. The choice depends on the potential seriousness and value of future disputes.

The fees payable to an arbitral tribunal of three will, of course, be about three times higher than those payable to a sole arbitrator.

Substantive law

Every contract should of course contain a governing law clause whether or not it provides for disputes to be resolved by arbitration. The substantive law of the contract will not necessarily be the same as the procedural law of the arbitration.

Language of the arbitration

A detail not to forget where the parties have different mother tongues.

CONCLUSION

International arbitration is the only practical method of final resolution of disputes for the vast majority of international commercial transactions entered into by Australian companies.

Getting the arbitration clause right will not guarantee a successful arbitration, and will not stop the court becoming involved. But it should significantly lessen the risk of lengthy and costly jurisdictional arguments delaying determination of the real dispute between the parties.