

HOW MUCH JUSTICE IS ENOUGH? FINDING THE BALANCE BETWEEN ARBITRAL AND JUDICIAL POWER — WHEN MAY THE COURT OF THE SEAT SET ASIDE (ANNUL) AN AWARD

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Cet article est la version éditée de la communication présentée par l'auteur en mars 2016, à Queenstown (NZ) lors de conférence Annuelle de Arbitrators' and Mediators' Institute of New Zealand, Inc (AMINZ) de l'International Academy of Mediators (IAM). L'interaction entre l'arbitrage commercial international et le contrôle des juridictions nationales du siège de l'arbitrage a présentée comme «un équilibre délicat» - une situation dans laquelle une trop grande autonomie conférée aux arbitres crée un risque d'apparition d'un aléa moral où trop de contrôle par les juridictions nationales finirait par priver les arbitres, librement choisis par les parties, de leur pouvoir de décision. Cet article s'intéresse aux différentes initiatives qui sur la base des lois Modèles proposées par la CNUDCI tendent toutes à instaurer un équilibre entre ces deux contraintes.

The interplay between international commercial arbitration and the control of the national courts of the seat of the arbitration has been characterised as "a delicate balance" – a situation where too much autonomy for arbitrators creates the possibility of moral hazard, and yet where too much control by the national courts deprives the arbitrators selected by the parties of their decision-making power.¹ This paper explores the search for that balance in the context of the UNCITRAL Model Laws.

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1 S Greenberg, C Kee and J Weeramantry (eds) *International Commercial Arbitration: An Asia-Pacific Perspective* (Cambridge University Press, 2011) 411.

I INTRODUCTION

Although the New York Convention (the "Convention") does not expressly limit the scope of national court review of awards in setting aside proceedings, Gary Born opines that the "better view" is that the Convention must be read as requiring Contracting States to recognise and enforce agreements to arbitrate under Article II consistently with Article V, by limiting the grounds for possible annulment of awards under their respective national arbitration regimes to those specified in Article V.²

Whether or not one ascribes to this interpretation of the Convention, in jurisdictions that have adopted the UNCITRAL Model Law, including New Zealand, Australia, Singapore and Hong Kong, generally, the balance has been struck such that the courts of the seat may set aside international arbitration awards only where the party challenging the award succeeds in establishing one or more of the exclusive grounds contained in Article 34(2)(a) of the Model Law, or where the relevant court determines, *ex officio*, that the dispute concerns a non-arbitrable subject matter or that the decision conflicts with the public policy of the State, pursuant to Article 34(2)(b).³

Unsurprisingly therefore, Williams and Kawharu observe that, apart from limited rights of appeal provided by Clause 5 of Schedule 2 of the Arbitration Act 1996 (the "NZ Act") - which would require an affirmative "opt in" by parties to an international arbitration - Article 34 "provides the only avenue for a party to directly challenge an award".⁴

Born elaborates:⁵

The grounds set forth in Article 34 parallel those applicable to recognition of an award under Article 36 of the Model Law and Article V of the New York Convention, save for the provisions of Article V(1)(e) and Article 36(1)(a)(5), dealing with awards that are not 'binding' or that are annulled in the arbitral seat. Specifically, Article 34 provides that an award may be annulled if (a) the arbitration agreement was invalid or a party thereto lacked capacity; (b) a party was unable to present its case, including for lack of due notice; (c) the award deals with matters outside the scope of the submission to arbitration; (d) the composition of the arbitral tribunal was not in accordance with

2 G Born *International Commercial Arbitration* (Kluwer, 2009) 2557.

3 *Ibid* 415.

4 D Williams and A Kawharu *Williams & Kawharu on Arbitration* (LexisNexis, Wellington, 2011) 467.

5 *Above n 3*, 2562.

the parties' arbitration agreement; (e) the dispute was non-arbitrable; or (f) the award violates local public policy. If none of these specified grounds is present, then the award may not be annulled.

II THE ARGUMENT FOR JUDICIAL REVIEW

An action to set aside an international arbitration award in the national court of the seat ensures that a state exercises at least a minimum level of control over the procedural and jurisdictional integrity of international arbitration taking place on its territory.⁶ Generally, a national court in a setting aside action does not review the merits of the dispute, and is not permitted to second-guess the arbitral tribunal's findings of fact or law. Rather, the focus is limited to confirming the procedural and jurisdictional integrity of the arbitral proceedings and that the minimum essentials of procedural fairness and natural justice have been complied with.

Redfern and Hunter offer three compelling reasons why the authority of the national courts faced with proceedings to set aside international arbitration awards ought be strictly limited in this manner. They are:

- 1 That the decisions of arbitrators specifically selected by or on behalf of the parties ought not be supplanted by the decisions of national court judges;
- 2 That a party that agreed to arbitration as a private method of resolving a dispute may find itself brought unwillingly before national courts that hold their hearings in public; and
- 3 That a lengthy appeals process may be used simply to postpone the day that payment is due, thus defeating one of the main purposes of international commercial arbitration – the speedy resolution of disputes.⁷

III SOME STATES PERMIT A GREATER RESTRICTION OF JUDICIAL REVIEW

Because the degree of judicial scrutiny involved in setting aside proceedings represents the minimum deemed essential to ensure procedural fairness and natural justice, as the New Zealand Court of Appeal held in *Methanex Motunui Ltd v Spellman*, the laws of many jurisdictions do not permit parties to "contract out" or further restrict judicial review to provide less protection than is specified in Article

6 M McIlwrath and J Savage (eds) *International Arbitration and Mediation: A Practical Guide* (Kluwer, The Netherlands, 2010) 331.

7 A Redfern, M Hunter, N Blackaby and C Partasides (eds) *Law and Practice of International Commercial Arbitration* (4th ed, Sweet & Maxwell, 2004) paras 9-36.

34 of the Model Law.⁸ But while such is the case in New Zealand, it should also be noted that other respected jurisdictions do allow parties to international arbitration to further restrict the scope of judicial review by agreement, or to preclude any setting aside procedure whatsoever.

For example, Article 1717.4 of the Belgian Code Judiciaire allows the parties to international arbitration to agree to waive all judicial review of an award at the seat "where none of the parties is an individual of Belgian nationality or residing in Belgium, or a legal person having its head office or branch there". Similarly, Section 51 of the Swedish Arbitration Act allows a waiver "where none of the parties is domiciled or has its place of business in Sweden". Switzerland, as well, at Article 192 of the Swiss Private International Law Act, allows the parties to agree to validly waive an action to set aside an award if "none of the parties have their domicile, their habitual residence, or a business establishment in Switzerland". International arbitrations set in these jurisdictions are therefore substantially "delocalised", as the parties sever one of the key links with the place of arbitration by validly removing the award from the control of the courts of such jurisdictions.⁹

IV THE SETTING ASIDE OF SUBSTANTIVELY PERVERSE OR FRAUDULENT AWARDS

It would beg credulity to suggest that a national court in set-aside proceedings would be likely to (or should) stand idly by if faced with an award where the law has been grossly misconceived and misapplied by the arbitrator and where the substantive result is perverse and grossly unfair.

Referring to the annulment or setting aside of international arbitration awards as "an unusual result" and an "exceptional occurrence", Born presents the argument favouring a limited substantive judicial review of awards, going beyond the usual grounds relative to the procedural and jurisdictional, in extreme instances of arbitrator failure.¹⁰ He writes:¹¹

Simply put, a limited measure of substantive judicial review arguably serves to safeguard the integrity of the arbitral process by permitting annulment of truly perverse

8 S Greenberg, C Kee and J Weeramantry, above n 2, 416, citing *Methanex Motunui Ltd v Spellman* [2004] 3 NZLR 454 (New Zealand Court of Appeal) paras 107-108. D Williams and A Kawharu, above n 5, citing *Downer-Hill Joint Venture v Government of Fiji* [2005] 1 NZLR 554 (HC) 61, 68, note that the rule against contracting out extends to any purported exclusion of review under institutional rules.

9 M McIlwrath and J Savage, above n 7, 331, para 6-012.

10 G Born, above n 3, 2561.

11 *Ibid* 2654.

decisions and by providing arbitrators with an enhanced incentive to do their job properly.

From this perspective, it is desirable to reserve the possibility of substantive judicial review in cases where arbitral tribunals depart entirely from the parties' agreement and the applicable law, and arrogate to their own subjective preferences the disposition of the parties' rights. Save where they have expressly waived any judicial review or agreed to arbitration *ex aequo et bono*, this is not what commercial parties bargain for and not what developed legal regimes should provide. Indeed, this is confirmed by the existence, in the form of putative 'public policy' exceptions, of limited judicial review of the merits of arbitral awards even in jurisdictions where such review is formally excluded.

In fact, even in those developed jurisdictions that recognise the widest party autonomy to exclude or restrict the scope of judicial review of awards in setting aside proceedings, and indeed, in the courts of many developed jurisdictions, the reviewing court may rely on the 'public policy' grounds of Article 34(2)(b)(ii) of the Model Law to set aside awards where arbitral tribunals depart entirely from the parties' agreement and applicable law.

In this regard, it must be noted that the national arbitration laws of New Zealand, Australia and Singapore go a step further than the Model Law by expressly authorising the setting aside of awards procured by fraud or rendered in breach of the rules of natural justice. Referring specifically to the "public policy" ground, section 34(6) of the NZ Act recites:

For the avoidance of doubt, and without limiting the generality of paragraph (2)(b)(ii), it is declared that an award is in conflict with the public policy of New Zealand if –

- a) the making of the award was induced or affected by fraud or corruption: or b) a breach of the rules of natural justice occurred –
 - i. during the arbitral proceedings; or
 - ii. in connection with the making of the award.

Section 19 of the Australian International Arbitration Act 1974, under the heading "public policy", provides:

Without limiting the generality of Articles 17I(1)(b)(ii), 34(2)(b)(ii) and 36(1)(b)(ii) of the Model Law, it is declared, for the avoidance of any doubt, that, for the purposes of those Articles, an interim measure or award is in conflict with, or is contrary to, the public policy of Australia if:

- (a) the making of the interim measure or award was induced or affected by fraud or corruption; or
- (b) a breach of the rules of natural justice occurred in connection with the making of the interim measure or award.

Section 24 of the Singapore International Arbitration Act (Chapter 143A), is similarly worded to the Australian provision, except that it expressly requires that any breach of the rules of natural justice in connection with the making of the award must be found to have prejudiced the rights of a party.

The Hong Kong Arbitration Ordinance (Cap 609) formally recites at Section 81(3): "Subject to subsection (2)(c) [an "opt-in" provision allowing limited appeals on issues of law, particularly for domestic cases], the Court does not have jurisdiction to set aside or remit an arbitral award on the ground of errors of fact or law on the face of the award".

The foregoing formal mandate of section 81(3) notwithstanding, the commentary of the Hong Kong Law Reform Commission makes clear that public policy, as used in Article 34(2)(b) of the Model Law and adopted in the Ordinance, does provide grounds for substantive review in serious cases of arbitrator error. The commentary even provides specific, and apparently non-exclusive, examples:¹²

The civil law concept of 'order publique' (translated in the English Language version of the Model law as 'public policy') covers fundamental principles of law and justice in procedural as well as substantive respects. These include corruption, bribery, fraud, and other serious cases, as well as the elements of the common law concept of natural justice. They would also include violation of Article 18 (equal treatment of parties).

One Hong Kong court has expressed in obiter that a successful challenge would require "a substantial injustice arising out of an award which is "so shocking to the Court's conscience as to render enforcement repugnant".¹³ Writing in 2011, Choong & Weeramantry noted: "there is no Hong Kong case that has yet applied the Article 34(b)(2)(b)(ii) public policy ground in an application to set aside an award".¹⁴ As of the date of this paper, this writer has found none.

As is the case generally in Model Law jurisdictions, numerous Hong Kong decisions have noted the reviewing court's residual discretion to enforce awards

12 J Choong and J Weeramantry *The Hong Kong Arbitration Ordinance: Commentary and Annotations* (Sweet & Maxwell, Hong Kong 2011) 431.

13 Ibid 431 para 81.58, citing *A v R* [2009] 3 HKLRD 389, 395 para 23.

14 Ibid 431.

despite proven existence of a valid Article 34 ground for setting aside. A court might exercise its discretion in this manner where it considers that the grounds for setting aside, even if proven, would not have resulted in sufficiently serious prejudice to the challenging party.¹⁵

V ***THE "DELICATE BALANCE" – WHEREIN LIES THE CHALLENGE***

As has been explained above, there is a forceful argument to be made to persuade even the most strident advocates of unfettered party autonomy and judicial non-interference that the courts of the seat must be permitted some avenue for the substantive review of awards, so they may set aside those very rare arbitral awards which any reviewing court would find "shocking to the conscience".

Born characterises the issue in the following terms:¹⁶

This type of very limited substantive review is best viewed as akin to a form of public policy exception: in rare instances, an arbitral tribunal's interpretation of the law (not facts) is so misconceived and in such wilful contradiction to settled statutory or judicial authority that it violates the concepts of the adjudicative process and of legal order. In these cases, and exceptionally, this notion of public policy is recognised even in states that do not permit substantive judicial review of arbitral awards in annulment actions. This possibility of limited, exceptional judicial review of substantive decisions by the arbitrators is at once both a necessary evil and an important bulwark against arbitrary abuses of arbitral authority.

But the difficulty lies in ensuring that "the exception does not swallow up the rule" to allow setting aside proceedings to wallow in the appellate system, beyond the purview of the Competent Authority designated by each Model Law state under Article 6 to perform the review function.

Born highlights the need for appellate courts to observe "careful limits", opining:¹⁷

National courts are subject to almost inevitable temptations to extend the scope of their review (in a counterpoint to adages about absolute power, 'partial power inspires thirst

15 See eg *Shanghai Fusheng Soya-Food Co Ltd & Another v Pulmuone Holdings Co Ltd* Hong Kong Court of First Instance, HCCT 48/2012, Hon Mimmie Chan J 25 April 2014.

16 Born, above n 3, 2654-2655.

17 Ibid 2654. See also, D Williams and A Kawharu, above n 5, 470, who observe: "In some instances the discretion has been approached rather too liberally, in that the court has effectively engaged in a merits review of the award", citing *Asian Foods West City Ltd v West City Shopping Centre Ltd* HC Auckland CIV-2007-404-1215, 11 September 2007 at 18, 31.

for more power'), and to be anxious to correct perceived errors even when not manifest. Nevertheless, where appellate courts maintain careful limits on the scope of any review of the merits of legal conclusions, the mere existence of this possibility helps reduce the risk of arbitrary, unfair, incompetent, or biased arbitral decisions.

VI A CONSTITUTIONAL CHALLENGE IN HONG KONG

The particular "balance" between international commercial arbitration and the control of the national courts adopted by Hong Kong was recently scrutinised and clarified by the Court of Appeal in *China International Fund Ltd v Dennis Lau & Ng Chun Man Architects & Engineers (HK) Ltd v Secretary for Justice* (12/08/2015, HCMP 2472/2014). In that case, the Court of Appeal considered a constitutional challenge to section 81(4) of Hong Kong's Arbitration Ordinance (Cap 609). Section 81(4) (the "Non-Appeal Provision") prohibits an application to the Court of Appeal for leave to appeal following an unsuccessful action to set aside an arbitral award. That is, except and unless leave to appeal is granted by the Court of First Instance, ie the same judge who refused to set aside the arbitral award, a losing party in setting aside proceedings will have no appeal to a higher court. The issue for determination in the case was whether it is constitutionally permissible to exclude the Court of Appeal from deciding whether the losing party may appeal a decision of the Court of First Instance refusing to set aside an arbitration award.

The Court of Appeal's decision and reasoning makes interesting and worthwhile reading.

The relevant facts of the case are straightforward. The applicant, the unsuccessful party in the arbitration, was ordered to pay US\$7.5 million. The applicant applied to the Court of First Instance, before specialist Commercial and Arbitration List Justice Louis Chan, to set aside the arbitration award. Justice Chan refused to set aside the award and further denied leave to the applicant to appeal to the Court of Appeal. In view of section 81(4) of the Arbitration Ordinance (Cap 609), the case ought to have ended there, the applicant having had one opportunity to argue its case before the arbitral tribunal and a second opportunity before the specialist list judge, Justice Chan.

Here is where it gets interesting. The applicant nonetheless filed a leave application in the Court of Appeal, urging the Court to strike down the section 81(4) Non-Appeal Provision in the Arbitration Ordinance as unconstitutional. The applicant relied on Article 82 of the Basic Law, which is the constitutional document of the Hong Kong Special Administrative Region (HKSAR) of the People's Republic

of China. Article 82 of the Basic Law provides that "the power of final adjudication of the Hong Kong Special Administrative Region shall be vested in the Court of Final Appeal of the Region".¹⁸

To paraphrase the saying, "it ain't over until the fat lady sings", the applicant's constitutional argument was that, in view of Article 82 of the Basic Law, the setting aside case cannot have been finally decided until the Court of Final Appeal was afforded the last word as to whether it would allow a further appeal to that Court. Given the constitutional implications of the case, Hong Kong's Secretary of Justice was invited to, and did, intervene. The Court of Appeal decided, unusually, that the leave application would be determined on a final basis, rather than the Court merely considering whether the constitutional challenge was "reasonably arguable", and that the issue would be decided by the full Court.

The parties stipulated that the Non-Appeal Provision did in fact breach Article 82 of the Basic Law because the Court of Final Appeal, Hong Kong's highest court, cannot adjudicate on the applicant's application for permission to appeal the refusal to set aside decision.

The Court of Appeal framed the issue before it as to whether this acknowledged breach of Article 82 of the Basic Law by the Arbitration Ordinance's Non-Appeal Provision, was nonetheless constitutional because it satisfied the three-part "proportionality test", where:

- 1 The restriction must pursue a legitimate aim;
- 2 The restriction must be rationally connected to the legitimate aim; and
- 3 The restriction is no more than necessary to achieve the legitimate aim.

Helpfully, the parties before the Court of Appeal were in further agreement that the objective of the section 81(4) Non-Appeal Provision pursued a legitimate aim, to wit, "the fair and speedy resolution of disputes by arbitration without unnecessary expense" enshrined in section 3 of Hong Kong's Arbitration Ordinance, and that the Non-Appeal Provision was rationally connected to this legitimate aim.

What the parties could not agree on, and the issue remaining for the Court of Appeal to decide, was the third leg of the proportionality test – whether the Non-Appeal Provision was no more than what was necessary to achieve this legitimate aim? As a preliminary observation, the Court of Appeal noted that Article 82, giving the Court of Final Appeal the last word, is a provision relevant to all levels of court

18 Within the Hong Kong court hierarchy, the Court of Final Appeal sits one level above the Court of Appeal.

or statutory tribunals in terms of the appellate process. That is, to follow the Court's logic, if a party is prohibited from seeking leave to appeal to any intermediate level court, such party will necessarily have been barred, in turn, from appealing its case to the Court of Final Appeal.

In deciding the challenge, the Court of Appeal noted that Hong Kong's Arbitration Ordinance, much like New Zealand's Arbitration Act 1996, gives due regard to party autonomy by providing a choice to disputing parties in the form of an alternative Schedule 2 scheme allowing for a greater degree of judicial involvement and review over arbitral proceedings.

The Court of Appeal observed that the effect of the Non-Appeal Provision is that the specialist arbitration judge sitting as the Court of First Instance, after first determining a set aside application, would then also have the final say as to whether an application for leave to appeal has a "reasonable prospect for success". The Court of First Instance becomes "the gatekeeper", who decides whether an applicant will be granted leave to appeal to the Court of Appeal.

Holding that the Non-Appeal Provision satisfied the third leg of the proportionality test, and was no more than necessary to achieve the legitimate aim of the Arbitration Ordinance, notwithstanding that the Court of First Instance served in a dual role as decision-maker and "gatekeeper", the Court of Appeal observed:

- 1 That judges are commonly called upon to decide whether to allow a losing party to appeal against their own decisions;
- 2 That there was no allegation in the case that specialist arbitration judge, Louis Chan, was not independent. If there were such allegations, then in such a rare case, the Court of Appeal could exercise a residual jurisdiction to intercede;
- 3 That setting aside proceedings are assigned to specialist Construction and Arbitration List judges. Such judges are best placed to decide whether an appeal would have a reasonable prospect of success; and
- 4 Decisions are then delivered with speed and expedition, which are key objectives of arbitration. The Parties in the case had not opted to avail themselves of the Schedule 2 regime. Their choice should be respected.

VII CONCLUSION

Parties opting for international arbitration under Model Law regimes must accept a risk that the proceedings may on occasion go egregiously wrong on the facts or on the law and that judicial review will be limited, generally, to the exclusive procedural and jurisdictional grounds of Article 34(2) of the Model Law. It is entirely

appropriate, moreover, that judicial review be limited, generally, to a single level of review in setting aside proceedings. This is because unless "careful limits" are observed by the appellate courts, to avoid interfering unless an award is manifestly arbitrary, unfair, incompetent, or biased, successful parties in arbitration will lose interest as they endure round after round of costly and time-consuming court appeals before enjoying the fruits of a hard-won victory.¹⁹

19 See, eg A Chin "International Arbitration in Hong Kong: You Only Get One Bite at the Cherry" *Global Arbitration News* <<http://globalarbitrationnews.com/international-arbitration-hong-kong-get-one-bite-cherry>> last accessed 6 February 2016.

