Blowing hot and cold on the International Arbitration Act

Three waves of litigation in the Castel v TCL Air Conditioner dispute

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Despite a failed application to the High Court challenging the Federal Court's jurisdiction to enforce arbitral awards, the TCL Air Conditioner dispute continues to have ramifications for Australia's arbitration system.

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Two recent judgments by Murphy J in the Federal Court of Australia (currently on appeal to the full court), related to a cross-border distributorship arbitration, have practical implications for Australian companies involved in international commerce, legal advisers and law reformers. The dispute underlying *Castel Electronics Pty Ltd v TCL Air Conditioner (Zhongshan) Company Ltd* [2012] FCA 21 and *Castel Electronics Pty Ltd v TCL Air Conditioner (Zhongshan) Co Ltd (No. 2)* [2012] FCA 1214 has also generated a failed constitutional challenge to the *International Arbitration Act 1974* (Cth) (IAA).[1]

Background

On 6 July 2010, the *International Arbitration Amendment Act 2010* (Cth) introduced the first major amendments to the IAA since 1989, when the IAA adopted the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration (Model Law) as the core arbitral law for international arbitrations seated in Australia.[2] A major aim of the amending Act was to promote Australia as a hub for cross-border dispute resolution in the Asia-Pacific region, given the burgeoning international arbitration caseloads in Singapore and Hong Kong.[3]

In 2010, Keane J (the then Chief Justice of the Federal Court) commented extracurially that there was a shift in Australian courts, in conjunction with reforms underway to arbitration legislation at both federal and state or territory levels, towards greater judicial support and less judicial intervention in the arbitral process.[4] The awaited decisions in the cross-

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International arbitration

- **It is uncertain whether the IAA's new s.21 applies retrospectively to pre-6 July 2010 international arbitration agreements.**
- **If not, there is a legislative 'black hole' for some categories of international arbitrations seated in Australia.**
- **An international arbitration award may be set aside, or its enforcement refused, if a breach of natural justice occurred in connection with the making of the award.**
- **This includes breaches of the "no evidence" or "no hearing" rule for the arbitral tribunal's findings of fact.**

border contractual dispute will help establish whether or not this observation can be maintained. They will also provide an important signal to arbitration users in the Asia-Pacific region as to whether Australia is an 'arbitration-friendly' jurisdiction.

The dispute involved an Australian distributor (Castel) and a Chinese manufacturer (TCL), which had entered into an exclusive distribution agreement for TCL's air-conditioners, governed by Victorian law and providing for arbitration in Victoria. Castel alleged a breach due to TCL selling them in Australia other than under the TCL brand name (that is, as original equipment manufacturer, or OEM, products).

Castel commenced arbitration in July 2008. On 23 December 2010, an arbitral tribunal issued a detailed award for $2.8 million in damages plus costs (assessed at $732,500 in a further award of 27 January 2011) in favour of Castel. It then sought to enforce these awards in the Federal Court of Australia under Chapter VIII of the Model Law, given the force of law in Australia by s.16 of the IAA.

A legislative 'black hole'

In a first judgment,[5] Murphy J ruled against TCL's argument that the Federal Court lacked jurisdiction to enforce an international arbitration award made in Australia (labelled a "non-foreign award").[6] The IAA had not expressly listed the Federal Court as having jurisdiction to enforce such an award under Chapter VIII (Articles 35-36) of the Model Law. Nevertheless, Murphy J interpreted the *Judiciary Act 1903* (Cth) to be applicable, thus conferring jurisdiction on the Federal Court.[7]

His Honour, in obiter dicta, suggested that the new s.21 of the IAA introduced as part of the amendments in 2010 was designed to ensure that all international arbitrations with their seat in Australia would be exclusively governed by the Model Law and, further, was intended to have retrospective effect. This meant that it would apply to international arbitration agreements concluded before 6 July 2010 where the parties had (expressly or impliedly) excluded the Model Law, as permitted by the old s.21, in force prior to the 2010 amendments.

The Court of Appeal of Western Australia did not approve this dicta.[8] To the contrary, it opined, also in obiter, that the new s.21 was intended to have prospective effect – a view that accords with earlier arguments by one of the present authors.[9]

If the new s.21 does not have retrospective effect, however, practitioners should be aware that a legislative 'black hole' results. That is, no comprehensive statutory support[10] exists for:

☐ an international arbitration agreement (say, between Australian and Chinese parties);
☐ concluded before 6 July 2010;
☐ where the parties have excluded the operation of the Model Law (most usually by selecting a state or territory *Commercial Arbitration Act* (CAA) as the arbitral law); and
☐ they have agreed that the seat of the arbitration is an Australian state or territory that has repealed its old CAA (which would have otherwise extended to such an international arbitration agreement) and replaced it with a new CAA (expressed only to apply to domestic arbitration agreements).[11]

There is a risk that some parties facing claims under contracts containing such international arbitration agreements may seek to take advantage of this black hole to avoid arbitration in favour of litigation or a favourable negotiated settlement.

Legislative reform to fix this problem is clearly desirable. There are two possible courses of action:

1. Amend the IAA to clarify that the new s.21 is not intended to have retrospective effect (so the parties' agreement prior to its commencement, if any, to exclude the Model Law remains effective); and
☐ amend the new CAA legislation by:
– reinstating the old CAA provisions for this category of international arbitration agreements; or
– adding that the new CAA provisions (based on the Model Law provisions) cover such agreements.[12]
2. Amend the IAA to clarify that the new s.21 is instead intended to have retrospective effect.[13] This is simpler to implement because the new CAA statutes then do not require further amendment. On the other hand, this pragmatic option is less attractive to those who generally dislike legislation having retrospective effect.

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Contesting awards as contrary to natural justice

Having found that the Federal Court had jurisdiction, Murphy J entertained TCL's application to set aside the awards due to violation of public policy under Article 34 of the Model Law, and Castel's separate application to enforce the awards. In a second judgment,[14] Murphy J dismissed TCL's application to set aside the awards and granted Castel's enforcement application.

TCL's key contention concerned the tribunal's assessment of Castel's loss arising from TCL's sale of OEM products in Australia. Castel's expert witness A adopted a substitution ratio of 1:1 (or 100 per cent) between TCL branded products and OEM products. The tribunal found that A lacked sufficient expertise and therefore rejected his opinion on substitutability. TCL relied on an expert witness B who opined that Castel could have expected to pick up a maximum of about 7.4 per cent of the sales of OEM products as extra sales of TCL branded products. However, B conceded that he relied on incomplete data. The tribunal found (and the court accepted) that B's estimate of the degree of substitutability was not reliable. Having regard to other lay evidence (not considered by B, and which contradicted some of the assumptions made by him), the tribunal concluded that Castel's lost sales were 22.5 per cent of sales of the OEM products in Australia, and assessed damages accordingly.

While it appeared to be common ground between the parties before the tribunal that the assessment of Castel's lost sales was not amenable to precise calculation, TCL contended that upon rejecting A's expert evidence, the tribunal was bound to accept B's evidence. TCL objected that the tribunal instead plucked

the 22.5 per cent figure "from the air".[15] TCL contended that two rules of natural justice (and public policy) were thereby violated when making the award:

- a breach of the no evidence rule, that is, no evidence supported the factual findings made by the arbitral tribunal in connection with the assessment of Castel's loss;[16] and
- a breach of the hearing rule, that is, TCL was not afforded a reasonable opportunity to address the relevant findings made by the tribunal, allegedly not based directly on evidence or arguments put before it.[17]

Public policy

Murphy J first considered the general principles relating to the concept of public policy in the IAA, holding:

- Where enforcement of an award is sought before a court at the arbitral seat, public policy has a similar meaning in relation to both an application to set aside the award and one to enforce the award.[18]
- The plain words of s.19(b) of the IAA[19] are that "any" breach of natural justice[20] will render an award in conflict with, or contrary to, the public policy of Australia for the purposes of Articles 34 and 36 of the Model Law.[21] However, Murphy J noted that:[22]

– it is difficult to see how a minor breach of the rules of natural justice should operate to render an award in breach of public policy;

– such an approach is arguably not consistent with the interpretative requirements laid down in s.39(2) of the IAA; and

– such an approach is not consistent with the IAA's pro-enforcement bias.

- The court will only exercise its discretion sparingly to set aside, or refuse enforcement of, an award, and only where it is satisfied that fundamental notions of fairness or justice have been offended.[23]
- The court should adopt a (detailed) review sufficient to determine whether there had been a relevant breach of the rules of natural justice.[24] Murphy J rejected TCL's argument for a broad review, examining the facts afresh and revisiting in full the questions before the tribunal. Castel had advocated only a limited review. Murphy J accepted that a balance needed to be struck.[25]

No evidence rule

The court proceeded on the basis that breach of the no evidence rule violated the rules of natural justice, but acknowledged that TCL faced a significant hurdle in proving such a breach.[26] Murphy J rejected this contention and concluded that the tribunal had acted on rationally probative evidence in arriving at the figure of 22.5 per cent. He held that the tribunal was entitled to have regard to the fact that TCL's expert based his opinion on incomplete data, and had not taken into account certain lay evidence which pointed to a figure higher than 7.4 per cent.[27]

Hearing rule

Regarding the hearing rule, Murphy J noted that numerous judgments have applied it in the context of arbitral hearings.[28] He accepted that the overriding objective was to avoid surprise. Thus, an arbitrator is not entitled to decide a matter by taking into account evidence or arguments extraneous to the hearing without giving the parties notice and an opportunity to respond. This includes basing a decision on the arbitrator's own opinions and ideas, if they are not reasonably foreseeable as potential corollaries of the opinions and ideas traversed during the hearing.

" ... [the] no evidence rule ... should not be used as a platform for backdoor attempts to review arbitrators' factual findings."

Murphy J concluded that a reasonable litigant in TCL's shoes would have understood the possibility of the reasoning of the type that led to the tribunal's findings – in particular, rejecting TCL's substitution rate of 7.4 per cent and adopting a higher substitution rate.[29]

Accordingly, the court rejected TCL's claim that there had been a breach of the rules of natural justice in connection to the making of the award. In any event, Murphy J noted that any breach of the rules of natural justice that might be found was minor, and certainly not one that could be described as offending fundamental notions of fairness or justice. He therefore was not persuaded that a case had been made out for the exercise of his discretion to set aside the award, even if a breach of the rules of natural justice had been established.[30]

Enforcing the award

Turning to Castel's application for enforcement, the court noted that under Article 35 of the Model Law, Castel needed only to produce the original (or copy) of the award to a competent court and that it had done so. As the court had rejected TCL's arguments that there had

ENDNOTES

1. *TCL Air Conditioner (ZhongShan) Co Ltd v The Judges of the Federal Court of Australia & Anor* [2013] HCA 5.
2. See generally A. Monichino, L. Nottage and D. Hu, "International arbitration in Australia: Selected case notes and trends" (2013) 19 *Australian Journal of International Law* (forthcoming), manuscript also at *ssrn.com/abstract=2133763*.
3. L. Nottage and R. Garnett, "Introduction" in L. Nottage and R. Garnett (eds), *International Arbitration in Australia*, 2010, Federation Press, p.1.
4. P.A. Keane, "Judicial support for arbitration in Australia" (2010) 4 *Australian Bar Review* 1, 2.
5. *Castel Electronics Pty Ltd v TCL Air Conditioner (Zhongshan) Company Ltd* [2012] FCA 21 (23 January 2012).
6. This is to be contrasted with a foreign award (an award made outside of Australia in an international arbitration) and a domestic award (an award made in Australia in a domestic arbitration).
7. For a further summary of the judgment and reasoning, see A. Monichino and A. Fawke, "International arbitration in Australia: 2011/2012 in review" (2012) 23 *Australian Dispute Resolution Journal* 234.
8. *Rizhao Steel Holding Group Co Ltd v Koolan Iron Ore Pty Ltd* (2012) 262 FLR 1.
9. Nottage and Garnett, above n.3, p.27-28; R. Garnett and L. Nottage, "The 2010 amendments to the International Arbitration Act: A new dawn for Australia?" (2011) 7 *Asian International Arbitration Journal* 29.
10. For example, for a court to issue a subpoena (to give evidence or to produce documents in aid of an arbitration), to hear challenges to arbitrators, or to set aside or enforce an arbitral award.
11. The old uniform CAA legislation is being repealed and replaced with new *Commercial Arbitration Acts*, based on the Model Law since October 2010. See for example *Commercial Arbitration Act 2010* (NSW), *Commercial Arbitration (National Uniform Legislation) Act 2011* (NT), *Commercial Arbitration Act 2011* (SA), *Commercial Arbitration Act 2011* (Vic) and *Commercial Arbitration Act 2013* (Qld).
12. R. Garnett and L. Nottage, "What Law (If Any) Applies to International Arbitration in Australia?" (2012) 35(3) *UNSW Law Journal* 955, also at *ssrn.com/abstract=2063271*.
13. A. Monichino, "The temporal operation of the new section 21 – Beware of the black hole" *ACICA News*, December 2012, 25-32. See *tinyurl.com/ao6u5p3*.
14. *Castel Electronics Pty Ltd v TCL Air Conditioner (Zhongshan) Co Ltd (No. 2)* [2012] FCA 1214 (2 November 2012).
15. Ibid at [135].
16. Ibid at [103].
17. Ibid at [157].
18. Ibid at [123].
19. Similar to s.8(7)(a) of the IAA, which applies to the enforcement of foreign awards in Australia.
20. See IAA, s.19(b), which defines public policy under Articles 34 and 36 of the Model Law to include a breach of the rules of natural justice occurring in connection with the making of an award.
21. *Castel v TCL (No. 2)* at [29].
22. Ibid at [30].
23. Ibid at [34].
24. Ibid at [60].
25. Ibid at [53].
26. Ibid at [104].
27. In particular, there was evidence that the Castel dealership network was being directly targeted by those for whom TCL had manufactured OEM products, such that the impact of the sale of OEM products in Australia fell disproportionately on Castel (as opposed to other sellers).
28. *Castel v TCL (No. 2)* at [159].
29. Ibid at [175]-[176].

been a breach of the no evidence rule or the hearing rule, it held that there was no compelling reason why the award should not be enforced.[31]

In our view, this second judgment in the Castel dispute is generally positive. However, it is regrettable that the court did not display a more 'hands off' approach but instead was drawn into a detailed review of the arbitral tribunal's findings of fact. Murphy J himself expressed some concerns that his review may have been overextensive, paying "insufficient respect to the Tribunal's findings and too little regard to the principles of certainty and finality of awards".[32]

Further, it is questionable whether a no evidence rule forms part of the rules of natural justice as recognised by Australian law.[33] Certainly, the supposed rule should not be used as a platform for backdoor attempts to review arbitrators' factual findings.

There is also serious doubt about the suggestion that s.19(b) of the IAA might be interpreted as allowing any breach of the rules of natural justice to violate public policy. In contrast, it has been held in New Zealand that only a serious breach of the rules of natural justice may render an award contrary to the public policy of New Zealand for the purposes of the similarly-worded Arbitration Act 1996 (NZ).[34]

Despite such concerns, we are inclined to the view that the second *Castel v TCL* judgment does not undermine Australia's attractiveness as a credible seat for international arbitration. More worrying in practice is that other Australian courts may embark on an expansive interpretation of the public policy exception to enforcing foreign arbitral awards, under s.8 of the IAA.[35] This possibility is enhanced if other courts follow Murphy J's view that public policy has similar contours whether enforcing awards from international arbitrations with their seat in Australia or abroad.[36] However, that view may be contestable,[37] and other recent court judgments in Australia have tended to take a narrow interpretation of public policy when enforcing foreign awards.[38]

Unfortunately, there is very little that Australian lawyers can do to minimise the risks of expansive court interpretations of the public policy exception to the enforcement of international arbitration awards. Perhaps it is time for the legislator to consider further amendment to the IAA, by reformulating the s.19(b) natural justice gloss on the public policy exception. It might even be removed, given that the concept of natural justice derives from the English common law tradition, and its addition has not been found necessary in many other Model Law jurisdictions that instead follow the civil law or other major legal traditions.

Conclusion

The two judgments in the *Castel v TCL* dispute reached results that might be seen to support international arbitration in Australia. The reasoning is not always convincing, however, and both remain subject to appeal. The constitutional challenge has further added to the delays and costs already incurred in resolving the underlying contractual dispute,[39] and the challenge itself was not helpful in promoting Australia as an arbitration-friendly jurisdiction.[40]

A common global standard for the enforcement of international arbitration awards is an essential feature of an effective international arbitration system. As Keane J has noted, international traders (and their advisers) have great freedom to choose their dispute resolution arrangements.[41] They expect high-quality, but minimal, judicial intervention in arbitration. If a jurisdiction does not offer this, they vote with their feet. □

30. Ibid at [178].
31. Ibid at [185]-[186]. Murphy J reiterated at [187] that any breach of the rules of natural justice was a minor one that did not justify the exercise of his discretion to resist enforcement.
32. Ibid at [61].
33. See for example, *Gas & Fuel Corporation of Victoria v Wood Hall Ltd & Leonard Pipeline Contractors Ltd* [1978] VR 385, where Marks J said (at 399) that a finding of fact in the absence of logically probative evidence does not of itself amount to a breach of the rules of natural justice, unless in addition it can be said that the error of fact was capable of arousing a reasonable suspicion in the mind of a fair-minded observer that the arbitrator did not proceed with the task with a fair and unprejudiced mind. This is a higher hurdle than insisting that an arbitrator's decision is supported by logically probative evidence.
34. *Amaltal Corporation Ltd v Maruha (NZ) Corporation Ltd* [2004] NZLR 614 at [47]. Articles 34(6)(b) and 36(3)(b) of Schedule 1 to the New Zealand statute declare that an award is contrary to public policy if a breach of the rules of natural justice occurred (i) during the arbitral proceedings, or (ii) in connection with the making of the award. See generally D. Kawharu and A. Williams (eds) *Williams & Kawharu on Arbitration*, 2011, LexisNexis, Wellington, pp.468, 487-93, 497-502.
35. A significant number of judgments deal with such applications for enforcement see Figure 1 in Monichino, Nottage and Hu, above n.2.
36. *Castel v TCL (No. 2)* at [123].
37. For example, it could be argued that an Australian court considering an application to set aside a 'non-foreign award' for public policy, for an arbitration with the seat in Australia, should be more cautious given the difficulties that the award creditor will face when seeking to enforce such an annulled award world-wide. By contrast, an Australian court considering not enforcing a foreign award need only consider the impact of non-enforcement in its own jurisdiction.
38. See for example, *Uganda Telecom Pty Ltd v Hi-Tech Telecom* (2011) 277 ALR 415; *Traxys Europe SA v Balaji Coke Industry Pvt Ltd (No. 2)* (2012) 201 FCR 535. An exception seems to be *Dampskibsselskabet Norden A/S v Beach Building & Civil Group Pty Ltd* (2012) 292 ALR 161, if Foster J's ground for refusing enforcement was indeed public policy. However, the impediment to non-enforcement derived from separate legislation: s.11 of the *Carriage of Goods by Sea Act 1991* (Cth). See further Monichino, Nottage and Hu, above n.2.
39. The arbitration was commenced over four-and-a-half years ago and the award on the merits was rendered over two years ago. The dispute has also given rise to other proceedings: see *TCL Airconditioner (Zhongshan) Co Ltd v Castel Electronics Pty Ltd* [2009] VSC 553 (8 December 2009) and *Castel Electronics Pty Ltd v TCL Airconditioner (Zhongshan) Co Ltd* [2013] VSC 92 (7 March 2013) relating to, respectively, the arbitrators' scope of jurisdiction and service out of Australia of court proceedings relating to a separate claim which, according to the earlier judgment, was beyond the scope of the arbitration agreement.
40. "High Court stoush puts arbitration standing at risk", *The Australian Financial Review*, 16 November 2012, 31.
41. P.A. Keane, *The Prospects for International Arbitration in Australia: Meeting the Challenge of Regional Forum Competition or Our House Our Rules*. Paper presented at AMTAC Annual Address (Brisbane, 25 September 2012), viewed 1 March 2013, see *tinyurl.com/a6zso3e*, at pp.16-17. □