Case Note

Sugar Australia Pty Limited v Mackay Sugar Ltd

Khory McCormick[1] and I-Ching Tseng[2]

Introduction

Under the *Commercial Arbitration Act 1990 (Qld)* (the **Act**), courts may set aside an award where the arbitrator has misconducted the proceedings under section 42.

In this case, the Supreme Court of Queensland (McMurdo J) was asked to determine whether the failure by the arbitrator to provide the applicant with an opportunity to address a point not raised by the parties in their Points of Contention to the arbitrator (which defined the dispute between the parties) amounted to misconduct.

The Applicant (**Sugar Australia**) was successful in having the award set aside.

Facts

Sugar Australia is the manager of a joint venture which operates a refinery at Racecourse in Mackay. The Respondent Mackay Sugar is a Participant in the joint venture and holds a 25% interest in the joint venture. Sugar Australia owns and operates the sugar mill adjacent to the refinery. The mill supplies raw sugar required by the refinery.

The joint venture is currently governed by an agreement dated 20 April 2006 (the "**JVA**") made prior to the deregulation of the scheme for the compulsory acquisition of raw sugar which had existed under the Act. The JVA anticipated and provided inter alia for the supply of raw sugar after deregulation.

> "2.8 Sugar Acquisition – Following Deregulation
>
> *In the event that the compulsory acquisition of raw sugar under the* Sugar Industry Act 1991 (Qld) *or other similar legislation in other states or territories of Australia or any Act in substitution or any similar Act in any other state or territory is abolished in whole or in part or is altered in such a way as to enable Mackay or CSR to sell either all or part of its raw sugar produced in Queensland directly to the Manager ("Abolition") then the provision of Schedule 2 shall apply."*

1 Khory McCormick is a Partner and Associate at Minter Ellison's Commercial Advisory and Dispute Resolution Group. He had carriage of the matter on behalf of Sugar Australia Pty Limited.

2 I-Ching Tseng is an associate at Minter Ellison's Commercial Advisory and Dispute Resolution Group.

The relevant parts of Schedule 2 to the JVA state:

> *"Schedule 2*
>
> *RAW SUGAR PURCHASE ARRANGEMENTS FOLLOWING ABOLITION*
>
> *This schedule sets out the principles under which the Participants of the Joint Venture will purchase their raw sugar requirements, for the Racecourse Refinery ("Requirements") in the event of Abolition. "Abolition" has the meaning given in clause 2.8.*
>
> *…*
>
> *Subject to production limitations, Mackay will sell to the Manager sufficient raw sugar to meet the Requirements using its best endeavours to meet the quality parameters of the Manager. Mackay will at all time give preference of supply to the Participants…"*

Following deregulation, Mackay Sugar and Sugar Australia entered into a "Sale Contract" dated 1 June 2007 for a term of three years. Clause 2 of the Sale Contract provided:

> *"2. QUANTITY*
>
> *Mackay Sugar will supply sufficient raw sugar to meet the raw sugar melt requirements for Sugar Australia's Racecourse Refinery* ***provided that it is no more than Mackay Sugar's total annual raw sugar production."*** (emphasis added)

Usually the raw sugar produced by the mill has been substantially in excess of the requirements of the refinery and the mill sells some of its production elsewhere. However, Mackay Sugar's raw sugar production during the 2010 crushing season was lower than usual. While Sugar Australia's requirements could still have been met had Mackay Sugar set aside the quantity Sugar Australia was predicted to require, earlier in the season, Mackay Sugar sold much of its productions to another buyer. By April/May 2011, Mackay Sugar ran out of reserves to supply the requirements of the refinery.

Sugar Australia claimed that the failure to supply its requirements was a breach of contract for which it should be compensated. The parties submitted the dispute to arbitration.

The Arguments Put To the Arbitrator

Each party accepted there was an obligation upon Mackay Sugar to supply the amount of raw sugar required by the refinery, although the obligation was subject to some express proviso or limitation concerning the extent of the mill's production. The parties, however, differed on the nature of the obligation.

Mackay Sugar contended that after the expiry of the Sale Contract on 30 June 2010, ongoing raw sugar supply is being made in accordance with its obligations under Schedule 2. It argued its inability to supply the refinery in 2011 was due to "production limitations" as a result of bad weather and poor harvest. It also argued that Sugar Australia had failed to mitigate its alleged losses.

Sugar Australia argued that the relevant contract was the Sale Contract, which had continued in force firstly by written agreement for an extension of three months at a meeting on 4 June 2010, and then by conduct.

The applicant claimed that each of these extensions involved the inclusion of cl 2 of the Sale Contract in its entirety.

The award

While the arbitrator accepted that a supply agreement existed between the parties for three months commencing 1 July 2010 based on the minutes of the 4 June 2010 meeting, he questioned whether objectively the parties intended to import clause 2 of the Sale Contract. The arbitrator focussed on the reference by clause 2 to "total annual production" and had difficulty applying this proviso in the context of an agreement expressed to operate for three months. The arbitrator therefore decided that the agreement made for the three months to September 2010 had not included clause 2. The arbitrator further found that the parties had made a further agreement with indefinite duration upon the same terms as the supply from 1 July 2010. Accordingly, clause 2 was not a term of the further agreement which operated after September.

The arbitrator held that as the Applicant had not established that clause 2 applied to the agreement which operated at the relevant time, no breach of contract was established.

A consequence of the arbitrator's reasoning was, after the expiry of the three year contract in June 2010, there was no contract which contained any term which obliged the Respondent, conditionally or otherwise, to supply any raw sugar to the Applicant. That was not a position asserted by the Respondent in any of its submissions or contentions. It in fact accepted that it was subject to such an obligation (subject to the proviso in Schedule 2 of the JVA). The relationship between the parties as determined by the arbitrator was markedly different from that contended by the parties.

The Proceedings Before the Court

Two proceedings were brought. One for the setting aside of the award pursuant to s. 42 of the Act. The other for leave to appeal under s. 38.

The principal argument was that the arbitrator has misconducted the proceedings by failing to provide Sugar Australia with an opportunity to address a point which was a critical element in his reasoning, as this was not a point which had been raised by the parties or which the Applicant should have anticipated.

Sugar Australia also asserted that this point involved an error of law manifest on the face of the award. If the challenge under s. 42 fails, the Court should grant leave to appeal on account of that error of law.

The Court set aside the award and therefore considered there was no need to address the s. 38 application.

The Court's Reasoning

McMurdo J found that a party is entitled to know the case put against it and to be given an opportunity of replying to that case. Similarly, a party is entitled to know of a point which, although not raised by its

opponent, is considered by the arbitrator to be adverse to its case.

The Court found the main issue is whether a party is deprived unfairly of an opportunity to put its case, by argument and evidence, against the reasoning by which the arbitrator rejects its claim. In circumstances such as those before the Court, the test is whether the Applicant should reasonably have anticipated that the arbitrator might determine the dispute by the reasoning he/she ultimately applied.

The issue of whether a term, in the words of clause 2, could sensibly operate within a contract for less than a period of a year, was not raised in either party's contentions. While Sugar Australia had indicated how the proviso within clause 2 might have operated within a contract existing in April/May 2011 (i.e. "Sugar Australia's requirements was no more than MSL's total raw sugar production for the 2010 season"), Mackay Sugar did not challenge the operation of the proviso. There was therefore no need for Sugar Australia to address the issue further before the arbitrator.

The Court concluded that Sugar Australia should not reasonably have apprehended that the arbitrator would dismiss its claim by adopting a view of clause 2, which had not been argued for without providing the parties with an opportunity to make submissions on the point. Consequently, there was "misconduct" within s. 42 by reason of a failure to provide natural justice.

The Court also addressed the effect of an order setting aside an award, specifically whether the arbitrator would be *functus officio*. While citing Murphy J's note in *Alvaro v Temple*[3] that opposing views exist in England that "an order setting aside the award not only voids the award, but also desseizes the arbitrator of the reference", his Honour preferred McPherson J's view in *Re Scibilia and Lejo Holdings Pty Ltd*[4] that the effect of the order setting aside the award is that the arbitration reverts to the position in which it stood immediately before the arbitrator published his award, the arbitrator is not functus officio and is entitled to reconsider the award. McMurdo J noted this does not mean that the arbitrator has to revisit findings or conclusions which are unaffected upon which submissions should have been sought.

Discussion

This case confirms two important issues:

Firstly, failure to inform the parties of the line of the arbitrator's reasoning which the party could not have reasonably anticipated deprives the parties of the opportunity to present their case. Under the Act, this amounts to procedural misconduct which constitutes grounds for setting aside an arbitral award. This allows courts broad discretionary power to review arbitral awards.

Under the Model Law based *Commercial Arbitration Bill 2011 (Qld)* (**Commercial Arbitration Bill**) currently being reviewed by the Queensland parliament, the scope of review by courts in considering a setting aside application is specifically limited to where:

3 [2009] WASC 205

4 [1985] 1 Qd R 94 at 102.

(a) a party to the arbitration agreement was under some incapacity, or the arbitration agreement is not valid;

(b) a party was not given proper notice of the appointment of an arbitral tribunal or the arbitral proceedings or the party was not able to present its case;

(c) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration;

(d) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or the Act; or

(e) the subject matter of the dispute is not capable of settlement by arbitration or the award is in conflict with the public policy of the State (i.e. Queensland).

The Commercial Arbitration Bill takes a pro-arbitration approach, and the discretionary power of the courts will be substantially reduced.

In February 2012 the Queensland Legal Affairs, Police, Corrective Services and Emergency Services Committee of the Queensland Parliament recommended the Bill be passed. It will be interesting to see whether Queensland courts consider any scope exists in the future for them to address circumstances such as those that occurred in the case under discussion.

Secondly, this decision confirms that the setting aside of an award in Australia will not render the arbitrator *functus officio*, and the arbitration reverts to the position in which it stood immediately before the arbitrator published his award.

[The views expressed are solely those of the authors.]