Developments in arbitration

Class action arbitration: *Stolt-Nielsen, S.A. v. AnimalFeeds International Corp.*

Introduction

On 27 April 2010, in a 5-3 decision, the Supreme Court of the United States emphatically rejected the availability of class action arbitration where the governing arbitration clause is silent on the availability of class action arbitration. The court based its decision on the fundamental tenet that arbitration derives its authority from the consent of the parties. It vacated an arbitral award by a panel of leaders in the international dispute resolution bar that had interpreted such a contract to permit class arbitration, concluding that the arbitral tribunal had 'exceeded its powers' because it had based its decision on its own policy choice rather than identifying and applying a rule derived from governing law.

The decision is likely to limit the number of class action arbitrations significantly in the United States. It may also herald a more expansive review of arbitral awards in the United States where arbitrators appear to base their decision on policy grounds rather than applicable law.

Background

In 2003, a US Department of Justice criminal investigation concluded that Stolt-Nielsen, a commercial shipping company, and other participants in the world market for parcel tanker shipping, had engaged in an illegal price-fixing scheme. AnimalFeeds, one of Stolt-Nielsen's customers, commenced an arbitration in New York pursuant to the arbitration clause in a highly standardised and specialised shipping contract first drafted in 1950. AnimalFeeds demanded a class arbitration, on behalf of itself and similarly situated shipping customers, despite the lack of an explicit provision in the arbitration clause either permitting or prohibiting class arbitration.

The parties submitted a supplemental agreement to the arbitral panel stipulating that the original arbitration clause was 'silent' on the question of class arbitration, and asking the panel to decide whether or not the clause authorised class arbitrations pursuant to rules developed by the American Arbitration Association. The panel issued a partial award stating that the arbitration clause permitted class arbitrations, citing a consensus of arbitral decisions interpreting 'a wide variety of clauses in a wide variety of settings,' but not citing any state or maritime law in support of that conclusion. Stolt-Nielsen challenged the award in the Southern District for New York, which vacated on the grounds that the panel had 'manifestly disregarded the law' because had it conducted a proper choice-of-law analysis the panel would have applied the rule of federal maritime law requiring contracts to be interpreted in light of custom and usage. The Second Circuit Court of Appeals reversed, finding that the strict requirements of 'manifest disregard' had not been satisfied because New York law had not established a rule against class action arbitration, and upheld the partial award. A majority (Alito J, joined by Roberts CJ, Scalia, Kennedy and Thomas JJ) of the US Supreme Court upheld an appeal and vacated the partial award.[1]

Judicial review of arbitral awards

Under the US Federal Arbitration Act ('the FAA'),[2] a court may set aside (or, in the language of the statute, 'vacate') an award in the following circumstances enumerated in section 10:

1. where it was procured by corruption, fraud or undue means;
2. where there was evident partiality or corruption in the arbitrators, or any of them;
3. where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or any other misbehaviour by which the rights of any party have been prejudiced; or
4. where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter was not made.

The statute does not expressly provide for any judicial review of an arbitral award on the basis of a mistake or error of law, and US courts had held an award may not be set aside on such grounds[3] and have otherwise construed these grounds as very limited.[4] In this respect the arbitral appellate framework in the United States, whilst it has not expressly incorporated the Model Law into domestic law, is similar to the appellate framework for international arbitral awards under the *International Arbitration Act 1974* (Cth)('the IAA'). Section 16 of the IAA adopts the Model Law. Article 34 of the Model Law enumerates the 'only' grounds for setting aside an award. Those grounds of review mirror those for refusal of enforcement under the New York Convention, and basically require a violation of due process or a breach of public policy. Like the FAA, it does not contemplate any right of appeal for errors of law.

Before 2008, the US courts of appeal were split as to whether an arbitral award could be vacated on the grounds that the arbitration panel had 'manifestly disregarded' the law, i.e., that the panel had knowingly and deliberately flouted a clear rule of law. In *Hall Street Associates, LLC v. Mattel, Inc,*[5] the Supreme Court held that a court may not vacate an arbitral award on grounds other than those provided in section 10 of the FAA, and those grounds of judicial review of an arbitral award can not be expanded by the agreement of the parties.[6]

Dicta in the Hall Street opinion suggested, however, that 'manifest disregard' might be interpreted as a 'shorthand' for certain section 10(a) grounds, and the Second Circuit Court of Appeals has recently upheld the 'manifest disregard' standard, post-Hall Street, under just such an interpretation.[7]

In Stolt-Nielsen the majority vacated the arbitral panel's award based on Section 10(a)(4) of the FAA, finding that the arbitrators had 'exceeded their powers' by deciding the class arbitration question based on their own policy judgment, and not on applicable law. According to the court, once the parties had stipulated that the arbitration clause was 'silent' on class arbitration, the panel's obligation was to determine the appropriate 'default rule' under the FAA or applicable maritime or New York state law; instead permitting class arbitration where not prohibited by agreement was better policy. The court said that the fact that the panel had not explicitly mentioned policy in its award was not determinative. Moreover, although the panel cited to an 'arbitral consensus' of other panels allowing class arbitrations in a 'wide variety' of circumstances, the court found that the panel had not attempted to determine the actual rule under maritime or New York law. This reliance on policy, without regard to governing law, 'exceeded its powers.' The minority disagreed with this conclusion contending it to be 'hardly fair' given policy was not mentioned in the arbitral award. Rather, the panel had based its decision on those made by other panels pursuant to Rule 3 of the American Arbitration Association's rules on class arbitrations, which it observed were 'consistent with New York law as articulated by the [New York] Court of Appeals…and federal maritime law.'

… compared with the United States Australia's class-action litigation system is still relatively inchoate.

The majority did not decide whether 'manifest disregard' of law had survived its decision in Hall Street, as an independent ground for review or as a 'judicial gloss' on the enumerated grounds for vacatur set forth in section 10. Rather, it merely noted that if such a standard applied, the above standard would apply for the same reasons and justify vacatur. Notwithstanding, the court's decision does seem to contemplate expanded review of arbitral awards.

Clear contractual authorisation required for class arbitration

After finding that the Stolt-Nielsen arbitral panel had exceeded its powers by looking to policy rather than applicable law on the question of class arbitration, the majority decided that question itself, and held that the FAA barred class arbitrations where the arbitration clause was 'silent.'

The court emphasised that the FAA's touchstone was the consent of the parties, and no arbitral panel could compel parties to submit to an arbitration to which they had not previously agreed. Class action arbitration also fundamentally changed the nature of arbitration which further militated against inferring a term in favour of class action arbitration. In the words of the majority:

> An implicit agreement to authorize class-action arbitration, however, is not a term that the arbitrator may infer solely from the fact of the parties' agreement to arbitrate. This is so because class-action arbitration changes the nature of arbitration to such a degree that it cannot be presumed the parties consented to it by simply agreeing to submit their dispute to an arbitrator. In bilateral arbitration, parties forgo the procedural rigor and appellate review of the courts in order to realize the benefits of private dispute resolution: lowers costs, greater efficiency and speed, the ability to choose expert adjudicators to resolve specialized disputes…But the relative benefits of class-action arbitration are much less assured, giving reason to doubt the parties' mutual consent to resolve disputes through class-wide arbitration.[8]

Accordingly, the majority concluded that consistently with the consensual basis of arbitration the question is whether the parties agreed to authorise class arbitration. They eschewed, however, as the minority noted, a conclusion that such authorisation had to be explicit. Presumably if the required authorisation is not express it would have to be capable of being inferred clearly and unambiguously from the other terms of the agreement.

Conclusion

Class-action arbitration has not yet become a feature of Australian dispute resolution. This no doubt reflects, amongst other things, the fact that compared with the United States Australia's class-action litigation system is still relatively inchoate. However, it has been developing quite rapidly in recent years following the proliferation of representative proceedings supported by litigation funders, the High Court's decision in Fostif[9] and other structural changes that have facilitated representative proceedings. In this respect the US Supreme Court's decision in Stolt-Nielsen is reminder of the fundamental basis of arbitration and the limitations

and difficulties in expanding that form of dispute resolution beyond bilateral disputes. Furthermore, leaving to one side any supervening constitutional considerations,[10] insofar as the decision in Stolt-Nielsen is suggestive of expanded review of arbitral awards on the basis of manifest disregard of law, it is out of step with the trend in Australia and other jurisdictions in favour of arbitral finality and minimal court interference with arbitral awards, as embodied in the Model Law.[11]

By Jonathan Redwood

1. The dissent (Ginsburg, joined by Stevens and Breyer JJ) concluded that the question was not ripe for judicial review under Article III of the Constitution because it was too preliminary and premature. The majority disagreed.
2. The statute was first enacted in 1925 but has been amended many times since. It covers international and interstate commercial arbitrations. State arbitration law generally governs intra-state arbitrations.
3. For example, *Baxter International Inc v Abbot Labs*, 315 F. 3d 829 (2003).
4. See *First Options of Chicago, Inc. v Kaplan*, 514 US 938. 942 (1995) holding that section 10(a) authorises vacatur 'only in very unusual circumstances'.
5. 552 U.S. 576 (2008).
6. The position may be contrasted with arbitral regimes in other jurisdictions (e.g., Hong Kong and the United Kingdom) that explicitly provide a statutory basis for the parties to 'opt-in' to provisions allowing review of awards for error of law. There is no such opt-in mechanism for review of errors of law under the IAA.
7. See *T.Co Metals, LLC v. Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 340 (2nd Cir. 2010); Stolt-Nielsen, S.A. v. AnimalFeeds Int'l Corp., 548 F.3d 85, 94-95 (2nd Cir. 2008) (interpreting manifest disregard as a 'judicial gloss' on the § 10(a) grounds).
8. At 21.
9. (2006) 229 CLR 386.
10. Such a limitation on precluding judicial review of an arbitral award for error of law might be derived from Ch III of the Commonwealth Constitution. See, for example, *Kirk v Industrial Court (NSW)* (2009) 239 CLR 531 at 578-581, although there would be powerful reasons for treating arbitration by private agreement of the parties differently to the supervisory review of inferior courts and administrative tribunals. It has also been held that an arbitrator does not exercise judicial power: *QH Tours Ltd and Sazalo Pty Ltd v Ship Design & Management (Aust) Pty Ltd and Gibbons* (1991) 105 ALR 371 at [25]-[30] and *Hi-Fert Pty Limited & Cargill Fertilizers Inc v Kiukiang Maritime Carries Inc & Western Bulk Carriers (Australia) Ltd* (1998) 159 ALR 142 at [12].
11. See, for example, *Soh Beng Tee & Co Pte Ltd v Fairmont Development Pte Ltd* [2007] SGCA 28 at [59]-[62] and *Thoroughvision Pty Ltd v Sky Channel Pty Ltd & Anor* [2010] VSC 139 at [15]-[17].

Worth Recycling Pty Ltd v Waste Recycling and Processing Pty Ltd [2009] NSWCA 354

In *Worth Recycling Pty Ltd v Waste Recycling and Processing Pty Ltd* [2009] NSWCA 354, the NSW Court of Appeal held that, following a mediation, a solicitor owed an obligation of confidence to an opposing party. The obiter remarks of Campbell JA leave no doubt that this decision applies equally to the bar.

In 2005, Veolia Environmental Services (Australia) Pty Limited (Veolia) commenced proceedings against the respondent (WSN) alleging breaches of Part V of the *Trade Practices Act 1974* (Cth). During 2008, the proceedings settled at mediation (at [5]-[7] & [9]).

Shortly thereafter the applicant (Worth) retained Veolia's solicitors (the solicitors) to proceed against WSN for substantially the same breaches of the TPA (at [14]-[15]).

WSN filed a Notice of Motion seeking to restrain the solicitors from acting for Worth, contending that they owed WSN an obligation of confidence arising from the mediation [16]. The mediation agreement had been signed by the parties and there was no additional confidentiality agreement signed by the attendees. Accordingly WSN did not bring a contract claim against the Solicitors [26]. The relevant confidentiality clause provided that '[a] person who acquires confidential information, whether oral or documentary, in the course of the Mediation will not disclose or use that information…' [7].

The Court of Appeal concluded that, if the accepted requirements for confidentiality[1] were satisfied, then the solicitors owed WSN an obligation of confidence [26].

WSN contended that at least the following material met those requirements [17]:

- WSN's position paper and opening statement
- Discussions on the strengths and weaknesses of the case
- Any offers and the response to any offers
- WSN's attitude towards the issues discussed at the mediation, including its negotiating position
- Any other information 'disclosed, discussed or otherwise communicated' by WSN at the mediation

The court appears to have accepted that some or all of that material was confidential. In reaching that conclusion the court was informed by 'the terms of the mediation agreement and the circumstances of the mediation' [28]. Unfortunately without further elaboration it is difficult to discern from the court's reasoning why it reached that conclusion in relation to particular classes of information. The application proceeded on the basis that there was no evidence that the solicitors had misused any confidential information [33]. Nonetheless the

court concluded that such misuse would be almost inevitable if the solicitors took part in any settlement negotiations [44], and that that was sufficient to establish a 'real and sensible possibility of misuse' of the confidential information. The broader implications of this decision for the bar include:

1. Barristers who are routinely briefed to appear against the same client may want to:

   a. insulate themselves from any involvement in the mediation process; or

   b. disclose the fact that they have (and anticipate continuing to have) other matters against the same client at the start of any mediation; and

   c. suggest amendments to any confidentiality clause in a mediation agreement.

2. While the court commented that the mediation agreement would not have precluded the solicitors from continuing to act for Veolia in the same litigation, [30] nonetheless, barristers briefed to appear for a client at mediation may want to:

   a. familiarise themselves with the confidentiality requirements of the mediation agreement; and

   b. consider whether they think that any amendments to the confidentiality clause are necessary so that, in the event that the mediation is unsuccessful, they can continue to fully advise the clients in the proceedings.

By Anne Horvath

Endnotes

1. The four requirements were set out by Gummow J in *Smith Kline & French Laboratories (Aust) Limited and Ors v Secretary, Department of Community Services and Health* (1990) 22 FCR 73 at 87

NSW Supreme Court Equity Division – Commercial Arbitration List

A new list has commenced in the Equity Division for proceedings concerning international or domestic commercial arbitration, over which the Commercial List judge presides. A practice note was issued on 15 December 2009, and commenced on 1 February 2010. It sets out the case management procedures for the Commercial Arbitration List (see Practice Note No. SC Eq 9 – Commercial Arbitration List).

A matter in the list must be commenced in the general form of summons prescribed under the *Uniform Civil Procedure Rules 2005* (NSW). The practice notice stipulates that the plaintiff must file, with the summons:

- a 'Commercial Arbitration List Statement', which is similar in form to the general form of Commercial List Statement and identifies the nature of the dispute, the issues likely to arise, and the plaintiff's contentions;
- a copy of the arbitral award (if the proceedings concern the award);
- a copy of any agreement under which the arbitration has taken place (or is to take place); and
- an affidavit setting out in summary form the facts which give rise to the dispute, and to which any further documents in support of the relief claimed are to be attached.

A defendant is required to file and serve a 'Commercial Arbitration List Response', in similar form to the usual form of Commercial List Response. With the response, a defendant is required to file:

- any additional arbitral award or agreement which is asserted to be relevant; and
- an affidavit setting out which of the facts in the plaintiff's affidavit are disputed, and any additional facts which are asserted to be material to the dispute, as well as attaching any further documents relied on to resist the relief sought.

Parts of Practice Note SC Eq 3 (Commercial List and Technology and Construction List) apply to the pleadings and entry into the new list, as well as to any other evidence that a party may intend to rely on.

The new practice note indicates an expectation that applications in the list will be given a hearing date on the first return date of the summons, and that practitioners are expected to agree to a timetable, and adopt the Usual Order for Hearing (or an agreed modified order for hearing) on that date. No orders will be made for discovery in any application in the Commercial Arbitration List, unless special reasons are established. Motions are to be listed at 9.15am on Fridays.

In practical terms then, it would appear likely that the Commercial Arbitration List will be administered in a similar fashion to the general Commercial List, albeit that there may be only one directions hearing before the matter is allocated a hearing date.

By Kylie Day

Gordian Runoff Ltd v Westport Insurance Corporation [2010] NSWCA 57

In this case, the Court of Appeal considered a number of issues that are of general importance to the practice of commercial arbitration, the proper conduct of applications for leave to appeal under s 38 of the *Commercial Arbitration Act 1984* (NSW) ('the Act'), and the circumstances in which that leave may be granted. It is probably the most significant decision on matters of general principle relevant to s 38 of the Act, since *Promenade Investments Pty Ltd v State of New South Wales* (1992) 26 NSWLR 203 and *Natoli v Walker* (1994) 217 ALR 201. The principal judgment is that of Allsop P, with whom Spigelman CJ and Macfarlan JA agreed.

The background to the appeal was as follows. The respondents were excess of loss reinsurers of Gordian's professional indemnity and directors' and officers' ('D&O') insurance portfolio for the 1999 year. A dispute arose between Gordian and the respondents as to whether the reinsurance contracts responded to certain claims made on Gordian under a D&O run-off policy issued to FAI Insurance Ltd and its former directors and officers. The dispute was referred to arbitration before a panel of experienced insurance arbitrators. The arbitral tribunal found that, taking the effect of s 18B of the *Insurance Act 1902* (NSW) into account, the reinsurance contracts did apply to claims made under the FAI policy within three years of its inception.

The reinsurers sought leave to appeal from the award, under s 38 of the Act. Over Gordian's opposition, the primary judge heard the application for leave to appeal and the appeal concurrently. The nub of the reinsurers' complaint about the award concerned the arbitrators' interpretation and application of s 18B. The primary judge held that the arbitrators had misunderstood s 18B to a degree that satisfied the relevant statutory grounds of manifest error of law on the face of the

award, and strong evidence of error of law, the determination of which may add, or may be likely to add, substantially to the certainty of commercial law (s 38(5)(b)(i) and (ii) of the Act). Accordingly, the primary judge granted leave to appeal from the arbitral award, allowed the appeal, set aside the award, and dismissed the claim of the applicant in the arbitration (i.e., Gordian). However, the Court of Appeal allowed the appeal from the primary judge's decision, set that decision aside, and refused the application for leave to appeal from the arbitral award, with costs. The decision of the Court of Appeal is an important one on the issues outlined above, for the following reasons.

First, it establishes that ordinarily an application for leave to appeal from an arbitral award should precede an appeal, and the two should only be heard concurrently in exceptional cases (see [102]-[113]). The Court of Appeal held that this follows from the context and legislative history of the Act. Here, it was an error of principle for the primary judge to hear the application for leave concurrently with the argument on the appeal. However, the Court of Appeal rejected the submission that the matter went to jurisdiction. That is, the Court of Appeal rejected the proposition that, on the proper construction of s 38, there was no jurisdiction for the primary judge to hear an appeal under s 38(2) in the absence of a pre-existing grant of leave or the consent of the parties (see [102]-[103], [109]).

Secondly, the decision confirms what is required by a 'manifest error of law' for the purpose of leave to appeal under s 38(5)(b)(i) of the Act (see [116], [240]-[242]). Such an error must be more than arguable; it must be evident or obvious. There 'must be powerful reasons leaving little or no doubt on a preliminary basis, without any prolonged adversarial argument, that there is on the face of the award an error of law' (at [116]). The respondents conceded in the course of the appeal that the primary judge erred in concluding that the arbitrator's construction of s 18B was manifestly wrong.

Thirdly, the decision confirms that the ground of 'strong evidence of an error of law' (under s 38(5)(b)(ii) of the Act) requires proof of a strong prima facie case that the arbitrators were wrong on a question of law (see [119]-[129]). Only if that is satisfied does one move on to the additional consideration of whether the determination of the question of law may (or may be likely to) add substantially to the certainty of commercial law (see [127]). Where determination of the relevant question involves 'primarily fact and context specific analysis and evaluation', it will not add substantially to the certainty of commercial law (see [194]). The Court of Appeal cautioned against any tendency 'to downgrade the statutory requirement of 'strong evidence' … because of the 'interesting' or important legal question involved'. It pragmatically acknowledged that '[t]he remit of arbitrators includes the making of errors; that is an inevitable part of any process of dispute resolution', noting that '[h]ow and what errors are to be corrected depends on the statute in question' (at [127]). Here, the Court of Appeal held that the primary judge erred in concluding that there was strong evidence of an error of law, where the arbitrators had adopted a broad construction of s 18B that was supportable by the words of the legislation (at [161]-[172]).

Fourthly, the decision illustrates the stringency of these requirements for leave to appeal, as applied to the issues in the case. For example, the Court of Appeal held (at [179]-[182]) that there was arguably error in the arbitrators' approach to causation of loss. However the error was not as to a question of law, nor was it either manifest or strongly arguable (at [182]-[183]). Furthermore, the court held that determination of the question would not add or be likely to add substantially to the certainty of commercial law (at [185]). In addition, the Court of Appeal rejected the submission that the reasons of the arbitrators were inadequate on the point (at [186]). Clearly, much more is required than an error, per se, before the court may exercise its discretion to grant leave to appeal from an arbitral award.

Fifthly, the Court of Appeal considered the nature of the requirement that an arbitrator provide reasons, rejecting the proposition that arbitrators have the same legal obligation to provide reasons as judges (see [196]-[224]). The Court of Appeal found no support for such a proposition in either international authorities on the UNCITRAL Model Law (Art 31(2)) or in the legislative history of the Act. The Court of Appeal held that the decision of the Victorian Court of Appeal in *Oil Basins Ltd v BHP Billiton Ltd* [2007] VSCA 255; 18 VR 346 was clearly wrong on this issue, and should not be followed.

Lastly, and although this aspect of the decision was strictly obiter (see [244]-[245], [266]-[282]), the Court of Appeal indicated that where questions of law arise out of an award and are agitated by the respondent as well as the applicant/appellant, all of the questions should be the subject of applications for leave to appeal under the Act (and not simply raised as 'points of contention' by the respondent, in its List Response).

By Kylie Day