

Supreme Court declines to enforce arbitral award with defective appeal provision: *Carr v Galloway Cook Allan* [2014] NZSC 75

Summary

In *Carr v Galloway Cook Allan* (20 June 2014) the Supreme Court has affirmed the fundamentally contractual nature of the arbitration process, finding that an arbitral award should be set aside on the basis that the underlying arbitration agreement contained a defective appeal provision. While the case turns somewhat on the fact that the parties had both mistakenly assumed the award could be appealed on questions of fact as well as law, the case demonstrates the necessity for a proper contractual basis for awards. The Supreme Court said:

"The absence of a valid arbitration agreement to underpin an award goes to the root of the parties' intention to arbitrate their dispute. Unless there are special intervening circumstances, it will rarely be appropriate for the Court to refuse to set aside such an award which has been made without jurisdiction."

* Stuart Dalzell, Partner and Amy Williamson, Associate review the decision.

Background

Galloway Cook Allan (GCA) had acted for Mr Carr in relation to a failed commercial transaction. Mr Carr claimed GCA had been negligent, causing a delay in settlement, which resulted in the transaction falling over when settlement did not occur within the time allowed in the agreement.

The parties entered into an arbitration agreement and the arbitrator found that, although GCA had been negligent, that negligence had not cause Mr Carr's loss. The arbitration involved a complex counterfactual analysis which led the arbitrator to

conclude that even if no negligence had occurred, the settlement would still have been missed by at least seven minutes.

A key clause in the arbitration agreement concerning rights of appeal indicated that an award would be subject to appeal to the High Court, by either party, for error of both fact and law. Importantly, the ability to appeal on questions of law and fact received express emphasis in the agreement.

Despite this, when Mr Carr appealed the award, GCA pointed out that the clause in the arbitration agreement allowing appeals on questions of fact was contrary to the requirements of the Arbitration Act 1996 ("Act") and so was ineffective in law. So there could be no right of appeal on questions of fact. Mr Carr accepted that the appeal provision was ineffective, but went further and applied under the Act to have the award set aside on the ground that the whole arbitration agreement was not valid in law. GCA opposed that application, arguing that it was possible to "sever" the defective appeal provision.

Where a contract is composed of several parts, and it is possible to divide it up so as to preserve part and disregard the other part, the contract is said to be severable. That is what GCA sought to argue in this case. Alternatively, GCA argued that the Court could and should decline to set the award aside in its discretion under the Act.

In the High Court, Ellis J set the award aside, on the basis that the invalid appeal provision was part of and could not be severed from the arbitration agreement. That decision was reversed by the Court of Appeal,

which emphasised the importance of upholding agreements to arbitrate, even when some aspect of the agreement is invalid. Mr Carr appealed to the Supreme Court.

Arbitration agreements defined

The first question the Supreme Court addressed was whether the entire agreement (including the clause purporting to allow appeals on questions of fact or law) formed the "arbitration agreement", or whether, as GCA argued, the arbitration agreement comprised only the clause whereby the parties agreed to submit to arbitration.

The Arbitration Act defines an arbitration agreement as an agreement to submit to arbitration. The Supreme Court held that, where a contract between parties includes a dispute resolution clause by which the parties agree to refer any dispute to arbitration, that clause forms a separate arbitration agreement, enforceable even if the balance of the contract has serious deficiencies. However, where (as here) the entire agreement in question deals with an agreement to arbitrate and sets out the way in which the arbitration was to be conducted, the Supreme Court agreed that the agreement in its entirety comprised an arbitration agreement.

Was the offending clause severable?

GCA argued that the clause allowing appeals on questions of fact was severable from the balance of the agreement, leaving a valid and enforceable arbitration agreement.

On an objective reading of the agreement, the Supreme Court held that the offending clause was central to the parties' agreement. Other

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clauses (including the clause by which the parties agreed to submit to arbitration) were expressed as subject to the appeal clause. Additionally, the words "questions of law and fact" were italicised in the agreement, followed by the statement: "(emphasis added)".

Therefore, the Supreme Court declined to sever the reference to appeals on questions of fact, and found the entire arbitration agreement to be invalid.

Setting aside arbitral awards

Under the Arbitration Act, the Court has discretion to set aside arbitral awards in specified circumstances. While those circumstances do not expressly include invalidity of an arbitration agreement, here the parties had attended the arbitration based on the mutual understanding that they could appeal the award on questions of fact. As noted, that was a matter of some importance given the factually intensive nature of negligence claims.

Given evidence that the invalid appeal provision was central to the parties' agreement to arbitrate, the Court (by majority, Arnold J dissenting) concluded that: "the absence of a valid arbitration agreement underpinning the award was so fundamental a defect that the High Court was correct to exercise the discretion in [article] 34 [of second schedule to the Act] to set aside the award. No issue of estoppel or waiver arises in the present case. Although the arbitration agreement has been substantially performed, this was on the basis of the mistaken assumption, shared by both parties, that there would be a right of appeal to the High Court on questions of fact."

In those circumstances the Supreme Court reinstated the High Court's decision to exercise its discretion to set aside the arbitral award.

Conclusion

Had the appeal clause not clearly been central to the agreement, it would likely have been severed insofar as it referred to questions of fact. In this particularly fact-reliant case, that would have seriously limited Mr Carr's ability to appeal. This highlights the importance of clearly identifying key contractual clauses.

One final point is that, because of the clear wording of the clause and the agreement in the context of the dispute, an analysis of the parties' negotiations including email communications preceding the formation of the agreement was not required. This was a key point of difference between the High Court and the Court of Appeal, and the use of pre-contractual material has been a controversial area when it comes to contract interpretation issues. Traditionally, and even in modern times, such material has been excluded insofar as it goes to the purely subjective intentions of the parties. In this case, however, the Supreme Court left open the question of if and when it may be appropriate to look at the pre-contractual negotiations of the parties when assessing whether or not a term is severable.