Re Solution

ISSUE 10 / AUG 2016

FROM THE EDITOR

Welcome to the tenth issue of *Re*Solution® in which we draw on the experience and expertise of leading experts in the field to bring you commentary, articles and reviews on topical matters relating to domestic and international dispute resolution.

In this issue we feature the topical issues of 'fair play' and bias in arbitration and adjudication.

We also look at the Permanent Court of Arbitration's (PCA's) award in the South China Sea case in which the Tribunal rejected China's claim to historic rights over all of the South China Sea as without any foundation in international law, the PCA's award in the Philip Morris case in which the Tribunal declined to exercise jurisdiction in the matter, the English High Court's approach to ruling on the jurisdiction of an arbitral tribunal, how the Hong Kong Court of Appeal recently dealt with the penalties rule; and more.

I wish to take this opportunity to thank all our contributors. We are most grateful for the support we receive from dispute resolution professionals, law firms, and publishers, locally and overseas, that allows us to share with you papers and articles of a world class s standard, and to bring you a broad perspective on the law and evolving trends in the delivery and practice of domestic and international dispute resolution.

Contributions of articles, papers and commentary for future issues of *Re*Solution® are always welcome. I do hope you find this issue interesting and useful. Please feel free to distribute ReSolution® to your friends and colleagues – they are most welcome to contact us if they wish to receive our publications directly.

-Editor and Director NZDRC

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ReSolution: In Brief

Judges Appointed

Attorney-General Christopher Finlayson announced the appointment of two High Court Judges on 10 August 2016. Auckland lawyers Sally Fitzgerald and Mathew Downs have been appointed Judges of the High Court, and will both sit in Auckland. Justice Fitzgerald comes from a specialised background in complex commercial dispute resolution, while Justice Downs has a longstanding history in Crown law, working as a Crown Counsel and more recently as Senior Crown Counsel.

In July 2016, the Attorney General also announced the appointment of two Acting District Court Judges who will hold Family Court warrants, and the appointment of a Principal Youth Court Judge. John Brandts-Giesen has been appointed an Acting District Court Judge in Invercargill, while Catriona Doyle has been appointed an Acting District Court Judge in Wellington. Further, Wellington District Court Judge John Walker has been appointed Principal Youth Court Judge.

International Mediation Guide – 2nd Edition

In light of growing recourse to mediation due to increasing desire for businesses to reduce litigation costs, and growing strain on the courts due to high case volumes, Clifford Chance has released the Second Edition of its International Mediation Guide, which presents the most comprehensive summary of the current ins and outs of mediation worldwide. The Guide explores over 45 jurisdictions in six continents, and has been compiled by a strong team of local and global counsel from a range of jurisdictions. Please click here to download the Second Edition Guide.

UK considers fixed costs for claims ≤ £250,000

Tasked with designing the civil costs regime in the UK, Lord Justice Jackson has proposed a controversial fixed costs regime for all claims up to £250,000. While Lord Jackson believes this will avoid lengthy negotiations and promote accelerated settlement, his proposal has been met by strong opposition from industry groups and the Law Society. While most accept that fixed costs may be appropriate for low value and non-complex cases, opposing parties argue Lord Jackson's proposal would have a detrimental impact on access to justice and could prejudice deserving claimants. Discussion and consultation is set to continue throughout the year over the extent to which Lord Jackson's proposal might be implemented. However, it is clear that despite controversy, the UK Government recognises that changes need to be made.

Supreme Court Decision on Mobil Oil Tenancy Obligations

On 20 July 2016, the Supreme Court released its decision on *Mobil New Zealand v Development Auckland Limited*. The Court considered the interpretation of "clean and tidy" conditions under tenancy agreements, specifically regarding whether Mobil was liable to pay remediation costs for the former oil storage site in Auckland's Wynyard Quarter when the lease ended. The Supreme Court upheld Katz J's decision in the High Court that Mobil is not required to pay clean up costs. On the issue of interpretation, the Court held that Mobil's interpretation was more consistent with the natural and ordinary meaning of the words used in the clean and tidy condition, which did not impose a remediation obligation as contended by Development Auckland. Click here to read the full decision.

UNCITRAL Guide on the New York Convention

UNCITRAL has enlisted the help of two experts, Professor Emmanuel Gaillard and Professor George Bermann, to prepare a Guide on the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York) (the New York Convention). Presented to the Commission in July, the Guide aims to promote uniform and effective interpretation and application of the New York Convention, and to limit the impact individual State practice may have on its application. The Guide is also supplemented by an online public platform, which hosts case law implementing

aims to promote uniform and effective interpretation and application of the New York Convention, and to limit the impact individual State practice may have on its application. The Guide is also supplemented by an online public platform, which hosts case law implementing the New York Convention from various jurisdictions, legislation and procedures put in place to enforce awards under the New York Convention and general information about the New York Convention. Click here to access the online forum.

Supreme Court – Limitation Uncertainty for Product Suppliers

The Supreme Court recently released its decision in *Carter Holt Harvey Ltd v Minister of Education* [2016] NZSC 95, an appeal by Carter Holt Harvey against the Court of Appeal's refusal to strike out actions against it in negligence for manufacturing allegedly defective "Shadowclad" sheet and cladding systems installed in various New Zealand schools.

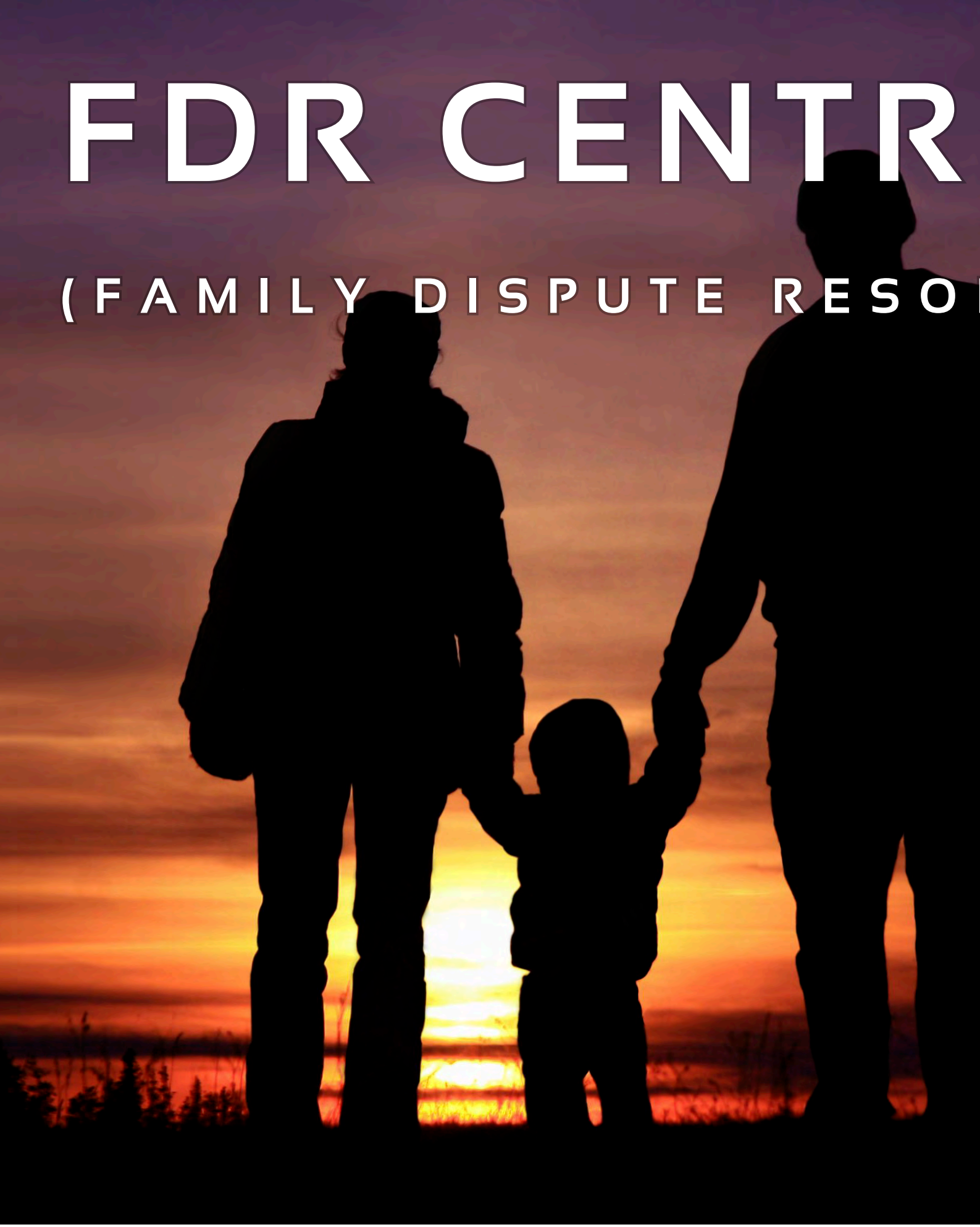
The Court's decision centred around operation of section 393 of the Building Act 2004 (Longstop) and the doctrine of "reasonable discoverability" – specifically whether reasonable discoverability is the applicable limitation test when the Longstop does not apply. The High Court and Court of Appeal had found that the manufacture and supply of cladding sheets did not amount to "building work" and therefore the Longstop provision under the Building Act was not applicable.

In its decision, the Supreme Court suggests that reasonable discoverability is not confined to proceedings related to "building work" (but can also relate to manufacture and supply of defective products). At paragraph [125] the Court stated: *The fact that the product has been used in the construction of a building does not mean that the civil proceedings against the manufacturer/supplier are proceedings relating to building work. They are proceedings relating to negligent manufacture and the supply of defective products, to which the usual rules that limitation periods arise on discoverability apply.*

The Supreme Court's decision signifies a departure from the existing authority, *Murray v Morel* [2007] NZSC 27, which confined the application of reasonable discoverability to latent building defect cases.

AMINZ Council Election

AMINZ recently announced the re-election of three sitting councillors to their positions. Mediators Nicola Hartfield, from Hawke's Bay, and Mark Kelly, along with another fellow Aucklander, arbitrator Mark Colthart, were re-elected. They join President John Walton, Vice President Royden Hindle and councillor Jenny Leith. We strive to ensure that we work with the best in the field, and accordingly it is particularly pleasing to see all AMINZ council members are also FDR, NZDRC, BDT and/or NZIAC panellists.



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FIND SOLUTIONS

ARBITRAL TRIBUNAL I
DECISION IN THE SOU

On 12 July 2016, an international arbitral tribunal in The Hague (the "Tribunal") unanimously ruled in favour of the Philippines and against China in the South China Sea Arbitration. The Philippines instituted the landmark case in 2013 under Annex VII to the United Nations Convention on the Law of the Sea (the "Convention"). The Permanent Court of Arbitration ("PCA") acted as the Registry in the proceedings. The Award is available here

In its sweeping decision, the five-member Tribunal rejected China's claim to historic rights over almost all of the South China Sea as without any foundation in international law. It also ruled against China on: (1) the status of certain maritime features in the South China Sea and the maritime entitlements they are capable of generating; (2) the lawfulness of Chinese actions in the South China Sea, including the construction of artificial islands and interference with Philippine fishing and oil exploration; (3) the effect of China's actions on the marine environment; (4) whether China's actions since the arbitration began had aggravated the dispute.

According to the Tribunal, it goes without saying that China is obligated to comply with the Award. China is required to do so by the express terms of Annex VII to the Convention and in accordance with the presumption in public international law of State compliance with treaty commitments.

The Tribunal did not have jurisdiction to rule on questions of sovereignty over land territory or to delimit boundaries between the parties. The scope of the ruling on questions regarding the Law of the Sea nonetheless was of monumental significance for both legal and geopolitical reasons. It provided long-sought clarity about the parties' legal rights and obligations under the Convention, which has widespread membership. It also intervened in one of the most tense and complex dramas playing out on the international stage today. With over 50% of the world's commercial shipping passing through the South China Sea each year, the outcome of the case will be of significance not only for the parties but also for all of the States bordering the South China Sea like Indonesia, Malaysia and Vietnam, and for the United States and other States that insist on freedom of navigation rights in the area.

Having refused to participate in the proceedings, China has insisted that it will ignore the final and binding decision. Its statement to that effect immediately following the ruling is available here.

Case background

The South China Sea Arbitration began on 22 January 2013, when the Philippines served China with a Notification and a Statement of Claim under the Convention. China refused to accept or participate in the proceedings. However, in December 2014 it published a Position Paper in which it asserted that the Tribunal lacked jurisdiction which the Tribunal

SSUES LANDMARK TH CHINA SEA CASE

VOLTERRA FIETTA
The public international law firm

deemed to constitute China's position on the matter.

Despite China's non-participation, the Tribunal continued the proceedings, as permitted by Annex VII of the Convention. The Tribunal, which was chosen by the Philippines and the President of the International Tribunal for the Law of the Sea ("ITLOS"), was presided over by Mr. Thomas Mensah of Ghana, a former President of the International Tribunal for the Law of the Sea in Hamburg, Germany. It also included three of the sitting judges on that court, Mr. Jean-Pierre Cot of France, Mr. Rüdiger Wolfrum of Germany and Mr. Stanislaw Pawlak of Poland, and the former director of the Netherlands Institute for the Law of the Sea, Professor Alfred H.A. Soons.

In October 2015, the Tribunal issued an Award on Jurisdiction and Admissibility, in which it concluded that it had jurisdiction over some of the Philippines' submissions and deferred a decision on others until it decided the merits. That Award is available here.

The hearing on the remaining jurisdictional issues and the merits was held in November 2015. It was attended by some 103 people, including representatives of the governments of Australia, Indonesia, Japan, Malaysia, Singapore, Thailand and Vietnam, which were given observer status due to their interest as littoral States in the South China Sea and/or their membership in the Convention. The United States was denied observer status on account of not being a party to the Convention.

Two interested States, Vietnam and Malaysia, each submitted statements to the Tribunal re-asserting their own claims and interests in the South China Sea and urging the Tribunal to respect them. Those statements are not available to the public.

Main findings of the Tribunal

In its most far-reaching decision, the Tribunal in yesterday's ruling rejected China's claims to more than 90% of the South China Sea on the basis of historic rights. China publically claims rights to all of the maritime areas encompassed by what it calls its "nine-dashed line". The Tribunal determined that the Convention comprehensibly allocates the maritime rights of States. Any pre-existing "historic rights" to resources were extinguished upon the entry into force of the Convention.

The Tribunal also found that, in any event, there was no evidence that China historically had exercised exclusive control in the South China Sea. Thus there was neither a legal nor a historical basis for China's claims to large swathes of the South China Sea, including areas to which the Philippines and some of the observer littoral States instead were entitled.

The Tribunal also ruled against China on a range of other important matters under the Convention and reminded China of its obligation to comply with international law.

The status of maritime features and the entitlement generated by these features

First, the Tribunal determined that none of the features claimed by China in the South China Sea was capable of generating an Exclusive Economic Zone ("EEZ"), which meant that they

Sea was capable of generating an Exclusive Economic Zone ("EEZ"), which meant that they fell within the EEZ of the Philippines instead.

In reaching this conclusion, the Tribunal first considered whether some of the reefs claimed by China were above water at high tide. Under Articles 13 and 121 of the Convention, features above water at high tide generate an entitlement to at least a 12-nautical mile territorial sea, while features that are submerged at high tide do not generate such entitlement. The Tribunal noted that many of the features that China claims generate entitlement have been subject to human modification, while the Convention classifies features only based on their natural condition. Consequentially, the Tribunal assessed the status of the features on the basis of archival materials and historical hydrographic surveys. The Tribunal concluded that Scarborough Shoal, Johnson Reef, Cuarteron Reef, Fiery Cross Reef, Gaven Reef (North) and McKennan Reef are features not submerged at high tide, therefore generate an entitlement to at least a 12-nautical mile territorial sea.

The Tribunal then went on to analyse whether these features found to be above water at high tide could be classified as islands. Under Article 121 of the Convention, islands generate an entitlement to an EEZ and to a Continental Shelf, while rocks that cannot sustain human habitation or economic life of their own do not generate such entitlement. The Tribunal found that the above-mentioned features, despite China's constructions on a number of them, cannot sustain human habitation or economic life. Consequentially, the Tribunal concluded that these features were rocks and not islands.

The Tribunal also considered whether any of the Spratly Islands that China claims or the Spratly Islands as a whole could generate extended maritime zones. The Tribunal found that the Spratly Islands had been used only by small groups of transient fishermen and mining enterprises and therefore could not be said to sustain human habitation or economic life. They therefore do not generate entitlement to an EEZ. The Tribunal also held that, under the Convention, the Spratly Islands do not generate maritime zones collectively as a unit.

The lawfulness of Chinese actions in the South China Sea

Second, having found that certain areas are within the EEZ of the Philippines, the Tribunal found that China had violated the Philippines' sovereign rights within those areas in a number of ways. Specifically, it found that China had: (1) interfered with Philippine fishing and petroleum exploration at Reed Bank; (2) constructed artificial islands at Mischief Reef without the permission of the Philippines; and (3) failed to prevent Chinese fishermen from fishing within the Philippines' EEZ at Mischief Reef and Second Thomas Shoal. The Tribunal also concluded that China had interfered with the Philippines' traditional fishing rights at Scarborough Shoal and created a serious risk of collision when they obstructed Philippine vessels.

The effect of China's actions on the marine environment

Third, the Tribunal made a first-time ruling on the Convention's provisions on environmental protection, finding that China had breached these too. Articles 192 and 194 of the Convention oblige States to protect and preserve the marine environment and take steps to avoid polluting it. The Tribunal found that China had breached these articles by severely harming the marine environment with its large-scale land reclamation and construction of artificial islands. By not preventing Chinese fishermen from harvesting endangered species in the area, China also had failed to fulfil its due diligence obligations under the Convention.

China's aggravation of the dispute

Fourth, the Tribunal determined that China had violated its obligation under international law not to aggravate the dispute during the pendency of the proceedings against it. The

Tribunal noted that, since the start of the proceedings, China had built a large artificial island in the Philippines' EEZ, caused irreparable damage to the coral reef ecosystem, and permanently destroyed evidence of the natural condition of features that formed part of the parties' dispute. All of these actions had aggravated the dispute.

Future conduct of the parties

Finally, in a pyrrhic victory for China, the Tribunal ruled that it was not necessary to grant the Philippines' requests for judgments declaring that China should bring its conduct into compliance with the Convention. These requests fell within the basic rule of international law that States should comply with their treaty obligations. It goes without saying that both China and the Philippines were required to comply with the Convention and the Award in accordance with that basic rule. The Convention itself is clear that awards under Annex VII "shall be complied with by the parties to the dispute." The Tribunal indicated that it expected as much from these parties.

Commentary

Yesterday's ruling in the South China Sea Arbitration brings to an end a case that has generated international attention due to its significant legal and geopolitical implications. The Tribunal has decided an issue of fundamental importance under the Convention for the States involved – the legality of China's nine-dashed line claim. It has also put all States Parties on notice that they can be held accountable under the Convention for failure to protect and preserve the environment in the world's oceans and seas.

The full extent of those implications remains to be seen, particularly now that all eyes are on China to see whether it will comply with the rule of law in its international conduct. As noted above, China has said that the ruling has "no binding force". It added that the Tribunal's conduct and award was "unjust and unlawful".

- Volterra Fietta

ARBITRATION:
REASONABLE OPPORTUNITY TO PRESENT CASE

- ALBERT MONICHINO QC

Amasya Enterprises Pty Ltd v Asta Developments (Aust) Pty Ltd [2016] VSC 326

This recent decision of the Arbitration List judge of the Supreme Court of Victoria suggests that the requirement that parties will be given a "reasonable opportunity" to present their case will be viewed robustly by a supervising court and not through the prism of domestic court litigation.

Article 18 of the UNCITRAL Model Law on International Commercial Arbitration sets out a pivotal requirement that the parties shall be treated with equality and be given a full opportunity of presenting their respective cases. Article 18 is reflected in section 18 of the new *Commercial Arbitration Acts* which regulate domestic arbitration in Australia, except that 'full opportunity' has been replaced with 'reasonable opportunity'.
A recent decision of the Arbitration List judge of the Supreme Court of Victoria suggests that the requirement that the parties be given a "reasonable opportunity" to present their case will be viewed robustly by a supervising court, and not through the prism of domestic court litigation.

Facts

Amasya ('**the Principal**') entered into a building contract with Asta ('**the Builder**') for the construction of a meat works factory. The contract contained an arbitration clause. The project stalled and each party filed a notice of dispute contending that the contract had been validly terminated by it. The respective disputes were referred to a single arbitrator (a senior barrister).

The Arbitrator conducted a preliminary conference where he confirmed that the governing law of the contract, and of the arbitration, was the law of Victoria, and that the principal issue in the arbitration was which party had validly terminated the contract. Both parties filed notices of defence. The notices of dispute and defence resembled court pleadings. There followed a seven day evidentiary hearing where both parties were represented by junior and senior counsel. Following the evidentiary hearing both parties exchanged comprehensive closing submissions in writing and submissions in reply. Three days later the Arbitrator conducted a final one day oral hearing.

In its notice of dispute the Builder claimed in the alternative that it was entitled to be compensated on a quantum merit basis. In its reply submission, in one short paragraph, the Builder contended for the first time (in the alternative) the contract had been mutually abandoned, and if the Arbitrator so found the Builder was entitled to a quantum merit. No mention of this new claim was made during the final one day oral hearing, either by the parties or the Arbitrator.

Ultimately, the Arbitrator found in his award, that the contract was mutually abandoned and that the Builder was entitled to be compensated on a quantum merit basis, to the tune of about $1 million.

Submissions

The Builder applied to enforce the award under section 35 of the *Commercial Arbitration Act 2011* (Vic). Conversely, the Principal sought to set aside the award under section 34, alternatively sought to resist enforcement under section 36. In particular, the Principal argued that it was not given a reasonable opportunity to present its case (sections 34(2)(a)(ii) and 36(1)(a)(ii)), alternatively that the lack of procedural fairness in connection with the making of the award meant that the award was in conflict with the public policy of Victoria (sections 34(2)(b)(ii) and 36(1)(b)(ii)). The nub of the Principal's complaint was that the award was made on a basis that was not articulated in the Builder's notice of dispute, nor argued during the hearing.

Decision

Croft J granted the Builder's application and enforced the award. In essence, his Honour found that the Principal had the opportunity to deal with the Builder's new argument during the final one day oral hearing but chose (for its own reasons) to ignore it. Quoting Menon CJ in the Singaporean case of AKN v AKL[2015] SGCA 18, Croft J noted that in setting aside proceedings the courts 'do not... and must not bail out parties who have made choices that they may come to regret'.

According to his Honour, if the Builder required more time to deal with the new point, it could have sought an adjournment. But it could not afford to simply ignore the point, which it did to its peril. Moreover, section 18 did not require the Arbitrator to warn the parties in relation to his proposed findings. It was sufficient for the point to have been raised in the Builder's reply submissions.

Croft J noted that while the "unable to present case" and "public policy" grounds in section 34 and 36 are conceptually different, they were practically indistinguishable as applied to the facts of the case.

His Honour also noted that while the new *Commercial Arbitration Acts* do not (unlike the *International Arbitration Act* – see sections 8 (7a) and 19) expressly provide that a breach of natural justice in connection with the making of an award will constitute a breach of "public policy", this may be inferred and that the Commonwealth provisions were inserted to "avoid doubt".

Comment

Whether a party has been afforded a reasonable opportunity to present its case is a question of fact and degree. The case in question is a borderline one. The arbitration had been conducted on the basis that one or other party had validly terminated the contract. Whether the contract had been mutually abandoned and the legal consequences of mutual abandonment (in terms of relief) had not been fully explored.

It is unfortunate that the Arbitrator did not squarely raise the new point at the final oral hearing (or indeed, thereafter) before deciding the case. It is not good arbitral practice for an arbitrator to decide a case on a particular basis without squarely giving the losing party an opportunity to address it. Be that as it may, it is a separate question whether an award should be set aside, or its enforcement resisted, on the basis that the losing party has not been afforded a reasonable opportunity to present its case. This decision demonstrates that the objecting party must be able demonstrate real practical unfairness before it can succeed on this ground.

AUTHOR PROFILE

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Albert practises as a barrister, arbitrator and mediator practicing in Australia. He has over 20 years experience. He is a Grade 1 arbitrator and is accredited as an advanced mediator. He was appointed Senior Counsel in 2010.

Albert is a principal arbitrator and mediator with NZDRC. For more on Albert Monichino QC CLICK HERE

- ALBERT MONICHINO QC

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FAIR PLAY - BIAS I AND ADJUDICATIO

"According to the fair play of the world, Let me have audience." William

Whilst Shakespeare's words echo in English law and legal practice, what fair play actually looks like in our modern, complicated and interconnected world has been the subject of debate of late. Specifically, the topic of bias in arbitration has been put under the microscope by two noteworthy judgments of the English High Court and new International Chamber of Commerce (ICC) guidance on the subject.

At the risk of losing the reader's attention in the second paragraph, whilst interesting and instructive, these developments have not fundamentally altered the status quo. The two cases reaffirm the supremacy of the well established English common law 'fair observer test' as the touchstone by which any accusation of apparent bias will be judged in this jurisdiction. The cases, however, do offer some lessons on how to deal with potential apparent bias and conflict situations which are likely to be of interest to those involved on the ground in arbitrations and adjudications (although we refer to arbitration throughout this article, many of the same principles will apply in adjudication). The updated ICC guidelines are a welcome initiative, but their usefulness is, obviously, limited only to ICC governed arbitrations. This article considers these developments in detail and offers some practical tips to avoid getting caught out.

Test for Apparent Bias

In the already much discussed case of *Cofely Ltd v Bingham & Knowles Limited* (2016) EWHC 240, Hamblen J considered an application under section 24 of the Arbitration Act 1996 for the removal of an arbitrator, Anthony Bingham, for alleged bias. While the facts of the case may have caught the imagination of those in the industry, the principles applied by Hamblen J are not new. Specifically, Hamblen J affirmed the primacy of the fair observer test for apparent bias from *Porter v Magill* (2002) AC 357 of whether "the fair minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased."

Cofely, a major construction company, and Knowles, a well known firm of construction claims consultants, were parties to an arbitration which started in early 2013. Mr Bingham was the arbitrator, having been appointed by the Chartered Institute of Arbitrators. The trouble started in late 2014 when the judgment in *Eurocom Ltd v Siemens Plc* (2014) EWHC 3710 came out. In that case, Ramsey J had refused to enforce an adjudication award rendered by Mr Bingham on the basis that Siemens had a real prospect of establishing that Mr Bingham had no jurisdiction because of circumstances surrounding his appointment, in which Knowles had been heavily involved. It emerged from that judgment that Mr Bingham had been repeatedly appointed by Knowles, or on behalf of clients of Knowles in cases in which Knowles was involved. He had not declared this prior to or after his arbitral appointment in the Cofely case. Cofely, through its legal advisors, therefore asked a series of questions of Mr Bingham in order to obtain the information it believed necessary to decide whether to raise a formal objection to Mr Bingham continuing as

-Kate A. Corby & Benjamin Levitt

whether to raise a formal objection to Mr Bingham continuing as arbitrator. Mr Bingham did not fully answer the questions and then, of his own volition, called a hearing and issued a ruling that there was no conflict or apparent bias. This prompted Cofely to make its section 24 application.

On the facts, Hamblen J considered that five of the seven grounds put forward by Cofely did indeed raise the possibility of apparent bias by Mr Bingham. These grounds were:

> i. The admissions made by Knowles in the *Eurocom v Siemens* case about how it sought to influence the appointment of arbitrators so that Mr Bingham was appointed and other arbitrators were excluded.
>
> ii. Mr Bingham's evasive and defensive response to questions from Cofely.
>
> iii. Mr Bingham's calling of an unrequested hearing to consider Cofely's request for information on his relationship with Knowles during which he 'descended into the arena', that is, acted unprofessionally.
>
> iv. The information which eventually emerged that, over the previous three years, Mr Bingham had been appointed as arbitrator in cases which involved Knowles 25 times, out of a total of 137 appointments in that time period. Those 25 cases reflected 25% of his income. He had held in favour of Knowles, or the party with which Knowles was involved, on 18 of those 25 occasions (72%).
>
> v. The overly defensive and aggressive approach Mr Bingham took in his witness statement in the court proceedings, and the fact that he had 'taken sides'.

The judge placed significant weight on the frequency of the appointments and the percentage of income that Mr Bingham had received from Knowles. The fact that an arbitrator is frequently appointed by the same party has been previously found to be a relevant issue when considering apparent bias, especially if there is an element of material financial dependence. He also emphasised that an 'unapologetic' or 'aggressive' reaction to questions on the arbitrator's independence has also previously been found to make apparent bias more, rather than less, evident — as it has been concluded that such actions indicate that the arbitrator realises something has gone wrong and that attack is the best form of defence.

Another important point was the 'no conflicts' declaration in the CIArb form signed by Mr Bingham on the acceptance of his nomination. Notably, Mr Bingham had left blank the answer to the following question, despite his clear previous involvement with Knowles: "If you are aware of any involvement, however remote, but in particular an involvement you or your firm has (or has had in the last five years) with either party to the dispute please disclose." Notwithstanding the oversight by the CIArb in allowing the appointment of Mr Bingham to go ahead when he had not filled in all of the nomination form, Mr Bingham's carefree approach to the CIArb conflict rules and corresponding nomination form was used as further evidence to demonstrate his apparent bias. On the basis of all of the above, the application was granted.

This case is clearly a high profile and helpful restatement of the fair observer test and a useful example of the application of that test on some interesting facts. Mr Bingham fell foul of one of the foundational rules of arbitration. Alongside the interest of justice requirement, the reasons why conflict disclosures are critical in arbitrations is to prevent any ground arising in which a losing party may challenge the arbitral award. This is a cornerstone of the arbitration process.

IBA Guidelines – Flawed?

In *W Limited v M SDN BHD* (2016) EWHC 422 (Comm), W brought a challenge to an arbitral award under section 68 of the Arbitration Act 1996 alleging serious irregularity arising out of the apparent bias of the arbitrator, an Alberta-based QC, who was appointed to resolve a dispute in relation to a project in Iraq. The challenge centred around the fact that the Canadian law firm from which the arbitrator conducted his practice as arbitrator had, unbeknownst to the arbitrator, regularly represented an affiliate of M.

Like Hamblen J in Cofely, Knowles J applied the fair observer test from *Porter v Magill* when assessing whether, on the facts, there was any apparent bias. So far, so uneventful. Why this case is interesting, however, is because it applied that test with nuance and also poured judicial criticism on one part of the 2014 edition of the International Bar Association's (IBA) Guidelines on Conflicts of Interest in International Arbitration.

The main thrust of W's argument was that the arbitrator was in breach of paragraph 1.4 of the non-waiverable red list in the IBA guidelines as his law firm regularly advised an affiliate of W. Paragraph 1.4 of the IBA guidelines states as non-waiverable a situation where: "[t]he arbitrator or his or her firm regularly advises the party, or an affiliate of the party, and the arbitrator or his or her firm derives significant financial income therefrom." The judge held that it was "hard to understand" why this situation should be included in the non-waiverable list as it pertains to a "situation where the advice is to an affiliate and the arbitrator is not involved in the advice." Knowles J stated that this type of situation is "classically appropriate for a case-specific judgment." Knowles J thought that parties should be able to use their discretion in assessing the potential conflict scenario in circumstances where an arbitrator is aware of this relationship and has disclosed it to the parties. Knowles J asked "why should the parties not, at least on occasion, be able to accept the situation by waiver?"

On this basis, Knowles J refused to follow the IBA guidelines. Whilst the IBA guidelines have become widely accepted, *W Limited v M SDN BHD* is a reminder that they do not, of course, supersede local law or the rules chosen for the arbitration (unless written into the arbitration agreement as binding). Applying the fair observer test, Knowles J concluded that despite the arbitrator's firm having previously acted for an affiliate of W (contrary to paragraph 1.4 of the nonwaiverable red list in the IBA guidelines) there was no apparent bias. This was because:

i. The arbitrator had not personally acted for that client.

ii. He effectively operated as a sole practitioner just using the firm for administrative support for his work as an arbitrator.

iii. The arbitrator had made other disclosures of potential conflicts of interest and "would have made a disclosure here if he has been alerted to the situation."

Knowles J therefore held that no fair minded and informed observer would conclude that the arbitrator was biased or lack any independence or impartiality. As such, whilst *W Limited v M SDN BHD* highlights the distinguished contribution of the IBA guidelines in the field of international arbitration, it also provides important judicial commentary on their

commentary on their application, at least under English law.

ICC Update: Disclosures and Third Party Funding

In February this year, the ICC issued new guidance on conflict disclosures by arbitrators, which has been incorporated into its broader note to arbitrators and parties. The ICC guidelines now place a considerable burden on any arbitrator being appointed in a case under the ICC arbitration rules to disclose: "Any circumstance that might be of such a nature as to call into question his or her independence in the eyes of any of the parties or give rise to reasonable doubts as to his or her impartiality."

The ICC guidelines also require all arbitrators to complete and sign a statement of acceptance, availability, impartiality and independence in a bid to ensure those qualities of arbitrators in ICC cases. The ICC guidelines list a host of circumstances that must be considered (but not necessarily disclosed), including whether the arbitrator or their law firm represents or advises one of the parties or one of its affiliates. This is similar to the requirement in the IBA guidelines at the heart of *W Limited v M SDN BHD.*

However, in the ICC guidelines, this is a circumstance for an arbitrator to consider upon deciding whether to make a disclosure; it is not a non-waiverable disclosure as it is in the IBA guidelines. Interestingly, the ICC guidelines state that such a disclosure does not imply, in and of itself, the existence of a conflict, which is similar to the view expressed by Knowles J in *W Limited v M SDN BHD*. Conversely, the ICC guidelines also state that whilst a failure to disclose is not automatically a ground for disqualification, that failure will be considered when assessing whether there are grounds to refuse an appointment. In the spirit of increasing transparency in the arbitration process even further, the ICC guidelines also attempt to introduce wider business/funding relationships into conflicts considerations. The ICC guidelines state that an arbitrator should consider whether they or their firm has any business relationship with one of the parties or an affiliate, or has a personal interest in the outcome of the dispute. Further, the ICC guidelines state that an arbitrator should consider whether they or their firm have a "relationship with any entity having a direct economic interest in the dispute or an obligation to indemnify a party for the award." Whilst this approach is already adopted by the IBA guidelines, its incorporation – word-for-word – in the ICC guidelines is a helpful addition, given the growth of third party funding arrangements.

The ICC guidelines are helpful, clarifying and progressive. The transparent approach to conflict disclosures they foster will hopefully create a more open culture in conflict disclosure conversations. Further, the update in respect of third party funding and other business relationships reflects changes to the industry and as such is welcome. However, the impact these changes will have is obviously limited to the ICC universe and it remains to be seen whether other arbitral institutions will follow suit.

Impact on the Legal Landscape?

Whilst you could be forgiven for thinking that the cumulative impact of the two recent High Court decisions, including judicial criticism of the IBA guidelines, and the new ICC guidelines could be a development of the law surrounding arbitration bias, the bottom line is that it has not changed the status quo; this is a case of plus ca change, plus c'est la meme chose.

The two High Court cases affirm the primacy, as far as English law is concerned, of the common law and the fair observer test when deciding upon apparent bias applications. The court's refusal to follow the IBA guidelines, whilst worthy of note, should not be overstated. Whilst heavily influential, the IBA guidelines are only non-binding guidelines and, as such, the court was not bound by them. Further, the

criticism given amounted to only one granular aspect of them; not the IBA guidelines generally. The ICC guidelines are a helpful clarifying tool in respect of an arbitrator's disclosure obligations in ICC arbitrations; especially in respect of third party funding. However, none of this represents anything akin to a seismic shift in how to approach conflicts.

One prevailing theme from the cases and the ICC guidance update is the need for arbitrators to lead an open and honest conflict disclosure process. At the heart of any arbitral appointment is the trust that the parties have in the arbitrator's integrity and judgment. Factors bearing down on an arbitrator not to disclose any potential conflicts should be resisted and a long-term view should be adopted. The arbitration community is relatively small and if an arbitrator does not disclose a conflict which subsequently emerges, then that arbitrator's reputation will be undermined. As unfortunate as it may be to lose an appointment, it would be more unfortunate to never be appointed again. The general rule for arbitrators still stands; if in doubt, disclose.

In the circumstance where a party does challenge an arbitrator's independence, it is key that the arbitrator must try to avoid descending into the arena as their continued credibility relies upon it. This can be difficult, especially if there are suggestions of dishonesty and improper conduct at play in the heat of the arbitration, but it is essential in order that the issues can be fairly heard, the arbitrator retains credibility and the process can run smoothly through to its natural conclusion with the least disruption as possible.

There are lessons to be learnt here for arbitrating parties as well. Whilst it is often commentated on that parties try things in arbitrations that they would not dream of doing in litigation, parties should still act as reasonably and transparently as possible. For a party to use allegations of an arbitrator's conflict when they do not believe things are going their way is at the very least distasteful, and, at most, an abuse of process. If a party has any concerns in respect of an arbitrator it is before, it should raise them in good time and as courteously as possible, remembering always that the arbitrator is not its adversary.

Finally, arbitral institutions must also ensure they play the appropriate role in trying to prevent issues of conflict or bias from arising in the first place. Perhaps most importantly, they should ensure that the declarations and forms they ask arbitrators to complete are, in fact, completed in full (and then properly considered) before each arbitrator is appointed.

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Author Profile

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BAKER & MCKENZIE

APPARENT JUDICIAL BIAS - A HARD ARGUMENT TO WIN?

- DANIEL KALDERIMIS, PARTNER, CHAPMAN TRIPP

The England and Wales Court of Appeal has declined to find apparent bias despite an extraordinary case of judicial indiscretion.

The decision confirms the approach adopted by the New Zealand Supreme Court in *Saxmere*[1] but also reflects a reluctance to uphold allegations of apparent judicial bias.

The case

Harb v HRH Prince Abdul Aziz Bin Fahd Bin Abdul Aziz [2016] EWCA Civ 556 concerned an appeal against a judgment enforcing a contract between Prince Abdul Aziz bin Fahd, a member of the Saudi royal family, and Mrs Harb. The Prince appealed on several grounds, including the appearance of judicial bias by the Judge, Peter Smith J.

The allegation centred on a letter which Peter Smith J sent to Blackstone Chambers advising that he would no longer support it because he did not wish "to be associated with Chambers that have people like Pannick in it".

Smith had taken objection to an article by a member of the Chambers, Lord Pannick QC, which criticised Peter Smith J's "inexcusably bullying manner and threats" in an earlier unrelated case,[2] in which the Judge recused himself after becoming involved in a personal dispute with the defendant, British Airways, over his own lost luggage.

The Prince's Counsel, also Blackstone members, argued that the apparent hostility toward Lord Pannick in particular and the Chambers in general would infect Peter Smith J's attitude toward the Prince himself.

The Court of Appeal rejected the claim, but remitted the matter to the High Court for re-trial on other grounds.[3]

The fair-minded observer

The Court's approach was in substance the same as that adopted by the New Zealand Supreme Court in *Saxmere*.[4] The test in both cases was, broadly, "whether the fair-minded and informed observer, having considered the facts, would conclude that there was a real possibility that the tribunal was biased".[5]

The Court found that, while Peter Smith J may have been biased (temporarily at least) against all members of Blackstone Chambers, the evidence was not sufficient to conclude that there was "a real possibility that this bias would affect the judge's determination of the issues in a case in which a party was represented by a member of Blackstone Chambers".[6]

Indeed, the Court concluded that it was "unrealistic"[7] to assume that Peter Smith J was actuated by bias against the Prince because, prior to the article's publication, he had:

- expressed a clear provisional view of the case, and
- drafted the bulk of his judgment.

- drafted the bulk of his judgment.

The fair-minded observer must not only be intelligent and dispassionate, but possessed of "all the relevant circumstances", including those that are not publicly available.[8]

Nonetheless, the Court was unsparing in its criticism of Peter Smith J's conduct:

> "It is difficult to believe that any judge, still less a High Court Judge, could have [written the letter]. It was a shocking and, we regret to say, disgraceful letter to write. It shows a deeply worrying and fundamental lack of understanding of the proper role of a judge".[9]

Chapman Tripp comments

The distinction between the appearance of bias or hostility toward counsel and bias toward the parties to the proceeding appears to be a fine one.

The Court commented that judges often become irritated by advocates but are expected to be true to their judicial oaths and not allow these feelings to affect their determination of the issue. An informed and fair-minded observer is taken to know this. Even so, there will surely be circumstances in which a fair-minded observer might consider there to be a real possibility that a judge's attitude toward counsel may undermine his or her ability to be impartial. The judicial oath will not be a complete answer in all cases.

This was, of course, the case in *Saxmere*, where the Supreme Court held that a fair-minded observer could reasonably consider the judge to have been beholden to counsel, albeit in a case involving a potential financial interest, in such a way as might unconsciously affect the impartiality of the judge's mind.

The difference between the two cases is that the Court in *Saxmere* found apparent bias to exist and the Court in *Prince Abdul* did not. One can sense the reluctance in the Court of Appeal to find apparent bias on facts which could surely have justified the finding.

It may be true that the Judge had already indicated a view and drafted most of his decision prior to the Pannick article. But the Judge's letter was still written and sent before the decision was delivered. The general public would be entitled to discern an element of generosity in the Court of Appeal's assessment.

Footnotes

1. Saxmere Co Ltd v Wool Board Disestablishment Co Ltd (No2) [2009] NZSC 122, 1 NZLR 76 (SC). See also Deliu v National Standards Committee [2015] NZHC 67; G v Psychologists Board HC Wellington CIV-2007-485-2558, 8 December 2009; Muir v Judicial Conduct Commissioner [2013] NZHC 989.
2. Emerald Supplies Ltd v British Airways [2015] EWHC 2201 (Ch).
3. The Court held that the Judge had failed to examine evidence and the arguments with the care that a proper resolution of the issues demanded, at [48].
4. Saxmere (at [4]): Judge disqualified if "a fair-minded lay observer might reasonably apprehend that the judge might not bring an impartial mind to the resolution of the question the judge is required to decide." Citing the High Court of Australia in Ebner v Official Trustee in Bankruptcy (2000) 205 CLR 337.
5. At [54].
6. At [74].
7. At [75].
8. Harb at [72].
9. At [68].

Author Profile

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ENGLISH HIGH COURT REFUSES TO DETERMINE THE EXISTENCE OF A DISPUTED ARBITRATION CLAUSE PRIOR TO THE COMMENCEMENT OF ARBITRATION PROCEEDINGS

Chris Parker (Partner) James Allsop (Senior Associate)
Herbert Smith Freehills

In a recent decision, the English High Court determined that it would be wrong in principle for the court to determine whether parties to a disputed contract had entered into a binding arbitration agreement in circumstances where one party intended to commence arbitration proceedings on the basis of the disputed arbitration agreement: *HC Trading Malta Ltd v Tradeland Commodities S.L.* [2016] EWHC 1279 (Comm) (click here for the full judgment).

The decision highlights the respect afforded to the arbitral process under the Arbitration Act 1996 ("**the Act**") and affirms that it is only in circumstances where the court is required to "fill a gap", such as with anti-suit injunctions preventing a party from commencing or continuing proceedings in another forum, that it will rule on the jurisdiction of an arbitral tribunal.

Background

The claimant alleged that the parties had entered into a binding contract under which the defendant was to purchase 250,000mt of clinker in bulk from the claimant, to be shipped in a series of parcels. The claimant further alleged that the contract contained a London arbitration clause. The defendant never received any parcels of clinker and denied that there was any contract of sale.

The claimant's solicitors asked the defendant to agree to accept service of an arbitration notice at its London solicitors, but the defendant did not do so. The defendant did not have any claim of its own against the claimant and took the position that it would contest the arbitrator's jurisdiction if the claimant commenced arbitration in London.

The claimant sought a declaration that there was a binding arbitration agreement which was subject to English law and which covered the claimant's intended claims. The defendant applied to set-aside the claimant's claim for declaratory relief on the following bases: (a) the court had no jurisdiction to entertain the claim under the Act; (b) alternatively, even if the court had jurisdiction it would be wrong in principle to do so; and (c) insofar as it was a matter for the court's general discretion it

matter for the court's general discretion it should be exercised against granting any relief.

Decision

The court dismissed the claimant's claim for declaratory relief. However, it did not accept the defendant's principal case that the court was deprived of declaratory jurisdiction under the Act. The judge considered that if it had been Parliament's intention to exclude the court's jurisdiction in that way, it would have been expressly stated in the Act. As the Act was silent on this point, it would be wrong to conclude that the Act impliedly limited the court's jurisdiction. Instead, the judge held that the issue was better considered as a matter of principle.

The judge highlighted the fact that the Act lays down an extensive code for the governance of arbitrations from start to finish, and considered the existence of that scheme to be highly relevant when considering the scope of the court's powers prior to commencement of arbitral proceedings. Although the court had jurisdiction to intervene, the judge accepted that in general terms, the court must be extremely slow to intervene where an arbitration is concerned.

The judge held that respect for the arbitral process includes respect for the scheme of and the principles underlying the Act. That scheme and those principles would be frustrated when an arbitration is on foot or contemplated if the parties were simply able to invoke a general declaratory power of the court, limited only by a broad exercise of discretion. Rather, disputes as to the existence or scope of an arbitration agreement should be determined by the detailed provisions of the Act, and in particular, as a starting point by the power of a tribunal to determine its own substantive jurisdiction under s30 of the Act. The only exception is where the court has to "fill a gap", as with anti-suit injunctions.

It would therefore be wrong in principle for the court to entertain any application for a declaration by a claimant where there are at least the following three factors:

1. the claimant asserts that there is a binding arbitration agreement;
2. the claimant has a claim which it wishes to assert and which therefore (on the claimant's own case) can only be litigated by way of arbitration; and
3. the claimant is clearly able to commence arbitration in pursuance of that agreement whether or not he has yet done so, and whether or not it is imminent.

Finally, even if there was no principled argument against granting the declaratory relief sought by the claimant and it was all a matter of the court's discretion, it would "unhesitatingly" refuse to exercise it in favour of granting relief. The judge's reasons including the following:

1. it was a needless invocation of the court's powers where the arbitral tribunal was capable of making a declaration as to the validity of the arbitration agreement;
2. it could not be said at this stage that it would necessarily be quicker or cheaper to use the court process rather than the arbitrators;
3. there was a very real risk that in deciding the issue of the existence of the arbitration agreement, the court would decide the central issue between the parties of whether there was a binding contract for sale; and
4. there was no practical impediment to the claimant commencing the arbitration straight away.

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HERBERT SMITH FREEHILLS

CASE IN BRIEF:
DRAKE CITY LTD V TASMAN-JONES [2016] NZHC 899

A recent case in which the High Court considered the effect of arbitration clauses on parties seeking relief in Court. The claimant sought summary judgment against the defendants for rent arrears as guarantors under a lease. The defendants argued the Court lacked jurisdiction to hear the claim, relying on an arbitration clause in the relevant lease.

Background & Facts

In 2011, the defendants guaranteed the performance of a lessee (**BMTJ**) for restaurant premises in Auckland's Victoria Park Market complex. In 2012, a new owner (**Drake**) became registered proprietor of the property and took a reversion of the lease. In the same year, the defendants, BMTJ and Drake collectively executed a variation to the lease relating to rental. In 2014, BMTJ fell into rent arrears payable under the varied lease, and BMTJ was placed into liquidation later the same year. The liquidators disclaimed the lease, at which point Drake re-leased the premises to new tenants and determined the existing lease on 1 January 2015.

In November 2015, Drake issued proceedings against the defendants, as guarantors, claiming rent and outgoings for the entirety of 2014.

The defendants sought to set-off the damages against Drake's claim for rent, arguing BMTJ sustained such damages as a consequence of misrepresentation and a breach of the lease by Drake.

As guarantors, the defendants were entitled to raise any defence a principal could have raised.[1] The defendants argued their claims constituted a 'dispute' which must be referred to arbitration in terms of the lease, which contained an arbitration clause.

In support of their argument to stay the plaintiff's claim for summary judgment, the defendants relied on the Supreme Court decision in *Zurich Australian Insurance Ltd t/a Zurich New Zealand v Cognition Education Ltd*,[2] where the Supreme Court upheld the principle of party autonomy and unanimously held that where parties have agreed to arbitrate disputes, there are only very limited circumstances in which a Court should hear a summary judgment application. Where there is an agreement to arbitrate for the pertinent type of claim or dispute, the Court must stay the (summary judgment) proceeding and refer it to arbitration.

Decision

While the Court's decision in *Zurich* is clear, whether proceedings should be stayed pending arbitration will ultimately depend on what the parties have agreed on a case by case basis. In the present case, the terms of the lease contained the following provisions:

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> Arbitration:
>
> 44.1 UNLESS any dispute or difference is resolved by mediation or other agreement, the same shall besubmitted to the arbitration of one arbitrator who shall conduct the arbitral proceedings in accordance with the Arbitration Act 1996 and any amendment therefore or any other statutory provision then relating to arbitration.
> ...
> 44.3 THE procedures described in this clause shall not prevent the Landlord from taking proceedings for the recovery of any rent or other monies payable hereunder which remain unpaid or from exercising the rights and remedies in the event of such default prescribed in clause 28.1 hereof.[3]

In considering the application for summary judgment and the relevant arbitration clauses in the lease, the Court dismissed the defendants' claim to have the application for summary judgment stayed. The Court found that the effect of the relevant lease provisions, particularly clause 44.3, preserved Drake's right as landlord to pursue separate legal proceedings for the recovery of any rent or other monies payable under the lease. The Court held that pursuant to the terms of the lease, the parties had expressly agreed to exclude claims for rent and other monies payable by the tenant (*ipso facto* the defendants as guarantors) under the lease from reference to arbitration. Consequently, there was no dispute capable of reference to arbitration by the Court in relation to Drake's claim for rent and other outgoings.[4]

The Court held that the defendants' reliance on *Zurich* was misconceived, as there was in fact no dispute to refer to arbitration concerning Drake's claim for rent and outgoings. While the defendants' claims of misrepresentation and purported lease breach by Drake were in fact disputes which should be referred to arbitration pursuant to clause 44.1, the fact those disputes should be referred to arbitration did not prevent Drake from taking the current separate proceedings to recover rent and outgoings.

Comment

This is an important decision, illustrating the application and potential limits of the Supreme Court's decision in *Zurich*. In the present case, the High Court acknowledged the principle of party autonomy in contracting with arbitration clauses unanimously endorsed in *Zurich*, but demonstrated that any such arbitration clauses will be strictly interpreted, and cannot be relied on to stay summary judgment proceedings outside of the precise category of disputes the parties have agreed to refer to arbitration.

Since *Zurich*, some have viewed the Supreme Court's decision as positive recognition from the Courts of arbitration as an alternative dispute resolution method, however others argue that referral to arbitration may cause some parties to be unnecessarily deprived

from the potential time and cost savings of summary judgment. Evidently, the Courts will uphold parties' arbitration clauses where appropriate, but such clauses will be subject to strict interpretation for referral to arbitration of only the disputes contracted for in the relevant arbitration clause(s).

Footnotes:

1 Hyundai Shipbuilding and Heavy Industries Co Ltd v Pournaras [1978] EWCA Civ J0517-3, [1978] 2 Lloyd's Rep 502.
2 Zurich Australian Insurance Ltd t/a Zurich New Zealand v Cognition Education Ltd [2014] NZSC 188, [2015] 1 NZLR 383.
3 Clause 28.1 of the lease provides for cancellation.
4 Drake City Ltd v Tasman-Jones [2016] NZHC 899 at [43].

Philip Morris Asia Limited (Hong Kong) v. The Commonwealth of Australia: Permanent Court of Arbitration Tribunal Publishes Redacted Version of Award on Jurisdiction and Admissibility

- Steven Nelson and Michael Robbins

The Permanent Court of Arbitration ("**PCA**") has just released the full award of the Tribunal in *Philip Morris Asia Limited (Hong Kong) v. The Commonwealth of Australia*, which was rendered in late 2015. We previously published here an eUpdate on the dispute and the outcome of the proceedings, in which Philip Morris had challenged Australian legislation that required tobacco companies marketing cigarettes in Australia to sell them only in logo-free, drab dark brown packaging (the "**Plain Packaging Measures**"). The full award now makes available to us the grounds on which the Tribunal declined to exercise jurisdiction in the matter.

The claim was brought by Philip Morris Asia Limited (Hong Kong) ("**Philip Morris HK**") under the provisions of Australia's 1993 Investment Promotion and Protection Agreement with Hong Kong (the "**Treaty**"), which is a bilateral investment treaty or "BIT". Philip Morris HK asserted that the Plain Packaging Measures "bar the use of intellectual property on tobacco products and packaging, transforming [the Claimant's subsidiary in Australia] from a manufacturer of branded products to a manufacturer of commoditized products with the consequential effect of substantially diminishing the value of [the Claimant's] investments in Australia", for which it sought declaratory relief and compensation. Its commencement of arbitration under the Treaty followed on the heels of the 2012 dismissal by the Australian High Court of a challenge to the law by Philip Morris and other major tobacco companies, including British American Tobacco, Imperial Tobacco and Japan Tobacco.

In its award, the Tribunal held that Philip Morris's attempt to challenge Australia's plain packaging laws was an abuse of rights. It determined that Philip Morris's claims were inadmissible and that it was thus precluded from exercising jurisdiction over the dispute.

Background to the Dispute

On 29 April 2010, Australia's Prime Minister Kevin Rudd and Health Minister Roxon unequivocally announced the Government's intention to introduce the Plain Packaging Measures.

On 23 February 2011, Philip Morris HK formally acquired shares in Philip Morris (Australia) Limited ("PM Australia") in an internal corporate reorganization. This restructuring gave Philip Morris HK prima facie standing to bring its claim under the investor-state dispute settlement provisions of the 1993 BIT between Hong Kong and Australia (the "Treaty").

1993 BIT between Hong Kong and Australia (the "**Treaty**").

On 21 November 2011, some nine months after Philip Morris HK had acquired the shares in PM Australia, the Plain Packaging Measures that had been announced the previous year were actually enacted. On the same day, Philip Morris HK served The Commonwealth of Australia with a Notice of Arbitration under the Treaty.

Australia objected to the Tribunal's jurisdiction on the basis that it was barred from considering Philip Morris HK's claim because the dispute was foreseeable when Philip Morris HK obtained the nominal protection of the Treaty through the restructuring in which it had acquired PM Australia and, therefore, that the resort to arbitration under the Treaty constituted an abuse of right. Under the extensive body of jurisprudence resulting from the lengthy history of arbitrations under BITs and similar intergovernmental agreements, the invocation of the protections under such agreements may be abusive if standing to do so is acquired through measures taken when a dispute has already arisen or is clearly foreseeable. That line of authority is grounded on the principle of good faith, and its application depends upon the subjective motivation for the measures in question, particularly whether the purpose was simply to obtain the benefits of the relevant treaty.

According to Philip Morris HK, the *"overall objectives of the restructuring were to minimise tax liability, align ownership with control, and optimize cash flows"*. There were also *"additional benefits"*, such as alignment of the ownership of the Australian subsidiaries with Philip Morris HK's pre-existing management control of the subsidiaries, optimization of the Philip Morris HK's cash flow, as well as *"additional BIT protection[s]"*. A further key motivation behind the restructuring was, according to Philip Morris HK, that restructuring aligned the ownership and management control of many Philip Morris affiliates. In the submission of Philip Morris HK, the restructuring had entirely legitimate objectives independent of its desire to obtain the protections of the Treaty.

Reasoning

In the view of the Tribunal, it would not normally be an abuse of right to bring a BIT claim in the wake of a corporate restructuring, if the restructuring was justified independently of the possibility of bringing such a claim. However, the Tribunal found that Philip Morris HK had not proved that tax or other business reasons were determinative of the restructuring. From all the evidence, the Tribunal was only able to conclude that *"the main and determinative, if not sole, reason for the restructuring was the intention to bring a claim under the Treaty, using an entity from Hong Kong"* after it received ample warnings that the Australian government was considering introducing the Plain Packaging Measures.

In the Tribunal's view, there was no uncertainty about the Australian Government's intention to introduce the Plain Packaging Measures after its announcement on 29 April 2010. The Tribunal held that, from that date, there was at least a reasonable prospect that legislation equivalent to the Plain Packaging Measures would eventually be enacted and that a dispute would arise. The Tribunal further held that the Australian Government's adoption of the Plain Packaging Measures was not only foreseeable but actually foreseen by Philip Morris when it chose to change its corporate structure.

The Tribunal concluded, accordingly, that the initiation of the arbitration constituted an abuse of rights, as the corporate restructuring by which Philip Morris HK acquired the Australian subsidiaries occurred at a time when there was a reasonable prospect that the dispute would materialise and was carried out for the principal, if not sole, purpose of gaining Treaty protection. Accordingly, the Tribunal held that the claim was inadmissible and that it was precluded from exercising jurisdiction.

was precluded from exercising jurisdiction.

Significance of the Case

The case is less important for what it decided than for what it did not. It has in fact become a "poster child" for political objections to investment treaties and trade agreements that allow investors, in practice usually foreign corporations, to bring legal challenges against governments, which would otherwise enjoy sovereign immunity. It has become a cause célèbre for those who see it as an intolerable subjection of the right of sovereign, democratic governments to regulate business conduct in their territories to abusive claims of large, well-financed multinational corporations, forcing states to defend their laws before tribunals composed of private individuals. This has, in fact, become a major issue in the negotiation of the Transatlantic Trade and Investment Partnership ("TTIP") Agreement currently under negotiation between the United States and the European Union, and it significantly influenced the disputes provisions of the recently-concluded but as-yet-unratified Transpacific Partnership ("TPP") Agreement.

This political backlash has obscured the fact that governments do occasionally take actions affecting foreign investors in violation of established principles of international law. The possibility of such actions reduces the security of investment, thus potentially depriving countries, particularly in the developing world, of much-needed capital investment, which is the purpose of BITs to encourage. The inability of the Tribunal to exercise jurisdiction in the Philip Morris case has deprived us of a possible opportunity for clarification of the line between legitimate regulation, which is recognized in nearly all BITs and in customary international law, and interference with rights protected by treaty and law. This is not a new conundrum in public international law, but it is one the balance of which is constantly shifting as economic and social conditions change. It is unfortunate that this case, having provoked so much angst and political hyperbole, could not have resulted in some much-needed clarification on the merits of that significant issue.

Author Profile

Steven Nelson is a Partner with Dorsey & Whitney LLP. Beginning with his service in the Office of the Legal Adviser of the US State Department, Steve has focused throughout his career on the complex legal issues involved in international trade and investment.

Although concentrated primarily in cross-border, multi-country M&A transactions, his practice has included extensive work on joint ventures, notably in emerging countries, as well as both litigation and arbitration of disputes involving multiple jurisdictions.

Michael Robbins is an Associate with Dorsey & Whitney LLP in Hong Kong. Michael is experienced in complex commercial disputes and helps his clients achieve their strategic objectives whether by litigation, arbitration or negotiation from a practical perspective.

HONG KONG COURT OF PRACTICAL VIEW ON T UPHOLDING A LIQUIDAT

In the recent case of *Brio Electronic Commerce Limited v Tradelink Electronic Commerce Limited* CACV 271/2013, the Hong Kong Court of Appeal (CA) held that a clause in the contract setting a sum of HK$5 million as liquidated damages in relation to an obligation of non-solicitation was not a penalty and was therefore enforceable. The CA affirmed the century-old traditional legal test for determining whether a clause is a liquidated damages clause – i.e., whether a clause that took effect on breach was a "genuine pre-estimate of loss" and therefore compensatory, or whether it was aimed at deterring a breach and therefore penal (*Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 79). In that regard, Hong Kong law now diverges from the latest position in England, which has recently over-ruled *Dunlop*.

Despite this recent development on the rule on penalties in England (click here and here to read our previous posts on the new rule on penalties in England), Hong Kong courts have not yet followed suit. Nevertheless, it does appear that the Hong Kong Courts are more open to the idea of taking a broad approach, which may have implications for parties entering into commercial contracts in Hong Kong going forward.

Background

Both the plaintiff and the defendant operated in a niche market of providing electronic trade declaration facilities. In 2003, the Government increased competition in the market by issuing a new licence. The plaintiff and the defendant entered into an agreement where the plaintiff agreed to cooperate solely with the defendant and not with the defendant's new competitor. The defendant ensured that none of the plaintiff's clients would connect with the service provided by the defendant's competitor, while the defendant agreed not to seek to persuade the plaintiff's customers from leaving the plaintiff to use the defendant's own services instead.

In 2006, the defendant poached two of the plaintiff's most important customers. The dispute was resolved by settlement with the defendant paying the plaintiff about HK$1.9 million and entering into a second agreement. The second agreement was similar to the first agreement, but there was a liquidated damages clause of HK$5 million in the second agreement. The plaintiff brought an action against the defendant for breach of the second agreement.

At the Court of First Instance, the defendant contended that the liquidated damages clause was a penalty and was therefore unenforceable. The defendant's argument was rejected by the lower court on the basis that, among various things, the second agreement was a commercial agreement entered into by parties who were very familiar with the trade, the agreement was made only after lengthy negotiations, and that the agreed amount of HK$5 million was the parties' best pre-estimate of the damages that were likely to be suffered in the event of a breach of the contractual obligations, the amount of which was not extravagant or unconscionable.

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- Gareth Thomas, Dominic Geiser, Priya Aswani

The defendant appealed. At the CA, the defendant argued that since the second agreement was entered as part of the settlement of the breach of the first agreement, the liquidated damages clause in the second agreement should be regarded as an attempt to deter the defendant from breaching its contractual obligations again, and was thus a penalty and was unenforceable. The CA too, rejected the defendant's argument and held in favour of the plaintiff.

Decision

In arguing for an unenforceable penalty clause, the defendant referred to the Dunlop case and then further suggested that assistance be derived from the approach in *Murray v Leisureplay Plc* [2005] EWCA Civ 963, where Arden LJ set out a five-stage test to determine whether a clause was a penalty:

> *i. To what breaches of contract does the contractual damages provision apply?*
> *ii. What amount is payable on breach under that clause in the parties' agreement?*
> *iii. What amount would be payable if a claim for damages for breach of contract was brought under common law?*
> *iv. What were the parties' reasons for agreeing the relevant clause?*
> *v. Has the party who seeks to establish that the clause is a penalty shown that the amount payable under the clause was imposed in terrorem, or that it does not constitute a genuine pre-estimate of loss for the purposes of the Dunlop case, and, if he has shown the latter, is there some other reason which justifies the discrepancy between (ii) and (iii) above?*

The CA rejected the restrictive approach in Murray. Instead the CA cited an earlier Hong Kong case Ip Ming Kin v Wong Siu Lan (unreported, 28 May 2013, CA, CACV 201/2012) as support for adopting a broader approach. If the Court had adopted the restrictive approach in *Murray*, it would have been necessary to adduce evidence and calculate damages. The CA held this would have been inconsistent with the purpose of a liquidated damages clause, which was precisely to dispense with the need to adduce evidence and calculate damages.

It is not clear whether in adopting the broader approach the Court would go as broad as the approach taken in *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis* [2015] UKSC 67, which now represents the current law on penalty clauses in England & Wales. The Supreme Court found that penalty clauses should be determined based on whether the innocent party's legitimate interest in enforcing the counterparty's contractual obligations were "out of all proportion". While it could be potentially more flexible than the traditional test, the Cavendish test has not been formally considered by the Hong Kong Courts.

Hence, the traditional "genuine pre-estimate of loss" test from *Dunlop* and its guidelines remain in place at least for the time being. Even so, the CA in Brio did consider that the

determination of a penalty clause was "a question that should be considered in broad and general terms". This may prompt future decisions to move towards Cavendish.

The key takeaways

- The law on penalty remains as it has been for Hong Kong contracts.
- Consider at the stage of negotiating a liquidated damages clause whether the amount stipulated in the clause is a genuine pre-estimate of the loss that is likely to occur.
- Where a genuine pre-estimate is not possible, consider whether the amount can be commercially justified.
- Be sure to maintain a record of all the negotiations (oral and written) and the commercial factors that the parties have considered which go to justifying the stipulate amount.
- Where possible, avoid a single amount that is payable irrespective of whether the loss is minor or of a greater magnitude.

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