IN THE SUPREME COURT OF NEW ZEALAND

SC 27/2013
[2014] NZSC 75

BETWEEN	EWAN ROBERT CARR First Appellant
	BROOKSIDE FARM TRUST LIMITED Second Appellant
AND	GALLAWAY COOK ALLAN Respondent

Hearing:	28 November 2013
Court:	Elias CJ, McGrath, William Young, Glazebrook and Arnold JJ
Counsel:	D J Goddard QC, P J Dale and A J Wicks for Appellants C A McLachlan QC, A V Foote and J L W Wass for Respondent D A R Williams QC and S E Fitzgerald for Intervener
Judgment:	20 June 2014

JUDGMENT OF THE COURT

A **The appeal is allowed and the judgment of the High Court setting aside the award of 9 May 2011 is reinstated.**

B **The respondent must pay to the appellants costs in this court of $25,000 together with reasonable disbursements.**

C **The order for costs in the Court of Appeal is set aside and the respondent is to pay the appellants' costs in that Court and the High Court to be fixed by those courts.**

REASONS

	Para No
Elias CJ, McGrath, William Young and Glazebrook JJ	[1]
Arnold J	[89]

ELIAS CJ, McGRATH, WILLIAM YOUNG AND GLAZEBROOK JJ

(Given by McGrath J)

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Introduction

[1] The appellants were in dispute with the respondent, a firm of solicitors, which they had instructed to act for them on the settlement of a commercial transaction. The settlement did not take place on the due date and the other party to the transaction cancelled the contract. The appellants contended that this outcome was the fault of the member of the respondent firm who had acted on the settlement and claimed that the respondent was liable for damages for professional negligence.

[2] The parties agreed to arbitrate this claim. It was a term of their agreement that each should have a right of appeal to the High Court on any question of law or

fact arising out of the arbitrator's award. The applicable rules for the conduct of arbitration under the Arbitration Act 1996 include an optional provision that permits an appeal to the High Court on any question of law arising out of an award. In their agreement, the parties purported to amend this provision by extending the right of appeal to apply to questions of fact as well as of law. It is now common ground that this extension was not permitted by the Arbitration Act.

[3] In due course, and after hearing the parties, the arbitrator delivered an award dismissing the appellants' claim. The central issues in this appeal concern whether the respondent is entitled to enforce the parties' agreement to arbitrate despite the invalid provision for appeal. If so, the award will be final and binding on the parties, subject only to a right of appeal on questions of law. If not, the arbitration agreement will be invalid and it will be necessary to decide the further issue of whether the judgment of the High Court setting aside the award was a correct exercise of the court's discretion in art 34 of schedule 1 of the Arbitration Act. Article 34(2)(a)(i) provides that the High Court "may" set aside an arbitral award where the arbitration agreement between the parties was not valid.

Background

[4] The appellants, Mr Carr and a company of which he is a director, were in dispute with interests associated with a Mr Humphries. The parties agreed to settle their differences on terms which included completion of certain transactions, involving the purchase by the appellants of farming and hotel assets, by 4pm on 31 May 2007, time being of the essence. The appellants were unable to complete by the stipulated time and the Humphries interests terminated the contract. Litigation disputing the termination followed in which the appellants were unsuccessful in their attempt to attribute the failure to complete to the Humphries interests. The Humphries interests' termination of the contract was upheld by the courts.

[5] The appellants then contended that a member of Gallaway Cook Allan, the respondent firm which had acted for them, was negligent in handling settlement of their transactions, causing delay which had ultimately enabled the Humphries interest to cancel the agreement.

[6] The appellants and respondent entered into an agreement to arbitrate their dispute. On 9 May 2011, the arbitrator, the Honourable Robert Fisher QC, delivered a partial award in which he held that the solicitor acting for the appellants had been negligent, but that his negligence was not causative of the inability of the appellants to settle by the due time and date. The arbitrator decided, on the basis of a detailed counter-factual analysis, that, even if the solicitor had not been negligent, he could not have completed settlement by the stipulated time on 31 May 2007. On the counter-factual analysis, settlement could not have occurred before 4.07pm on that day, a mere seven minutes after the stipulated time. The appellants had failed by that narrow margin to prove causation, and their claim failed.

[7] In accordance with what they believed were their rights under the agreement to arbitrate, the appellants then applied to the High Court for an order setting aside the award or, in the alternative, for leave to appeal on the grounds of errors of fact and law by the arbitrator.

The agreement to arbitrate

[8] The provision concerning rights of appeal appears in that part of the agreement of 28 September 2010 by which the parties submit their dispute concerning negligence by the respondent to arbitration. It reads:

> The parties agree as follows:
>
> 1. Arbitral tribunal and remedies
>
> 1.1 The dispute is submitted to the award and decision of the Honourable Robert Fisher QC as Arbitrator whose award shall be final and binding on the parties (subject to clause 1.2).
>
> 1.2 The parties undertake to carry out any award without delay subject only to such rights as they may possess under Articles 33 and 34 of the First Schedule to the Arbitration Act 1996 (judicial review), and clause 5 of the Second Schedule (appeals subject to leave) but amended so as to apply to "*questions of law and fact*" (emphasis added).
>
> …

The italics and the words in parentheses appear in the agreement.

[9] The problem leading to the present litigation arises from the qualification, in the final words of cl 1.2, to the provision in cl 1.1 for finality of the arbitral award in relation to the dispute. The italicised words indicated that an award would be subject to appeal to the High Court, by either party, for errors of both fact and law. It is common ground that this provision is contrary to the requirements of the Arbitration Act, a theme of which is reducing the extent of court intervention in the arbitral process. The parties, however, differ as to the consequences of the ineffectiveness of the provision extending the optional right of appeal.

Recourse to the courts under the Arbitration Act

[10] It is convenient at this point to set out the provisions of the Arbitration Act concerning recourse to the courts to impugn an award. Section 6(1) provides that the procedural rules set out in schedule 1 of the Act apply where the place of arbitration is in New Zealand. Article 5 of schedule 1 states:

> **5 Extent of court intervention**
>
> In matters governed by this schedule, no court shall intervene except where so provided in this schedule.

Article 34 of schedule 1 provides for recourse to the courts in relation to awards, but only in limited circumstances:

> **34 Application for setting aside as exclusive resource against arbitral award**
>
> (1) Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3).
>
> (2) An arbitral award may be set aside by the High Court only if—
>
> (a) the party making the application furnishes proof that—
>
> (i) a party to the arbitration agreement was under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it, or, failing any indication on that question, under the law of New Zealand; or
>
> (ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present that party's case; or

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decision on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this schedule from which the parties cannot derogate, or, failing such agreement, was not in accordance with this schedule; or

(b) the High Court finds that—

(i) the subject matter of the dispute is not capable of settlement by arbitration under the law of New Zealand; or

(ii) the award is in conflict with the public policy of New Zealand.

(3) An application for setting aside may not be made after 3 months have elapsed from the date on which the party making that application had received the award or, if a request had been made under article 33, from the date on which that request had been disposed of by the arbitral tribunal. This paragraph does not apply to an application for setting aside on the ground that the award was induced or affected by fraud or corruption.

…

(6) For the avoidance of doubt, and without limiting the generality of paragraph 2(b)(ii), it is hereby declared that an award is in conflict with the public policy of New Zealand if—

(a) the making of the award was induced or affected by fraud or corruption; or

(b) a breach of the rules of natural justice occurred—

(i) during the arbitral proceedings; or

(ii) in connection with the making of the award.

The mandatory rules in schedule 1 essentially replicate those of the UNCITRAL Model Law on International Commercial Arbitration. The principles of the Model Law are extended by the Arbitration Act to cover domestic arbitrations.

[11] Under s 6(2)(b), additional procedural rules in schedule 2 to the Arbitration Act apply to New Zealand domestic arbitrations unless the parties "agree otherwise". The parties may accordingly opt out of these procedural rules. Clause 5 of schedule 2, which applies notwithstanding arts 5 and 34 of schedule 1,[1] makes provision for appeals against arbitral awards, but only on questions of law:

> **5 Appeals on questions of law**
>
> (1) Notwithstanding anything in articles 5 or 34 of Schedule 1, any party may appeal to the High Court on any question of law arising out of an award—
>
> (a) if the parties have so agreed before the making of that award; or
>
> (b) with the consent of every other party given after the making of that award; or
>
> (c) with the leave of the High Court.
>
> (2) The High Court shall not grant leave under subclause 1(c) unless it considers that, having regard to all the circumstances, the determination of the question of law concerned could substantially affect the rights of 1 or more of the parties.
>
> (3) The High Court may grant leave under subclause 1(c) on such conditions as it see fit.
>
> (4) On the determination of an appeal under this clause, the High Court may, by order—
>
> (a) confirm, vary, or set aside the award; or
>
> (b) remit the award, together with the High Court's opinion on the question of law which was the subject of the appeal, to the arbitral tribunal for reconsideration or, where a new arbitral tribunal has been appointed, to that arbitral tribunal for consideration,—
>
> and, where the award is remitted under paragraph (b), the arbitral tribunal shall, unless the order otherwise directs, make the award not later than 3 months after the date of the order.
>
> (5) With the leave of the High Court, any party may appeal to the Court of Appeal from any refusal of the High Court to grant leave or from any determination of the High Court under this clause.
>
> (6) If the High Court refuses to grant leave to appeal under subclause (5), the Court of Appeal may grant special leave to appeal.

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[1] As was proposed by the Law Commission report on which the Arbitration Act 1996 is based: see Law Commission *Arbitration* (NZLC R20, 1991) at [93] and [97].

(7) Where the award of an arbitral tribunal is varied on an appeal under this clause, the award as varied shall have effect (except for the purposes of this clause) as if it were the award of the arbitral tribunal; and the party relying on the award or applying for its enforcement under article 35(2) of Schedule 1 shall supply the duly authenticated original order of the High Court varying the award or a duly certified copy.

(8) Article 34(3) and (4) of Schedule 1 apply to an appeal under this clause as they do to an application for the setting aside of an award under that article.

(9) For the purposes of article 35 of Schedule 1,—

(a) an appeal under this clause shall be treated as an application for the setting aside of an award; and

(b) an award which has been remitted by the High Court under subclause (4)(b) to the original or a new arbitral tribunal shall be treated as an award which has been suspended.

(10) For the purposes of this clause, **question of law—**

(a) includes an error of law that involves an incorrect interpretation of the applicable law (whether or not the error appears on the record of the decision); but

(b) does not include any question as to whether—

(i) the award or any part of the award was supported by any evidence or any sufficient or substantial evidence; and

(ii) the arbitral tribunal drew the correct factual inferences from the relevant primary facts.

[12] To summarise: there is a general rule against court intervention in matters governed by schedule 1, which applies where the place of arbitration is New Zealand. The only permitted means of recourse to the court against an award under schedule 1 is by application for setting aside under one of the limited grounds of irregularity prescribed by art 34(2). The Law Commission has observed that the grounds on which an award may be challenged under art 34 "must be taken to be fundamental to the procedure of arbitrations which the Model Law establishes".[2]

[13] There is also, however, an optional overriding provision in cl 5 of schedule 2 for a right of appeal on a question of law in domestic arbitrations. Clause 5 applies

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[2] At [291]. See also *Methanex Motunui Ltd v Spellman* [2004] 3 NZLR 454 (CA) at [110].

notwithstanding arts 5 and 34 of schedule 1. It makes provision for a limited right of appeal to the High Court against an award on any "question of law".[3] The Law Commission recognised that its proposal for inclusion in the Act of a power to review an award, beyond that in art 34, was a considered departure from the spirit of the Model Law.[4]

[14] None of these provisions or any other in the Arbitration Act provides any basis for a right of appeal against an arbitral award on a question of fact. Nor does any other New Zealand legislation. In New Zealand, a right of appeal to a court only exists where created by statute.[5] Contracting parties cannot, by agreement, create such a right of appeal to a court where no statutory authorisation exists. It follows that the words "but amended so as to apply to '*questions of law and fact*' (emphasis added)" in cl 1.2 of the parties' agreement are ineffective. At issue in this appeal is whether there is, nevertheless, an agreement by the parties to arbitrate that can be enforced.

The present proceeding

[15] On 8 August 2011, the appellants applied under art 34(2) to set aside the partial award on the ground that the arbitration agreement was not valid in law. They also sought relief under the Contractual Mistakes Act 1977, and orders estopping the respondent from asserting that there was no jurisdiction to appeal against the arbitrator's findings of fact. As well, they appealed against the award, giving particulars of errors said to be of both fact and law and seeking leave to appeal, if necessary.

[16] In this Court, it is only the contention that the award should be set aside because of the invalidity of the arbitration agreement that is in issue. The appellants contend that, in consequence of the defective provision concerning appeals, the agreement to arbitrate lacks legal force. They submit that the words at issue – "but

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3 Under cl 5(10)(b) of schedule 2 to the Arbitration Act, set out at [11] above, a question as to whether there was sufficient or substantial evidence supporting an award is not a "question of law". Nor is a question as to whether the arbitrator drew the correct inferences from the relevant primary facts. Clause 5(10) was inserted by s 9 of the Arbitration Amendment Act 2007.

4 Law Commission, above n 1, at [93] and [97].

5 By contrast, the High Court has inherent jurisdiction to hear and determine applications for judicial review.

amended so as to apply to '*questions of law and fact'* (emphasis added)" – cannot be severed from cl 1.2, and that the invalidity of the provision renders the entire agreement unenforceable. On that basis, the appellants submit that the Court should set aside the arbitral award under art 34(2)(a)(i) of schedule 1 to the Arbitration Act.

[17] The respondent's argument in the High Court and Court of Appeal was that the agreement can be enforced with the words in issue severed from cl 1.2. Alternatively, they said the power to set aside the award under art 34(2) is discretionary and the discretion should be exercised against the appellants. In this Court, the respondent has advanced these arguments again, but also raises a further preliminary point in resisting the contention that the agreement to arbitrate is invalid and the award should be set aside under art 34.

[18] The further ground raised by the respondent concerns what comprises the "arbitration agreement" that the appellants contend is invalid. The respondent says that the arbitration agreement is that part of the parties' agreement which refers the dispute to arbitration by the arbitrator, and nothing else. On this basis, the arbitration agreement is only the words in cl 1.1 that submit the dispute to the named arbitrator and provide that his award shall be final and binding on the parties. From this premise, the respondent says that the arbitration agreement does not include the provision for appeals in cl 1.2 and that the deficiencies of that clause are accordingly not a ground for setting aside an award.

High Court decision

[19] In the High Court, Ellis J decided that the words "and fact"[6] could not be severed from cl 1.2 and, accordingly, the arbitration agreement as a whole was not valid under New Zealand law.[7] Ellis J approached the issue of severability primarily on the basis set out in the Privy Council's judgment in *Carney v Herbert*[8] and that of McHugh J of the High Court of Australia in *Humphries v The Proprietors "Surfers*

6 As indicated above, we see the issue as whether the phrase "but amended so as to apply to '*questions of law and fact'* (emphasis added)" can be severed from the agreement, given that the removal of that entire phrase is necessary to ensure cl 1.2 is both valid and makes sense.

7 *Carr v Gallaway Cook Allan* [2012] NZHC 1537, [2012] 3 NZLR 97 at [50] [*Carr* (HC)].

8 *Carney v Herbert* [1985] AC 301 (PC).

Palms North" Group Titles Plan 1955,[9] both of which we discuss below. Applying those principles, Ellis J considered that it was necessary to consider the relative importance of the clause to the parties and whether it could objectively be inferred that they would not have entered into the contract without it. If that was so, severance was difficult to justify.[10]

[20] The italicisation of "questions of law and fact" and the parenthetical reference to "emphasis added" in cl 1.2 were, in the Judge's view, "express indications of its importance to the parties".[11] This indicated that the inclusion of a factual appeal right "might objectively be seen as particularly critical".[12] The highly factual nature of the dispute underscored the importance of the extended provision for appeals.[13] As well, to the extent that it could properly be taken into account, correspondence between the parties prior to their agreement clearly suggested that the respondent, in particular, would not have agreed to arbitrate without the inclusion of a right to appeal on questions of fact.[14] Ordering severance would also actively improve the contractual position of the respondent, the party who now sought to enforce the contract. In the Judge's view the interests of justice did not support that outcome.[15]

[21] In relation to exercise of the art 34 discretion, Ellis J decided that setting aside the award was the proper course because otherwise the respondent would "reap the very substantial benefit" of a mistake for which it was at least partly responsible.[16] In the result, Ellis J set aside the award on the basis that the arbitration agreement was not valid under New Zealand law.

[22] Ellis J went on to consider an alternative basis for the appellants' claim under the Contractual Mistakes Act. The appellants asserted that the parties had been influenced in deciding to enter the agreement by their common mistaken view that

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9 *Humphries v The Proprietors "Surfers Palms North" Group Titles Plan 1955* (1994) 179 CLR 597.
10 *Carr* (HC), above n 7, at [43].
11 At [44].
12 At [44].
13 At [45].
14 At [46]–[47].
15 At [48].
16 At [51].

they could provide for an appeal on questions of fact. Ellis J accepted this was the position but decided that the mistake had not "at the time of the contract" resulted in a "substantially unequal" exchange of values or benefits in terms of s 6(1) of the Contractual Mistakes Act.[17] That precluded the grant of relief and the Judge granted the respondent summary judgment on this ground of the appellants' claim.

[23] This finding was not challenged in the Court of Appeal or before this Court. Although in this Court counsel referred to the Contractual Mistakes Act in their submissions on the issue of severance, we are not required to address the High Court's finding that the Contractual Mistakes Act did not apply.

Court of Appeal decision

[24] In the Court of Appeal, the parties took different positions in their characterisation of the arbitration agreement.[18] The respondent argued that it was an agreement to arbitrate, with an ancillary right of appeal. The appellants submitted that it was an agreement to which the right of appeal on questions of fact was integral.

[25] The Court of Appeal summarised the principles to be applied:[19]

> (a) The arbitration agreement must be construed as a whole including the relevant provisions of the Arbitration Act to determine whether excision of the offending words "of fact" will change the nature or merely the extent of the mutual promises.
>
> (b) In determining this question it is appropriate to enquire whether:
>
> > (i) the offending words are so interconnected with the rest of the agreement that it can be said that they form an indivisible whole without which the character of the agreement cannot survive;
> >
> > (ii) expressed slightly differently, the excision of the offending words would leave unchanged the subject matter of the agreement and the parties' primary obligations;
> >
> > (iii) if the offending words are excised, there is an identifiable element of the consideration which remains apportionable to the enforceable promises; and

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17 At [64]–[65].

18 *Gallaway Cook Allan v Carr* [2013] NZCA 11, [2013] 1 NZLR 826 (Harrison, Wild and Ronald Young JJ) [*Carr* (CA)].

19 At [42].

(iv) the invalidity taints the whole agreement.

(c) The issue is to be determined by:

(i) assessing the agreement at the date when it was entered into; and

(ii) excluding a subjective enquiry into a party's intentions or a hindsight analysis of the result under the wider umbrella of fairness.

(d) However, the fact of performance of the parties' obligations is relevant and may be taken into account at this stage or within the later discretionary enquiry.

[26] The Court of Appeal saw as important that the purpose of the Arbitration Act was to give effect to finality of awards where there was no departure from principles of law or breach of natural justice.[20] In the present case, the Court decided that severance of the offending phrase would not alter the nature and character of the agreement to arbitrate. The parties' primary obligations, to which the factual right of appeal was only subsidiary, would remain unchanged.[21] The policy of the law was to give effect to a contractual relationship wherever possible, despite the existence of a vitiating factor and even more so where parties have substantially performed the agreement.[22] As well, the invalidity was by reason of a statutory prohibition; there was no reprehensible element to taint the agreement as a whole.[23]

[27] In view of the Court of Appeal's decision that the agreement to arbitrate was valid, art 34(2)(a)(i) of schedule 1 of the Arbitration Act did not apply. The Court nevertheless recorded its view that the discretion in art 34 is of a wide and apparently unfettered nature, which was to be exercised in accordance with the purposes and policy of the Arbitration Act.[24] The Court's view was that, if it were wrong in its conclusion on the severability issue, the statutory principles and philosophy plainly rendered it inappropriate to exercise the discretion to set aside the award.[25]

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20 At [46], citing *Gold and Resource Developments (NZ) Ltd v Doug Hood Ltd* [2000] 3 NZLR 318 (CA).
21 At [48](a)–[48](b).
22 At [48](d)–[48](e).
23 At [48](c).
24 At [66].
25 At [67].

Issues

[28] There are three issues for determination in the present appeal:

(a) First, what constitutes an "arbitration agreement" for the purposes of the Arbitration Act?

(b) Second, can the ineffective words in cl 1.2 be severed from the remainder of the parties' agreement?

(c) Third, if they cannot, so that the parties' arbitration agreement is invalid, should this Court set aside the award under art 34(2)(a)(i)?

Purposes and principles of the Arbitration Act

[29] All three of these issues must be considered having regard to the purpose and in the context of the relevant legislation. Section 5 of the Arbitration Act is its purpose provision:

> **5 Purposes of Act**
>
> The purposes of this Act are—
>
> (a) to encourage the use of arbitration as an agreed method of resolving commercial and other disputes; and
>
> (b) to promote international consistency of arbitral regimes based on the Model Law on International Commercial Arbitration adopted by the United Nations Commission on International Trade Law on 21 June 1985; and
>
> (c) to promote consistency between the international and domestic arbitral regimes in New Zealand; and
>
> (d) to redefine and clarify the limits of judicial review of the arbitral process and of arbitral awards; and
>
> (e) to facilitate the recognition and enforcement of arbitration agreements and arbitral awards; and
>
> (f) to give effect to the obligations of the Government of New Zealand under the Protocol on Arbitration Clauses (1923), the Convention on the Execution of Foreign Arbitral Awards (1927), and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) (the English texts of which are set out in Schedule 3).

[30] The word "agreed" in s 5(a) is a reminder that the Act's policy of encouraging the use of arbitration as a method of resolving commercial and other disputes is premised on arbitration being the parties' agreed method to resolve the dispute. As Lord Mustill once said in delivering a judgment in the Privy Council:[26]

> Arbitration is a contractual method of resolving disputes. By their contract the parties agree to entrust the differences between them to the decision of an arbitrator or panel of arbitrators, to the exclusion of the Courts, and they bind themselves to accept that decision, once made, whether or not they think it right.

Arbitration accordingly has its origins in and depends for its continuing authority on the agreement of the parties.[27] When the parties enter into an arbitration agreement they provide the contractual basis on which the statutory regime is founded.

[31] Section 5(d) of the Arbitration Act states a purpose of redefining and clarifying the limits of judicial review of the arbitral process and of arbitral awards. The regulation of court intervention in the arbitral process is achieved through arts 5 and 34 of schedule 1 and, (unless the parties opt out) cl 5 of schedule 2, already discussed. Section 5(e) sets out the associated purpose of facilitating the recognition and enforcement of arbitration agreements and arbitral awards. This is relevant to the statutory policy favouring finality of arbitral determination subject to limited exceptions provided in the Arbitration Act.

[32] The arbitral procedure is regulated by the Arbitration Act partly in order to maintain a fair and uniform process for exercise of its adjudicative function, and in part to accord finality to the award to facilitate its enforcement. But it is the parties who select arbitration rather than court proceedings, and who, subject to mandatory statutory rules, set up the process by which arbitration will be conducted. The parties' choices must be respected if contractual principles are to have due application in the arbitration context.[28]

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[26] *Pupuke Service Station Ltd v Caltex Oil (NZ) Ltd* PC 63/94, 16 November 1995 at 1. An abridged version of the judgment is reported as an Appendix to *Gold and Resources Developments (NZ) Ltd v Doug Hood Ltd*, above n 20, at 338.

[27] See Law Commission, above n 1, at [41] and Megan Richardson "Arbitration Law Reform: The New Zealand Experience" (1996) 12 Arbitration International 57.

[28] See Law Commission, above n 1, at [42].

The "arbitration agreement"

[33] In that context, we consider the respondent's submission in relation to the meaning of "arbitration agreement". Section 2 of the Arbitration Act defines "arbitration agreement" as follows:

> **arbitration agreement** means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not …

This meaning applies also to schedule 1 and thus to art 34.

[34] An arbitration agreement may be in the form of an arbitration clause in a contract.[29] If it takes that form, it has effect independently of the contract. Its separate status is affirmed by art 16(1) of schedule 1 to the Act.[30] Art 16(1) provides for the competence of an arbitral tribunal to rule on its jurisdiction in these terms:

> **16 Competence of arbitral tribunal to rule on its jurisdiction**
>
> (1) The arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitral tribunal that the contract is null and void shall not entail *ipso jure* (necessarily) the invalidity of the arbitration clause.

This is referred to as the doctrine of separability.

The parties' submissions

[35] Mr McLachlan QC for the respondent, in support of his submission that in this case the arbitration agreement was confined to the words in cl 1.1, argued that the purpose and effect of the doctrine of separability is to ensure that defects in parties' contractual arrangements outside of an arbitration agreement do not affect their consent to arbitration, and accordingly do not displace the arbitrator's jurisdiction to resolve disputes coming within the clause. Treating cl 1.1 as separate from the remainder of the submission agreement was in accordance with that

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[29] Arbitration Act, schedule 1, art 7.
[30] Law Commission, above n 1, at [334].

purpose. Mr McLachlan cited the Court of Appeal's judgment in *Methanex Motunui Ltd v Spellman*[31] as an instance of a New Zealand Court treating an arbitration agreement within a settlement agreement as being a separate agreement, suggesting that the position in the present case was analogous.

[36] Counsel for the intervener, the Arbitrators' and Mediators' Institute of New Zealand, supported this submission, drawing a distinction in their written submissions between the "arbitration agreement", which refers the dispute to arbitration, and collateral matters concerning the procedure and outcome of the arbitration that may be included in the broader "submission agreement". Mr Williams QC and Mr McLachlan, in developing that submission, argued that the procedural provisions, including those for an appeal, are not a part of an arbitration agreement. It was submitted that this position has gained wide international acceptance. As well, to support the separation of the arbitration agreement from the procedure governing it, Mr McLachlan emphasised that the law governing the material validity, scope and interpretation of an arbitration agreement may be different from the 'curial law' that governs the parties' rights of recourse.[32]

[37] In response, Mr Goddard QC submitted that neither the text nor purpose of the Act supported the interpretation contended for by the respondent and intervener. He said that "arbitration agreement" is used through the Act and schedule 1 to refer not only to the core submission of the dispute to arbitration, but also to encompass provisions governing the manner in which the arbitration is to be conducted. At the hearing, he emphasised that such an interpretation is consistent with ordinary usage.

Our evaluation

[38] The meaning of "arbitration agreement", which is defined in general terms in s 2, is to be ascertained from the text of the Arbitration Act, considered in light of its purpose and statutory context.[33]

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31 *Methanex Motunui Ltd v Spellman*, above n 2, at [49]–[56].

32 See Lord Collins (ed) *Dicey, Morris and Collins on the Conflict of Laws* (15th ed, Sweet & Maxwell, London, 2012) at 829.

33 Interpretation Act 1999, s 5.

[39] The context in which "arbitration agreement" is used in the Arbitration Act indicates that it has a broad meaning going beyond the formal submission of disputes to the arbitral tribunal. For example, s 12 contemplates that the parties may, in their arbitration agreement, modify the powers of an arbitral tribunal.[34] Section 14 states that the parties may agree "in the arbitration agreement or otherwise" to terms governing the privacy and confidentiality of the arbitral proceedings. This provision contemplates that such terms can form part of the arbitration agreement itself.

[40] Schedule 1 sets out procedural rules for arbitration. Article 4 is concerned, in part, with departures from requirements under the arbitration agreement. A party who, knowing of non-compliance, fails to object in a timely manner, is deemed to have waived the right to object. This article also clearly contemplates that procedural requirements will form part of the arbitration agreement. Article 7(1) provides that "an arbitration agreement may be in the form of an arbitration clause in a contract or that of a separate agreement". It is implicit in the latter case, that the whole of the separate agreement is the "arbitration agreement". Finally, art 31(5) provides for arbitration agreements to deal with interest on the amounts of awards.

[41] These provisions provide context which indicates that, within the scheme of the New Zealand Arbitration Act, the term "arbitration agreement" has a broad meaning that encompasses procedural matters on which the parties agree.

[42] We do not read art 16 of schedule 1 as requiring a more limited meaning of "arbitration agreement". There is an important distinction between an arbitration clause which forms part of a contract (whether establishing the relationship between the parties, or providing for settlement of a dispute, as in *Methanex*), and an arbitration clause in a submission agreement, being an agreement wholly concerned with submission of a particular dispute to arbitration and the terms of that submission.

[43] Under art 16 of schedule 1 to the Arbitration Act, separation of an arbitration clause from a principal contract, of which it is part, ensures that the arbitration clause will have an independent existence, thereby giving the arbitrator jurisdiction to

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[34] In relation to remedies, relief and awarding interest.

determine the validity of the principal contract. Any issue as to that contract's illegality or invalidity is capable of being referred to arbitration. If the arbitration clause were not severable, this would lead to the absurd result that, if an arbitrator held that there was a defect in the contract that rendered it invalid, this would be to determine that the arbitration clause itself was invalid, and deprive the arbitrator of jurisdiction. Article 16 overcomes this potentially destructive consequence. As Lord Hoffman has said:[35]

> The principle of separability enacted in s 7 means that the invalidity or rescission of the main contract does not necessarily entail the invalidity or rescission of the arbitration agreement. The arbitration agreement must be treated as a "distinct agreement" and can be void or voidable only on grounds which relate directly to the arbitration agreement.

[44] There is, however, no possibility of the destructive result where an arbitration clause is contained in a submission agreement that is distinct and separate from the contract to which the dispute being submitted to arbitration relates. In such circumstances, a finding by the arbitrator that the contract from which the dispute arises is invalid would not undermine arbitral jurisdiction. For these reasons, we do not accept the submission that art 16 requires or supports the proposition that the meaning of "arbitration agreement" is to be confined to the contractual term submitting a dispute to arbitration, so as to exclude any procedural terms agreed by the parties.

[45] Furthermore, treating the arbitration agreement, whether in the form of an arbitration clause or clauses within a contract, or a submission agreement, as including both the provision submitting the dispute to arbitration and any governing procedural terms agreed on by the parties respects the autonomy of the parties, consistently with the purposes and principles underlying the Arbitration Act. It enables them to agree to arbitration with particular features. This is important where the ultimate issue is whether, as in this case, there was ever an agreement to arbitrate at all.

[46] The fact that different rules apply to the agreement to arbitrate and the procedure governing the arbitration does not mean that they are separate agreements.

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35 *Fiona Trust & Holding Corp v Privalov* [2007] UKHL 40, [2007] 4 All ER 951 at [17].

In our view, if parties' contractual assent to arbitration is made conditional, in the specific clause submitting the dispute to arbitration, upon certain procedural matters or other terms, it must follow that those conditions are part of the arbitration agreement. That is the case with cl 1.2 of the agreement that is the subject of the present appeal, as the language of submission in cl 1.1 is expressed as being "subject to clause 1.2". The parties' "arbitration agreement" is (at least) the whole of cl 1 of the submission agreement.[36]

Severance of void contractual provisions

Introduction

[47] The respondent's alternative submission is that the words at issue can be deleted from cl 1.2, and the remainder of the arbitration agreement enforced. It is to the law of contract that the Court must turn to decide this question. Most of the cases that bear on this issue involve contractual terms that were found to be illegal or contrary to public policy, rather than merely ineffective, but they nonetheless are of assistance.

[48] The invalidity of a contractual provision does not necessarily render the entire agreement unenforceable. In *Pickering v Ilfracombe Railway Co*, Willes J said:[37]

> The general rule is that, where you cannot sever the illegal from the legal part of a covenant, the contract is altogether void; but, where you can sever them, whether the illegality be created by statute or by the common law, you may reject the bad part and retain the good.

[49] At one time, the emphasis of the common law was on the requirement that an illegal promise could only be severed if it was supported by separate consideration. But, towards the end of the nineteenth century, the courts began to develop a broader

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36 Had we decided that procedural terms were part of a separate agreement an issue would arise over whether the two agreements were so closely connected that the submission agreement could not stand if the procedural agreement were invalid.

37 *Pickering v Ilfracombe Railway Co* (1868) LR 3 CP 235 at 250. See also J Beatson, A Burrows and J Cartwright *Anson's Law of Contract* (29th ed, Oxford University Press, New York, 2010) at 432–433.

approach to the issue of severability. The start of this development can be seen in 1893, in *Kearney v Whitehaven Colliery Co*, where Lopes LJ said:[38]

> It has been argued that the result of that unlawful provision is to vitiate the whole contract of employment. The law is clear that where the consideration for a promise or promises contained in the contact is unlawful, the whole agreement is void. The reason is that it is impossible to discriminate between the weight to be given to different parts of the consideration, and therefore you cannot sever the legal from the illegal part. But where there is no illegality in the consideration, and some of the provisions are legal and others illegal, the illegality of those which are bad does not communicate itself to, or contaminate, those which are good, unless they are inseparable from and dependent upon one another.

The approach in Carney v Herbert

[50] In *Carney v Herbert*,[39] the Privy Council brought more directly into consideration both the severability of an offending provision, and the policy concern that the entire contract might be tainted by the provision sought to have severed. The Privy Council approved the reasoning of Jordan CJ in *McFarlane v Daniell*,[40] who had recognised that the question of severability had two limbs: the first being whether valid promises supported by legal consideration were severable from the invalid and, if so, the second being whether the valid promises were enforceable. As to severability, Jordan CJ said:[41]

> When valid promises supported by legal consideration are associated with, but separate in form from, invalid promises, the test of whether they are severable is whether they are in substance so connected with the others as to form an indivisible whole which cannot be taken to pieces without altering its nature. If the elimination of the invalid promises changes the extent only but not the kind of the contract, the valid promises are severable. If the substantial promises were all illegal or void, merely ancillary promises would be inseverable.

And later as to whether the modified contract was enforceable:[42]

> The exact scope and limits of the doctrine that a legal promise associated with, but severable from, an illegal promise is capable of enforcement, are not clear. It can hardly be imagined that a Court would enforce a promise, however inherently valid and however severable, if contained in a contract one of the terms of which provided for assassination.

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38 *Kearney v Whitehaven Colliery Co* [1893] 1 QB 700 (CA) at 713.
39 *Carney v Herbert*, above n 8.
40 *McFarlane v Daniell* (1938) 38 SR (NSW) 337 (FC).
41 At 345 (citations omitted), quoted in *Carney v Herbert*, above n 8, at 311.
42 At 346, quoted in *Carney v Herbert*, above n 8, at 311.

[51] The Privy Council said of these passages in *Carney*:[43]

> Their Lordships agree with both observations. There are therefore two matters to be considered where a contract contains an illegal term, first, whether as a matter of construction the lawful part of the contract can be severed from the unlawful part, thus enabling the plaintiff to sue on a promise unaffected by any illegality; secondly, whether, despite severability, there is a bar to enforceability arising out of the nature of the illegality.

The Privy Council rephrased the first consideration, saying that where the elimination of the illegal provision would "leave unchanged the subject matter of the contract and the primary obligations" of the parties, the valid portion would be severable.[44] This reflects Jordan CJ's reference to elimination of invalid promises that changed "the extent only but not the kind of contract".

[52] On the Privy Council's approach, if the first question were answered "yes" and the second question "no", the contract could be enforced with the unlawful provision severed. On the other hand, if the lawful part was severable from the unlawful, public policy might still preclude enforcement of a contract, from which an illegal promise had been severed, because of the tainting affect of the excised provision, even after severance. It is not, however, suggested that any such policy consideration arises in the present case, so this Court need only address the first question.

[53] But *Carney* also recognised that answering these two questions may not complete the inquiry. Earlier in its judgment, the Privy Council had reiterated the limits to the guidance given by the application of tests:[45]

> Questions of severability are often difficult. There are not set rules which will decide all cases. … [T]ests for deciding questions of severability that have been formulated as useful in particular cases are not always satisfactory for cases of other kinds.

The test in *Carney* for severability provides only limited guidance because there is no single statement of principle that will provide the answer in all cases. This

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43 *Carney v Herbert*, above n 8, at 311.
44 At 316.
45 At 309.

highlights the necessity for the courts when addressing severability to exercise judgment, with regard to the circumstances of particular cases.

[54] In *Carney* itself, where a lawful contract included an unlawful ancillary term (for a mortgage to secure impermissible financing) the illegal term had been included for the exclusive benefit of the party seeking to enforce the contract. In that context the Privy Council said that a court might well enforce the contract without the illegal provision if the justice of the case so required and there was no public policy objection.[46] It accordingly rejected the proposition that a party could resist severance of a provision that solely benefited the other party on the basis that such a term was essential to that party. This observation has no relevance to the present case because the invalid provision for an appeal on questions of fact was not included solely for the benefit of the respondent which is the party seeking to enforce the contract without it.

The Humphries *approach*

[55] In his judgment in the High Court of Australia case of *Humphries v The Proprietors "Surfers Palms North" Group Titles Plan 1955*,[47] McHugh J adopted the Privy Council's views about the limited assistance that any single test could provide:[48]

> However, this is not an exclusive test. The test of severability is a flexible one. "There are no set rules which will decide all cases" … .

McHugh J also observed that in *Humphries* the unenforceable provision was not for the exclusive benefit of the plaintiffs as it had been in *Carney*.[49] This was significant in His Honour's evaluation. He said that, in cases like *Humphries*:[50]

> … where a provision in a contract is void, is not for the exclusive benefit of the party seeking to enforce the contract, and is part of the consideration for an indivisible promise of the defendant, the proper test for determining

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46 At 316–317.

47 *Humphries v The Proprietors "Surfers Palms North" Group Titles Plan 1955*, above n 9. McHugh J's articulation of the approach was applied in New Zealand by the Court of Appeal in *Atrium Management Ltd v Quayside Trustee Ltd (In Receivership and Liquidation* [2012] NZCA 26, (2012) 7 NZ ConvC 96–001 at [41]–[43].

48 At 619, citing *Carney v Herbert*, above n 8, at 309.

49 At 620–621.

50 At 621–622 (citations omitted).

> whether the void provision is severable from the indivisible promise is that formulated by the Full Court of the Supreme Court of Victoria in *Brew v Whitlock [No 2]*. In that case, the Full Court said that "once the conclusion is reached that the invalid promise is so material and important a provision in the whole bargain that there should be inferred an intention not to make a contract which would operate without it", the invalid promise should be treated as inseverable from the contract.

The United States approach

[56] Mr McLachlan cited two United States cases in support of the proposition that it is appropriate to sever a provision that purports to agree to a higher standard of court review of an arbitration award.

[57] *Kyocera Corp v Prudential-Bache Trade Services, Inc* was a decision of the United States Court of Appeals, Ninth Circuit.[51] The arbitration agreement provided that a court could vacate, modify or correct any award "where the arbitrators' findings of fact are not supported by substantial evidence" or "where the arbitrators' conclusions of law are erroneous".[52] These grounds for judicial intervention went beyond those provided for in the federal arbitration legislation and the Court held that the words purporting to expand the scope of court review were legally unenforceable.[53]

[58] The Court also decided that the invalid words could be severed from the remainder of the arbitration clause because they were not integrated into and interdependent with the remainder of the contract or sufficiently central to the purpose of the agreement. A factor influencing the Court's decision, which distinguishes it from the present case, was the absence of indications that the scope of court review was central to the parties' agreement:[54]

> Although Kyocera asserts that the potential for expansive appellate review was critical to the entire agreement, its briefs cite absolutely no evidence that supports this assertion. … Under the circumstances, we find that the offending clauses must, in the interests of justice, be severed from the remainder of the contract.

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51 *Kyocera Corp v Prudential-Bache Trade Services, Inc* 341 F 3d 987 (9th Cir 2003).
52 At 990–991.
53 At 994 and 998–1000.
54 At 1001–1002.

[59] Mr McLachlan also relied on the decisions of the Ninth Circuit Court of Appeals and the Supreme Court of the United States in the case of *Hall Street Associates, LLC v Mattel, Inc*.[55] The arbitration agreement in that case provided for the same two grounds of court review as were at issue in *Kyocera*: unsupported factual findings, and erroneous legal conclusions.[56] The Court of Appeals and Supreme Court both decided that the contractual terms purporting to expand the scope of judicial review were legally unenforceable.[57]

[60] In relation to severability, the Court of Appeals decided that *Kyocera* was controlling and could not be distinguished:[58]

> The evidence that the parties intended that the entire arbitration agreement should fail in the event that the expanded standard of review provision failed is not strong enough to distinguish this case from *Kyocera.*

On appeal, the Supreme Court did not address the issue of severability.

[61] These judgments indicate that United States federal law does not permit parties to expand, beyond the grounds provided for by statute, the basis on which a court can review, vary or set aside an arbitral award. We do not, however, accept that these United States authorities establish any principle requiring the severance from an arbitration agreement of words purporting to expand the scope of court review. They are merely examples of instances where, in the circumstances and on the basis of the evidence before the court, severance has been held to be appropriate.

Summary of principles

[62] The overall approach to severability that emerges from these decisions is one that is founded on core contractual principles. The significance of severance of an invalid contractual provision is evaluated in the course of examination of what the parties are to be taken to have agreed in the words they used. This is an issue of construction of the contract. It is likely to be permissible to sever an invalid promise

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55 *Hall Street Associates, LLC v Mattel, Inc* 113 Fed Appx 272 (9th Cir 2004) [*Hall Street Associates* (CA)]; and *Hall Street Associates, LLC v Mattel, Inc* 552 US 576 (2008) [*Hall Street Associates* (SC)].

56 *Hall Street Associates* (SC), above n 55, at 579.

57 *Hall Street Associates* (CA), above n 55, at 272–273; and *Hall Street Associates* (SC), above n 55, at 584–589.

58 *Hall Street Associates* (CA), above n 55, at 273.

which is subsidiary to the main purpose of the contract, but severance may not destroy the main purpose and substance of what has been agreed.[59] Severance cannot be permitted to alter the nature of a contract. This approach to severability is also consistent with the first purpose of the Arbitration Act expressed in s 5, which is the encouragement of the use of arbitration as an agreed method of resolving commercial and other disputes. It highlights the Act's contract based approach to the choice of arbitration over court processes to resolve a dispute.[60] We would adopt the approach as applicable in New Zealand.

A subjective inquiry?

[63] The key point of difference between the judgments of the High Court and the Court of Appeal in this case concerned Ellis J's application of what McHugh J had said in *Humphries*.[61] The Court of Appeal saw Her Honour's application of McHugh J's approach as introducing a "but for" test: whether the invalid promise was so material that an intention should be inferred that, but for the inclusion of the invalid words, the parties would not have entered the bargain.[62]

[64] This, in the Court of Appeal's opinion, involved a subjective inquiry into the intentions of the contracting parties, in the course of which Ellis J had taken into account and relied on evidence given at trial of the parties' subjective intentions:[63]

> That was extraneous to the contract and inadmissible, and introduced a wider and more problematic inquiry than was permissible on the speculative rationale that without it an injustice might arise.

In support, the Court of Appeal referred to observations in *Carney v Herbert* which indicated that there should be no subjective inquiry into intention.[64]

[65] In this Court, Mr Goddard for the appellants submitted that the Court of Appeal was wrong to criticise as subjective the approach taken by McHugh J in

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59 MP Furmston, GC Cheshire and CH Stuart *Cheshire, Fifoot and Furmston's Law of Contract* (16th ed, Oxford University Press, Oxford, 2012) at 530, citing *Goodinson v Goodinson* [1954] 2 QB 118 (CA).

60 See Richardson, above n 27, at 58.

61 Ellis J's analysis is summarised at [19] above.

62 *Carr* (CA), above n 18, at [29].

63 At [30].

64 At [29]–[30]. See *Carney v Herbert*, above n 8, at 316.

Humphries and by Ellis J in the High Court. Counsel said that assessing whether a provision was so material and important to the parties' bargain that no intention could be inferred to enter a contract without it, was not invoking subjective intention. The inquiry was an objective one.

[66] We agree that the approach of McHugh J is based on objective manifestation of contractual intentions and does not involve a subjective inquiry.[65] It does not reduce severability to a question of whether the parties would have entered into the agreement had the relevant words been severed. The approach is one way of establishing whether applying the doctrine of severance would leave the subject matter of the contract and the primary obligations of the parties unchanged: it is an expression, in different words, of the first stage of inquiry into the severability referred to in *Carney*. An implied term approach as suggested by Mr Goddard would permit few, if any, contractual clauses to be capable of deletion since, by definition, the parties have included them.

Application of principles to the present case

[67] In the present case, the respondent seeks to enforce the contract shorn of its provision for a right of appeal on matters of fact. This involves severing the words "but amended so as to apply to '*questions of law and fact*' (emphasis added)" from the end of cl 1.2 of the parties' agreement.

[68] The nature of the transaction entered into by the parties was to submit their dispute to the award and decision of the nominated arbitrator for final and binding determination, with an important reservation concerning their agreement that the arbitrator's award would be final. The submission of the dispute to arbitration was stated to be subject to cl 1.2, being the term that provided for appeal on questions of law and fact. The parties' mutual undertaking to carry out any award without delay was also subject to that qualification in cl 1.2. By invoking cl 5 of schedule 2 of the Arbitration Act, the parties made it plain that they were not opting out of it. They

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[65] It is not necessary for the purposes of the present appeal to consider 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.

did that, however, on the impermissible and unenforceable basis that cl 5 would be amended to apply to allow an appeal on "questions of law and fact".[66]

[69] Whether this provision goes to the very nature of their contract (and not merely its extent), and whether it was so material and important a provision in their agreement to submit the dispute to arbitration that objectively there should be inferred an intention not to submit the dispute to arbitration without it, is really the same issue. It is an issue of construction of their contract.

[70] In the present case, the parties indicated in their agreement to arbitrate the degree of importance that they attributed to the scope of their ability to challenge the award on appeal. Their italicisation of the words "questions of law and fact", followed by the notation "(emphasis added)" made clear, objectively, that the scope of the appeal right did go to the heart of their agreement to submit their dispute to arbitration. It is unnecessary to consider further the pre-contractual email discussion also relied on by Mr Goddard, as it is plain from the contractual terms themselves that an appeal on fact as well as law was central to the agreement of the parties. While that may not always be the position with a provision in an arbitration agreement that purports to expand recourse to the courts from what the Act permits, it is undoubtedly so in this instance. The dispute was submitted to arbitration on this basis.

[71] Furthermore, as Ellis J pointed out,[67] the factual matrix at the time the parties entered into the arbitration agreement reinforces the importance they attached to the right to bring a factual appeal. They had agreed to resolve by arbitration a dispute over the respondent's liability in negligence which would have to address both the conduct of solicitors and whether that conduct caused loss to the appellants. That arbitration, as Ellis J said, would involve a "highly fact driven enquiry".[68] This indicates why the parties' reservations concerning the finality of the arbitrator's award, and their alteration of cl 5 to provide full rights of appeal was so important and indeed a critical feature of their agreement. The words at issue, constituting the

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66 We have already explained the reasons for the invalidity of cl 1.2 at [10]–[14] above.

67 *Carr* (HC), above n 7, at [47].

68 At [45].

condition to which the agreement to arbitrate was subject, are so material and important a promise in the agreement to arbitrate that they are not severable.

[72] For the above reasons, the agreement to arbitrate fails. The appellants have accordingly established, as required by art 34(2)(a)(i) of schedule 1 to the Arbitration Act, that the arbitration agreement is not valid. It is therefore necessary for the Court to determine the third issue, to which we now turn, of whether the High Court was correct to exercise its discretion, under art 34, to set aside the arbitral award.

Exercise of the art 34 discretion

The parties' submissions

[73] The respondent contends that the discretion to set aside the award, under art 34(2) of schedule 1 to the Arbitration Act, should not be exercised in favour of the appellants in this case, so that the award should stand. Mr McLachlan submitted that the statutory discretion is broad and unfettered. The only guiding principles are those of the Arbitration Act itself, including the need to respect the parties' decision to submit their disputes to arbitration, the need for finality and the principle of non-intervention in the merits of an award. Counsel added that the key circumstances in the case were that an agreement to arbitrate had been reached between the appellants and the respondent and there was no dispute over how the arbitration had been conducted by the appointed arbitrator. To strike down the award in those circumstances, he argued, would be contrary to the Arbitration Act's purpose and principles and would provide the appellants with the windfall of having the award set aside without having established that there were any errors of fact or law.

[74] Mr Williams submitted for the Intervener that the Court should adopt the pro-enforcement approach of the international treaties on which art 34 is based, and the presumption in favour of upholding awards except in exceptional circumstances. He emphasised the importance of the principle of finality in arbitration and said that the Court should not interfere in the absence of compelling reasons. He also emphasised the importance of limiting review to be consistent with international practice. In this case, it was the parties' own legal error which had led to the invalidity and they should carry responsibility for that. They should have foreseen

that appeals on questions of fact were invalid. As a matter of principle, the courts should not exercise the discretion in art 34 to assist the party disenchanted with the award to escape the consequences of its error.

[75] Mr Goddard for the appellants pointed out the wide range of defects to which art 34 applied. He accepted that, in general, a court could refuse to set aside an award if the appellants had not been prejudiced by the matter giving rise to the application to set aside the award. But, if the defect was the absence of a valid agreement to arbitrate, the whole basis for enforcement of the award was absent. In such a case, only a subsequent valid agreement, or circumstances amounting to an estoppel, would justify refusal to set aside in the court's discretion. Mr Goddard added that, in this case, it would be unjust to leave the appellants bound by an award without the rights of review for which they had contracted.

Our evaluation

[76] Article 34 provides for a limited exception to the finality of arbitral awards.[69] It sets out an exhaustive list of the grounds upon which an award may be set aside. If the applicant party satisfies the High Court that one of those grounds exists, under art 34(2) the award "may" be set aside by the Court. The Court accordingly has a residual discretion not to set aside an award even though a ground specified in art 34 is made out.[70]

[77] While the specified grounds for setting awards aside can generally be characterised as "serious defects",[71] it is clear that the potential flaws listed in art 34 have differing degrees of seriousness. As Lord Mance said in *Dallah Real Estate and Tourism Holding Co v Ministry of Religious Affairs of the Government of Pakistan*:[72]

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69 Article 36 of schedule 1 and cl 5 of schedule 2 to the Arbitration Act contain further exceptions to the finality of awards.

70 David AR Williams QC and Amokura Kawharu *Williams & Kawharu on Arbitration* (LexisNexis, Wellington, 2011) at 469.

71 See AJ Van den Berg *The New York Arbitrators Convention of 1958: Towards a Uniform Interpretation* (Kluwer Law and Taxation Publishers, Deventer (The Netherlands), 1981) at 265.

72 *Dallah Real Estate and Tourism Holding Co v Ministry of Religious Affairs of the Government of Pakistan* [2010] UKSC 46, [2011] 1 AC 763 at [68].

> … in relation to some of [the grounds] it might be easier to invoke such discretion as the word "may" contains than it could be in any case where the objection is that there was never any applicable arbitration agreement between the parties to the award.

[78] This is pre-eminently so in relation to challenges to the jurisdiction of the arbitrator on the ground of invalidity of the arbitration agreement under art 34(2)(a)(i), which strike at the foundations of arbitration. Under a statutory scheme that mandates a contractual approach to arbitration, it is a basic requirement that an award is based on a valid arbitration agreement. As Lord Collins pointed out in *Dallah*, art 34(2)(a)(i) protects the right of a party that has not agreed to arbitration to object to the jurisdiction of the tribunal.[73] This applies equally to a party that has agreed to arbitration only on certain terms. Where an arbitration agreement has been impeached (because of the invalidity of a provision that cannot be severed or for some other reason), that defect goes to the jurisdiction of the arbitrator and the legitimacy of the award.

[79] The decision of the United Kingdom Supreme Court in *Dallah* provides helpful guidance on the appropriate exercise of the discretion in art 34(2) in cases where there was no valid arbitration agreement between the parties. Lord Mance said:[74]

> Absent some fresh circumstance such as another agreement or an estoppel, it would be a remarkable state of affairs if the word "may" enabled a court to enforce or recognise an award which it found to have been made without jurisdiction, under whatever law it held ought to be recognised and applied to determine that issue.

In *Dallah*, the Supreme Court was concerned with s 103 of the Arbitration Act 1996 (UK), which is the equivalent of art 36 rather than art 34 of schedule 1 to the New Zealand Arbitration Act. Article 36 is concerned with the grounds on which recognition or enforcement of an arbitral award can be refused. Articles 34 and 36 are, however, "parallel" provisions,[75] which indicates that the approach taken to the discretion under art 36(1)(a)(i) is applicable in the context of art 34(2)(a)(i).

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[73] At [102] per Lord Collins.
[74] At [68]. See also [127] per Lord Collins.
[75] Law Commission, above n 1, at [398].

[80] The absence of a valid arbitration agreement to underpin an award goes to the root of the parties' intention to arbitrate their dispute.[76] 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.[77]

The relevance of art 34(2)(a)(iv)

[81] We have not overlooked the inclusion in the ground for setting aside under art 34(2)(a)(iv) of additional words that do not appear in art 36(1)(a)(iv):[78]

> (2) An arbitral award may be set aside by the High Court only if—
>
> (a) the party making the application furnishes proof that—
>
> …
>
> (iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, *unless such agreement was in conflict with a provision of this schedule from which the parties cannot derogate,* or, failing such agreement, was not in accordance with this schedule; …

In his dissent, Arnold J concludes that the ground for setting aside an award under art 34(2)(a)(iv) is a relevant matter in considering the exercise of the discretion to set aside an award under art 34(2)(a)(i). Subparagraph (iv) provides that an award may be set aside if the "arbitral procedure was not in accordance with the agreement of the parties", unless the agreed procedure was in conflict with a mandatory statutory provision in schedule 1 of the Arbitration Act.[79] Arnold J reasons that subpara (iv) establishes a general principle that parties will not be entitled to have an award set aside on the basis of failure to follow an agreed procedure, no matter how important, if that agreed procedure is in conflict with a mandatory rule of New Zealand law.[80] Therefore, Arnold J says that where such a conflict is the reason for the invalidity of the parties' arbitration agreement, the discretion in art 34(2)(a)(i) should generally be exercised to uphold the award.[81]

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76 It is not necessary in the present case for the Court to consider the appropriate approach to the exercise of the discretion in relation to other grounds in art 34(2)(a).
77 See Williams and Kawharu, above n 70, at [17.2].
78 Emphasis added.
79 Article 34(2)(a)(iv) is set out above at [10].
80 See [113]–[114] of Arnold J's reasons.
81 See [89] and [109] of Arnold J.

[82] We disagree. Article 34(2)(a)(iv) provides a basis for setting aside an award where there is a valid and subsisting arbitration agreement setting out a procedure agreed by the parties, which has not been complied with.

[83] The additional words, which reflect provisions in the Model Law, were inserted to make clear that parties' arbitration agreements which fell within the jurisdiction of the domestic court were subject to mandatory procedural provisions of domestic law in relation to arbitration. They were not included to lay down a general principle for exercise of the court's powers under art 34.[82] Furthermore, the scope of art 34(2)(a)(iv) is limited to matters of arbitral procedure, and the added words refer only to conflict with the rules set out in schedule 1 of the Act. This is another indication against the generality of the application of the principle in subpara (iv). We see no reason for going beyond its terms even if a right of appeal is to be characterised as arbitral procedure, which may be doubted.[83] Subpara (iv) is accordingly inapplicable in the present case, at least because the appeals rule from which the invalidity of the parties' agreement arises is found in schedule 2 of the Act.[84]

[84] The travaux préparatoires make clear that subpara (iv) was intended to encompass minor or trivial departures from agreed procedure,[85] but that does not provide a basis for giving it primacy over subpara (i) in relation to a term so fundamental to an agreement to arbitrate as to be incapable of severance from the arbitration agreement.

[85] Finally, the ground for setting aside under art 34(2)(a)(i) is separate and distinct from that under art 34(2)(a)(iv). Like the other grounds in para (a), they are expressed as true alternatives so that where one specified ground is made out, the court is not restricted in its exercise of the discretion by the fact that one or more

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[82] Possible explanations of why similar words were not included in art 36 are put forward in Howard M Holtzmann and Joseph E Neuhaus *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary* (Kluwer Law and Taxation Publishers, Deventer (The Netherlands), 1989) at 1060–1061.

[83] See [96](d), [107] and [114] of Arnold J's reasons.

[84] It is not necessary to decide whether appeal rules are a procedural or substantive matter.

[85] See Holtzmann and Neuhaus, above n 84, at 921–922.

other grounds are not. For the same reason the ground in subpara (iv) cannot be deployed as context to undermine subpara (i).

Exercise of the discretion in this case

[86] For these reasons, we conclude 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 art 34 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. Finally, there is no other circumstance that would warrant the extraordinary step of upholding the award of an arbitral tribunal after it has been established that there was no contractual basis on which the award could have been made.

Conclusion

[87] The appeal is accordingly allowed and the judgment of the High Court setting aside the award of 9 May 2011 is reinstated.

[88] The respondent must pay costs in this court of $25,000 together with reasonable disbursements. The order for costs in the Court of Appeal is set aside and the respondent is to pay the appellants' costs in that Court and the High Court, to be fixed by those courts.

ARNOLD J

[89] Like the Court of Appeal, and in disagreement with the majority in this Court, I consider that the High Court should not have exercised its discretion to set aside the arbitrator's award under art 34(2)(a)(i) of sch 1 to the Arbitration Act 1996, although for rather different reasons than those given by the Court of Appeal. In summary, my view is that the courts' power to set aside an award under art 34(2)(a)(i) should not be exercised in such a way as to undermine the principle underlying art 34(2)(a)(iv). To set aside the award in this case does, in my view, undermine that principle.

[90] Before I outline my reasons, I should say that I agree with the majority on the question of what constitutes the arbitration agreement (at [33] to [46] above) and on the general approach to be taken to severance (at [47] to [66] above). I also agree that the agreement concerning the availability of an appeal to the High Court on questions of fact was, viewed objectively, fundamental to the parties' agreement to arbitrate.

[91] I will not repeat the background, which is set out in the majority judgment. I will make three preliminary points, however. First, the first of the purposes of the Act set out in s 5 is "to encourage the use of arbitration as an agreed method of resolving commercial and other disputes". As Williams and Kawharu note, although the law of arbitration derives principally from contract law, it contains an overlay of public law and policy.[86] Modern arbitration law as it applies to both domestic and international arbitrations contains policy elements which make a purely private law contractual approach to arbitrations inappropriate. This is reflected, for example, in the fact that there are standards or processes which must be applied in arbitrations whatever the parties may agree. Examples are the principles of natural justice and the availability of review through the courts on the statutory grounds. The law of arbitration, then, is not simply about party autonomy, important as that undoubtedly is. As Mr Williams QC submitted on behalf of the intervener, the Arbitrators' and

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[86] David AR Williams QC and Amokura Kawharu *Williams & Kawharu on Arbitration* (LexisNexis, Wellington, 2011) at [1.3.3].

Mediators' Institute of New Zealand Inc, party autonomy is not determinative of the interaction between the courts and the arbitral process – that is delineated in the Act.

[92] Second, art 5 of sch 1 to the Act provides that in matters covered by the schedule, "no court shall intervene except where so provided in this schedule". Although it is not a comprehensive code as to judicial intervention, the article is an important affirmation of the principle of limited judicial intervention in arbitral matters. Article 5 of sch 1 is expressly qualified by several provisions in sch 2, including relevantly cl 5 dealing with appeals. The various provisions in the Act and the schedules dealing with the circumstances in which judicial intervention is permissible give effect to one of the purposes of the Act, namely "to redefine and clarify the limits of judicial review of the arbitral process and of arbitral awards".[87]

[93] Third, art 34 of sch 1 sets out the circumstances in which a court may set aside an award. It applies to arbitrations where the seat of arbitration is New Zealand. By contrast, art 36 of sch 1, which sets out the circumstances in which a court may refuse to recognise or enforce an award, applies to all arbitrations, whether the seat of arbitration is New Zealand or elsewhere.[88] As the majority note, sch 1 to the Act is based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration. The grounds in arts 34 and 36 of sch 1, which are substantially the same albeit not identical, replicate those in arts 34 and 36 of the Model Law, which were in turn based on art V of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention).[89] As I develop later in this judgment, it is not possible to contract out of review under art 34.[90]

[94] Because I differ from the majority in respect of the interpretation of art 34, I will set out the relevant portion of the article again:

87 Arbitration Act 1996, s 5(d).
88 See Williams and Kawharu, above n 86, at [17.3.1].
89 Convention on the Recognition and Enforcement of Foreign Arbitral Awards 330 UNTS 38 (opened for signature 10 June 1958, entered into force 7 June 1959) [New York Convention].
90 See [101]–[103] below.

34 Application for setting aside as exclusive recourse against arbitral award

(1) Recourse to a court against an arbitral award may be made only by an application for setting aside in accordance with paragraphs (2) and (3).

(2) An arbitral award may be set aside by the High Court only if—

(a) the party making the application furnishes proof that—

(i) a party to the arbitration agreement was under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it, or, failing any indication on that question, under the law of New Zealand; or

(ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present that party's case; or

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decision on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or

(iv) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this schedule from which the parties cannot derogate, or, failing such agreement, was not in accordance with this schedule; or

(b) the High Court finds that–

(i) the subject matter of the dispute is not capable of settlement by arbitration under the law of New Zealand; or

(ii) the award is in conflict with the public policy of New Zealand.

[95] The point on which I differ from the majority concerns the relationship between arts 34(2)(a)(i) and (iv). Relevantly, art 34(2)(a)(i) confers a discretion on the court to set aside an award where the arbitration agreement is invalid under New Zealand law and art 34(2)(a)(iv) confers a discretion where the agreed arbitral

procedure has not been followed, subject to the caveat that the agreed procedure must not conflict with a provision in sch 1 from which the parties to the arbitration are not free to derogate (a non-derogable provision).

[96] I make four points about art 34(2)(a)(iv):

(a) First, art 34(2)(a)(iv) does not distinguish between agreed procedures on the basis of their importance or materiality. The agreed procedure that has not been followed may be fundamental or relatively unimportant. It is clear from the travaux préparatoires to the Model Law that the intention was that the relative importance of the procedural failure would be relevant to the exercise of the court's discretion.[91]

(b) Second, the limitation in art 34(2)(a)(iv) that a court may not set aside an award where an agreed procedure has not been followed if that agreed procedure conflicts with a non-derogable provision reflects a deliberate decision to limit party autonomy: where there is a non-derogable provision, the parties will not be entitled to adopt by agreement an alternative procedure and, if they do, they will not be entitled to have the award set aside where the arbitrator does not follow the agreed procedure but rather that in the non-derogable provision. In effect, art 34(2)(a)(iv) treats those who go to arbitration as being bound by that which cannot be derogated from even though they chose some other procedure, whether through mistake or otherwise. This is to be contrasted with the position under art 36 in relation to refusing recognition or enforcement of an arbitral award. Under art 36(1)(a)(iv) the court has the power to refuse to recognise or enforce an arbitral award where, among other things, the arbitral procedure was not in accordance with the agreement of the parties: there is no exception in relation to non-derogable provisions.

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[91] Howard M Holtzmann and Joseph E Neuhaus *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary* (Kluwer Law and Taxation Publishers, Deventer (The Netherlands), 1989) at 921–922.

(c) Third, where an arbitration agreement contains an agreed arbitral procedure that is in conflict with a non-derogable provision, the arbitration agreement may well be invalid, on the same basis as the arbitration agreement in the present case is invalid. That is, the agreed procedure may, viewed objectively, be fundamental to the parties' agreement to arbitrate. This raises the question whether it is possible to circumvent the limitation contained in art 34(2)(a)(iv) by invoking instead art 34(2)(a)(i).

(d) Fourth, art 34(2)(a)(iv) refers to an agreement about "arbitral procedure". There is a question whether this language is apt to include an agreement concerning appeals. Further, art 34(2)(a)(iv) refers to a "conflict with a provision of this schedule" (ie, sch 1). In the present case, the conflict is with the appeal provision in sch 2, namely cl 5. Accordingly there is an issue as to the relevance of art 34(2)(a)(iv) in the present circumstances. In brief, my answer is that, even if art 34(2)(a)(iv) does not apply directly, the principle underlying it is relevant to the exercise of the court's discretion under art 34(2)(a)(i) in the particular circumstances of this case.

[97] In discussing these points I will begin with the background to art 34(2)(a)(iv). As noted, arts 34 and 36 of sch 1 to the Act mirror arts 34 and 36 of the Model Law, which in turn have their origins in art V of the New York Convention. That article provides that recognition and/or enforcement of an award in a contracting state may be refused only if it is established that, among other things:[92]

> the composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.

While this language was retained in art 36(1)(a)(iv) of the Model Law in relation to recognition and enforcement of arbitral awards, it was modified in art 34(2)(a)(iv) in relation to setting aside. The modification was that the words "*unless such agreement was in conflict with a provision of this schedule from which the parties*

[92] New York Convention, art V(1)(d).

cannot derogate"[93] were added and the words after "failing such agreement" were replaced with "was not in accordance with this Law". The language of both provisions was carried over into sch 1 except that "Law" in art 34(2)(a)(iv) became "schedule". For ease of reference I will refer to the italicised words as the "added words".

[98] Holtzmann and Neuhaus explain the background to the introduction of the added words into art 34(2)(a)(iv) as follows:[94]

> The history of this new phrase begins in a footnote to the Secretariat's initial draft of what became Article 36, which was incorporated by reference into the early drafts of Article 34. That footnote noted that the view then prevailing among commentators was that the language of the New York Convention gave "absolute priority to the agreement of the parties, ie irrespective of whether such agreement was in conflict with a mandatory provision of the 'applicable' procedural law". The Secretariat said that it was clear that this rule could not possibly apply to the enforcement of *domestic* arbitral awards – the kind of awards with which Article 34 is concerned – presumably since the domestic courts would by definition be bound to apply the mandatory provisions of domestic procedural law.
>
> The Working Group agreed; its Report stated, "It was understood – and possibly to be expressed in [the Model Law] – that the agreement [of the parties] was subject to the mandatory provisions of the law". This understanding was expressed in the Working Group's subsequent drafts of the provisions on recognition and enforcement of domestic awards and the subsequent drafts of Article 34, initially using the phrase "the mandatory provisions of this Law". The Working Group later redrafted the language to substitute for the term "the mandatory provisions of this Law" the phrase "a provision of this Law from which the parties cannot derogate," because the longer phrase was considered more readily understandable in all legal systems.
>
> During the Commission's consideration of the Working Group's final draft – which was the same as the final text – a potential ambiguity was noted by several delegations. They said that the provision might still be interpreted not to allow an award to be set aside where the procedure set forth in the arbitration agreement had been followed, but where that procedure conflicted with the mandatory provisions of the Model Law. While no change was made to the text of the Law, the Commission Report recorded the understanding that where the agreement was in conflict with a mandatory provision of the Law, the provision of the Law would prevail.

[99] The result of this is that a court has a discretion under art 34(2)(a)(iv) of sch 1 to set aside an award where:

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93 Emphasis added.

94 Holtzmann and Neuhaus, above n 91, at 916–918 (citations omitted). See also at 1060–1061 for further discussion of the change in wording and the difficulties it creates.

(a) there has been a failure to follow the agreed procedure except where that agreed procedure conflicts with a non-derogable provision in sch 1, in which case it is the non-derogable provision that must be applied, not the agreed procedure, and setting aside for non-compliance is not available; or

(b) absent agreement, the procedure followed was not in accordance with sch 1 (ie, both derogable and non-derogable provisions).

In respect of agreed procedures that conflict with non-derogable provisions, then, art 34(2)(a)(iv) limits party autonomy.

[100] Article 4 of sch 1 is also relevant in this context. It provides:

> **Waiver of right to object**
>
> A party who knows that any provision of this schedule from which the parties may derogate or any requirement under the arbitration agreement has not been complied with and yet proceeds with the arbitration without stating that party's objection to such non-compliance without undue delay or, if a time limit is provided therefor, within such period of time, shall be deemed to have waived the right to object.

The language of art 4 indicates that compliance with a non-derogable provision of the schedule may not be waived. Discussing the equivalent art 4 of the Model Law, Holtzmann and Neuhaus say:[95]

> Where there is no agreement on a procedural point, the procedural provisions of the Model Law take effect. Under Article 4, a party's right to insist on these provisions will be waived by failure to make a timely objection. A waiver under Article 4, however, applies only to the non-mandatory provisions of the Law, that is, those provisions which the parties may agree to the contrary. This qualification – which was not part of the initial draft of the provision – was specifically included to "soften" its effect.

As with art 34(2)(a)(iv), then, art 4 places a limit on party autonomy.

[95] At 197 (footnotes omitted). See the discussion in Williams and Kawharu, above n 86, at [17.4] where it is noted that a party "may not rely on defects of which it was aware during the course of the arbitral proceedings if that party went ahead with the arbitration without raising its objection to the defects, except where the defects derogate from mandatory provisions of the NZ Act".

[101] The decision of the Court of Appeal in *Methanex Motunui Ltd v Spellman* provides a further illustration of a situation in which arbitration law limits party autonomy.[96] In that case, the Court of Appeal held that the parties to an arbitration agreement could not exclude review based on the grounds specified in art 34 of sch 1.[97] A dispute arose as to the calculation of economically recoverable reserves of the Maui gas field under a contract for the sale and purchase of gas between a consortium of mining interests (the vendor) and the Crown. The price of Maui gas which Methanex purchased from the Crown would be affected by the recalculation. The vendor and the Crown agreed that the issue would be submitted to arbitration. Methanex agreed to accept the result of the arbitration in return for the right to participate in it. The arbitration agreement purported to limit the grounds on which the arbitrator's determination could be challenged to situations of fraud.

[102] Following the arbitration, Methanex issued proceedings to have the arbitrator's determination set aside under art 34, alleging a breach of natural justice. It was met with a strike out application, based on the contention that it was not a party to the arbitration agreement and accordingly did not have standing to challenge the award. Further, it was argued that the grounds of the challenge were not within those permitted by the arbitration agreement.

[103] The Court of Appeal upheld the findings of the High Court that Methanex was not a party to the arbitration and did not have standing to challenge the award.[98] However, on the assumption that Methanex did have standing, the Court of Appeal considered whether Methanex had an arguable case based on its allegation of breach of the rules of natural justice. Although it considered that Methanex had freely contracted to exclude review, that there were sound commercial reasons for that and that there was no unfairness, the Court concluded that the law did not permit parties to exclude review based on the grounds set out in art 34.[99] The Court went on to hold on the facts that there was no breach of the rules of natural justice.[100]

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96 *Methanex Motunui Ltd v Spellman* [2004] 3 NZLR 454 (CA).
97 At [108].
98 At [82] and [91].
99 At [107]–[108] and [116].
100 At [161].

[104] As I noted at [96](a) above, another issue discussed during the drafting of art 34(2)(a)(iv) of the Model Law was the materiality of procedural defects, in particular, whether setting aside would be available where the defect in the agreed procedure was minor. It was suggested that, in order to give rise to the possibility of setting aside, the error should be serious or material to the result. Ultimately, this suggestion was not adopted and it was agreed that the gravity or materiality of the error would be a factor going to the exercise of the court's discretion.[101]

[105] How is all this relevant to art 34(2)(a)(i)? First, I agree with the majority that the parties' attempt to create a right of appeal to the High Court on questions of fact as well as questions of law in cl 1.2 of the arbitration agreement was ineffective and, to that extent, the arbitration agreement was invalid, albeit not illegal.[102] Parties cannot by private agreement confer on the High Court a jurisdiction which, by statute, it does not have.

[106] Second, as I have said, it is clear from the travaux préparatoires that the drafters of the Model Law contemplated that procedural agreements falling within art 34(2)(a)(iv) would range from the important to the relatively minor. Even where a procedural agreement was important to the parties, an arbitrator's refusal or failure to follow it would not be a basis for setting aside under art 34(2)(a)(iv) if it conflicted with a non-derogable provision. The logic of this approach seems obvious enough – if parties choose to utilise arbitration to resolve their disputes, they will be treated as being bound by those aspects of the arbitral process from which they cannot legally derogate whatever they might agree.

[107] Third, as I have mentioned, there is a question whether the reference to "agreed procedure" in art 34(2)(a)(iv) is apt to include an agreement as to the appeal process. Further, art 34(2)(a)(iv) in the Act refers to non-derogable provisions in sch 1, not sch 2. As a consequence, it may be that art 34(2)(a)(iv) is not directly applicable to the present situation. While I consider the contrary view to be arguable, ultimately that need not be resolved because the principle underlying

[101] Holtzmann and Neuhaus, above n 91, at 922.

[102] For discussion of the difference see John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (4th ed, LexisNexis, Wellington, 2012) at [13.2].

art 34(2)(a)(iv) may, at least in some circumstances, be relevant to the exercise of the court's discretion under art 34(2)(a)(i), as I now endeavour to explain.

[108] Assume that an arbitration agreement contains an agreed procedure which is clearly essential to the parties but which conflicts with a non-derogable provision in sch 1 (rather than sch 2 as in the present case). The arbitrator follows the procedure set out in the non-derogable provision in preference to that agreed by the parties. The unsuccessful party in the arbitration applies to set aside the resulting award under art 34(2)(a)(i), on the basis that the arbitration agreement contains an invalid provision that (1) was, viewed objectively, essential to the parties and (2) cannot be severed from the remainder of the arbitration agreement. As a consequence, the unsuccessful party argues, the whole arbitration agreement is invalid.

[109] In my view, where a court is asked to set aside an award under art 34(2)(a)(i) on the basis that the parties to an arbitration agreement have agreed a process which is, objectively, fundamental to their agreement but is contrary to a non-derogable provision, it should take account of the principle underlying art 34(2)(a)(iv). In general, this will mean that the application to set aside should be declined.[103] The majority hold that art 34(2)(a)(iv) provides a basis for setting aside an award only "where there is a valid and subsisting arbitration agreement setting out a procedure agreed by the parties, which has not been complied with".[104] In my view that is inconsistent with the manifest intention of the framers of art 34, who recognised that procedural agreements that were in conflict with non-derogable provisions might be important to the parties but, despite that, denied (in art 34(2)(a)(iv)) the availability of the setting aside remedy where non-derogable rather than agreed procedures were followed. In at least some cases in this category, the arbitration agreement would be invalid on the same basis as it is in the present case. As I see it, the effect of the majority's approach is, in cases where the agreed procedure is fundamental to the arbitration agreement, to allow parties to circumvent the limitation contained in art 34(2)(a)(iv) by relying instead on art 34(2)(a)(i). As will be apparent, I do not agree that art 34(2)(a)(iv) applies only where there is a valid arbitration agreement – that interpretation narrows, unjustifiably, the scope of art 34(2)(a)(iv).

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103 I say "in general" to allow for the possibility of exceptional situations.
104 Above at [82].

[110] A somewhat similar issue arises under art 36(1)(a). Article 36(1)(a)(i) provides that recognition or enforcement of an award may be refused where it is proved that:

> a party to the arbitration agreement was under some incapacity; or the said agreement is not valid under the law to which the parties have subjected it, or, failing any indication on that question, under the law of the country where the award was made.

The art 36(1)(a)(iv) ground reads as follows:

> the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place.

As I have said, these provisions are ultimately derived from arts V(1)(a) and (d) of the New York Convention.

[111] In his treatise on the New York Convention, van den Berg addresses the interaction between arts V(1)(a) and (d).[105] He says that the composition of the arbitral panel or aspects of arbitral procedure can only be a basis for non-recognition or non-enforcement if there has been no agreement on these matters, so that the law of the country where the arbitration took place must be applied: where there has been agreement, art V(1)(d) does not provide relief even though the agreed positions are inconsistent with the applicable law. He argues that, in this latter situation, a disgruntled party may not challenge the award under art V(1)(a) on the basis that the agreed position is not consistent with the applicable law, so that the arbitration agreement is invalid, as that would allow a court to refuse to recognise or enforce the award "through the backdoor" in circumstances where art V(1)(d) would not permit that outcome: the specific provision (art V(1)(d)) governs rather than the general (art V(1)(a)).[106]

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105 Albert Jan van den Berg *The New York Arbitration Convention of 1958* (Kluwer Law and Taxation Publishers, Deventer (The Netherlands), 1981) at 289–290.

106 At 289.

[112] The author illustrates the point with an example:[107]

> Let us assume that an arbitration agreement provides for arbitration by two arbitrators in the Netherlands and that Dutch law governs the arbitration according to the conflict rules in Article V(1)(a). Under Dutch law an arbitration agreement providing for two arbitrators is invalid as the law mandatorily prescribes an uneven number of arbitrators. In the enforcement proceedings of the Dutch award in another Contracting State the respondent cannot object to the enforcement on the basis of Article V(1)(d) as the composition of the arbitral tribunal was in accordance with the agreement of the parties. The respondent must then be deemed not to be entitled to bypass Article V(1)(d) by relying on Article V(1)(a), arguing that the arbitration agreement is invalid under Dutch law.

He goes on to say that the respondent could seek the setting aside of the award before the Dutch courts on the basis of non-compliance with Dutch law. (That would, of course, be consistent with art 34(2)(a)(iv) as the parties' agreement would be subject to any mandatory provisions of the relevant law.) If the Dutch court did set aside the award, a court in a contracting state would have the power not to recognise or enforce the award under art V(1)(e) (the equivalent being art 36(1)(a)(v)). van den Berg justifies his view on the basis that art V(1)(d) gives primacy to the agreement of the parties; only if there is no agreement may resort be had to the law of the country where the arbitration took place; it is inconsistent with this to permit an argument under art V(1)(a) that the arbitration agreement is invalid because the agreed procedure was inconsistent with the law of the country where the arbitration took place.

[113] In my view a similar analysis applies under art 34(2)(a). The parties to an arbitration agreement are free to agree their own procedure except in respect of non-derogable provisions. Where the arbitrator does not follow an agreed procedure, that will be a ground on which the court may exercise its discretion to set aside the award, except in relation to processes in non-derogable provisions in sch 1, which the arbitrator must follow in preference to any inconsistent agreed procedure. Where an arbitrator follows a procedure in a non-derogable sch 1 provision in preference to an inconsistent agreed procedure, setting aside is not available under art 34(2)(a)(iv). To this extent, party autonomy is restricted. Given that the drafters of the Model Law on which sch 1 is based contemplated that agreements as to arbitral procedures

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107 At 289–290 (citation omitted).

might deal with matters of real importance to the parties, I think it is inconsistent with the limit in art 34(2)(a)(iv) to permit resort to art 34(2)(a)(i) where art 34(2)(a)(iv) would deny relief.

[114] Article 34(2)(a)(iv) refers to non-derogable provisions in sch 1. In the present case, it is cl 5 in sch 2 that is the relevant non-derogable provision. Clause 5 applies "notwithstanding anything in articles 5 or 34 of Schedule 1". Like art 34, cl 5 imposes limits on the courts' ability to review arbitral decisions, in particular in relation to matters of fact, and, in respect of those limits, is non-derogable. If, as I believe to be the case, art 34(2)(a)(iv) is intended to limit the ability of parties to arbitrations to have awards set aside on the basis of the arbitrator's failure to follow agreed procedures, there does not appear to be any reason of principle not to apply a similar analysis in respect of an agreed appellate process that is inconsistent with cl 5 of sch 2. Like art 34, cl 5 enables court intervention in the arbitral process and is linked to art 34 to the extent that it incorporates various of its provisions. Accordingly, I see the principle underlying art 34(2)(a)(iv) as being relevant in the present context.

[115] How does that conclusion affect the application of art 34 in the present case? The majority have concluded that the arbitral agreement is invalid, so that art 34(2)(a)(i) applies, and have held that the Court's power to set the award aside should be exercised. Relying in particular on what is said in *Dallah Real Estate and Tourism Holding Co v Ministry of Religious Affairs of the Government of Pakistan*,[108] they conclude that the scope of the court's discretion under art 34(2)(a)(i) is narrow – once a finding of invalidity has been made, the award will almost inevitably be set aside.[109] *Dallah* was an unusual case in that the award purported to impose an obligation to make a substantial payment on a non-party to the arbitration agreement. It was determined under s 103 of the Arbitration Act 1996 (UK) (the equivalent of art 36 of sch 1) and the international context assumed particular importance in their Lordships' reasoning. As Lord Collins said:[110]

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108 *Dallah Real Estate and Tourism Holding Co v Ministry of Religious Affairs of the Government of Pakistan* [2010] UKSC 46, [2011] 1 AC 763.
109 See above at [79]–[80].
110 (citations omitted).

> [127] Since section 103(2)(b) [invalidity of arbitration agreement] gives effect to an international convention, the discretion should be applied in a way which gives effect to the principles behind the Convention. One example suggested by [van den Berg *The New York Arbitration Convention of 1958* at 265] is where the party resisting enforcement is stopped from challenge, as was adopted by Mance LJ in *Dardana Ltd v Yukos Oil Co*, para 8. But, as Mance LJ emphasised at para 18, there is no arbitrary discretion: the use of the word "may" was designed to enable the court to consider other circumstances, which might on some recognisable legal principle affect the prima facie right to have the award set aside arising in the cases listed in section 103(2). See also *Kanoria v Guiness*, para 25, per Lord Phillips CJ. Another possible example would be where there has been no prejudice to the party resisting enforcement: *China Agribusiness Development Corpn v Balli Trading*. But it is not easy to see how that could apply to a case where a party has not acceded to an arbitration agreement.

[116] Although the scope of the discretion under art 36(1) may be rather more limited than that under art 34(2) in some situations (because the considerations which bear upon the exercise of the court's power under arts 34(2) and 36(1) may differ as a consequence of the fact that in the former case the seat of arbitration will be New Zealand and in the latter another jurisdiction),[111] I agree with the general proposition that there is likely to be little scope for a court to refuse to set an award aside where the relevant arbitration agreement is invalid, in contrast to other grounds in art 34(2) where factors such as materiality and prejudice are likely to be relevant.

[117] In *Dallah*, Lord Collins regarded the various grounds on which recognition or enforcement of an award might be refused under art V of the New York Convention as fundamental to the arbitral process. His Lordship said that the discretion under art 36 should be applied in a way that gives effect to the principles behind the convention.[112] In my view, a similar analysis applies in the present case. The principle behind art 34(2)(a)(iv) is that the parties will not be entitled to have an award set aside for failure to follow an agreed procedure where that agreed procedure is in conflict with a non-derogable provision in sch 1, no matter how important that agreed procedure was to them. In my view, a court should not allow the limitation contained in art 34(2)(a)(iv) to be circumvented where there is an agreement as to arbitral procedure which is contrary to a non-derogable provision in

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111 Williams and Kawharu, above n 86, at [19.5] note that the High Court has to date approached the discretion under art 34 in a "relatively open way" but say that a more cautious approach should be adopted under art 36 where the enforcement of a foreign arbitral award is concerned.

112 *Dallah Real Estate and Tourism Holding Co*, above n 108, at [102].

sch 1.[113] Although cl 5 is a non-derogable provision in sch 2 rather than sch 1 and the agreement concerned the scope of appeal rights rather than the arbitration itself, I consider that the same principle is relevant to the exercise of the art 34(2) discretion in the present case. In my view, the High Court was wrong to exercise its power to set aside the award under art 34(2)(a)(i) in this case as in doing so, it undermined the principle underlying art 34(2)(a)(iv).

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[113] In effect, art 34(2)(a)(iv) envisages the replacement of the invalid agreed procedure with the non-derogable procedure. In a sense, then, it envisages severance of the invalid provision from the arbitration agreement.