

# Kluwer Arbitration Blog

## Finality Confirmed, Constitutionality Upheld: Major Victory for International Arbitration Community in Australia

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### Introduction

Last Wednesday, the international arbitration community in Australia won a significant victory. Indeed, in *TCL Air Conditioner (Zhongshan) Co Ltd v The Judges of the Federal Court of Australia* [2013] HCA 5 (13 March 2013), S178/2012, the Australian High Court (“Court”) dismissed a challenge to the constitutionality of the International Arbitration Act 1974 (Cth) (“the Act”), and thus confirmed Australia’s appeal as a hub of international arbitration in the Asia-Pacific. The decision has important implications not only because it confirms the finality of international arbitral awards, but also because it clarifies the demarcation between judicial power and arbitral authority under Australian law. As we argue in this post, this is a welcome move, particularly in light of the Australian Government’s resolution to no longer include investor-state dispute settlement provisions in BITs and FTAs, a decision which sent shockwaves throughout the international arbitration community and placed a question mark on Australia’s commitment to its growing international arbitration industry.

### Facts of Underlying Dispute

The dispute revolved around an exclusive distribution agreement between plaintiff (“TCL”), a Chinese-based company, and defendant (“Castel”), an Australian-based company. The agreement provided for the submission of disputes to arbitration in Australia. In July 2008, Castel referred breach of contract claims totaling over \$30 million to arbitration, and TCL counter-claimed. In December 2010, the Tribunal awarded Castel \$3.67 million in damages and \$732,500 in costs (“the Awards”). TCL was also awarded almost \$200,000 for its counter-claim.

In default of payment, in March 2011 Castel applied to the Federal Court of Australia (“FCA”) to enforce the Awards under s.16(1) of the Act, which incorporates Article 35 of the [UNCITRAL Model Law on International Commercial Arbitration](#) (“Model Law”). Article 35 of the Model Law provides that “[a]n arbitral award, irrespective of the country in which it was made, shall be recognized as binding and, upon application in writing to the competent court, shall be enforced” subject to limited grounds for refusal under Article 36 of the Model Law. In a separate action, TCL applied to set aside the Awards under Article 34 of the Model Law.

## TCL's Challenge of the Act's Constitutional Validity

In a parallel High Court proceeding, TCL challenged the constitutional validity of the Act by arguing that the Act confers judicial power on an arbitral tribunal contrary to Chapter III of the Australian Constitution ("Constitution").

In particular, TCL argued that, in cases where the FCA under Articles 35 and 36 of the Model Law is unable to refuse to enforce the award on the ground of error of law, section 16(1) of the Act is unconstitutional because it:

- Undermines the institutional integrity of the FCA as a court exercising the judicial power of the Commonwealth, by requiring the FCA knowingly to perpetrate legal error; or
- Impermissibly vests, or delegates, the judicial power of the Commonwealth on the arbitral tribunal that made the award, by giving the arbitral tribunal the last word on the law applied in deciding the dispute submitted to arbitration.

Thus, TCL submitted that to avoid contravening the Constitution, "courts must be able to determine whether an arbitrator applied the law correctly in reaching an award." (*TCL Air Conditioner (Zhongshan) Co Ltd v The Judges of the Federal Court of Australia* [2013] HCA 5 (13 March 2013), S178/2012 [hereinafter "Decision"] at ¶67) The FCA's inability to undertake a merits review of the award, TCL argued, distorted its institutional independence as a branch of the judiciary.

TCL also submitted that Article 28 of the Model Law required the Tribunal to correctly apply the "rules of law as are chosen by the parties." Alternatively, TCL submitted that a term to that effect was implied in every arbitration agreement under Australian law.

### Decision

Split across two opinions, the Court unanimously dismissed TCL's application in its entirety, and upheld the constitutional validity of the Act. In short, the Court held that "Article 35 of the Model Law neither undermines the institutional integrity of the Federal Court nor confers judicial power on an arbitral tribunal." (Decision at ¶5) As such, there is no distortion of institutional independence of the FCA and no delegation of its judicial power. The Court also summarily rejected TCL's argument that Article 28 of the Model Law or an implied term of an arbitration agreement requires an arbitral tribunal to be correct in law.

In clarifying the distinction between judicial power and arbitral authority in Australian law, the Court noted that:

“. . . the existence and scope of the authority to make the arbitral award is founded on the agreement of the parties in an arbitration agreement. The exercise of that authority by an arbitral tribunal to determine the dispute submitted to arbitration for that reason lacks the essential foundation for the existence of judicial power. ”  
(Decision at ¶31)

Accordingly, the inability of the Court under Articles 35 and 36 of the Model Law to refuse to enforce an arbitral award on the ground of error of law appearing on the face of the award does

nothing to undermine the institutional integrity of the Court. This, the Court noted, is because “[e]nforcement of an arbitral award is *enforcement of the binding result of the agreement of the parties* to submit their dispute to arbitration, not enforcement of any disputed right submitted to arbitration.” (Decision at ¶34 (emphasis added)) That the Court can enforce an award but not, save in limited circumstances, substantively review it, “serves the legitimate legislative policy of encouraging efficiency and impartiality in arbitration and finality in arbitral awards.” (Decision at ¶105) Finality, the Court noted, has a number of benefits, including the ability to rely “on the award in legal proceedings in ways that do not involve enforcement, such as founding a plea of former recovery or as giving rise to a *res judicata* or issue estoppel.” (Decision at ¶23)

## Comment

This result is a boon for the international arbitration community, particularly for those that have worked to create a legislative framework that both supports and promotes the existing facilities that have been developed to attract a greater amount of international arbitration work to Australia. However, the wider context in which this dispute occurred deserves further comment.

To the extent that this result seems at all surprising, any element of surprise derives more from external factors, rather than from anything the High Court ruled upon in this case. Indeed, in the context of the Philip Morris High Court litigation (*JT International SA v Commonwealth of Australia; British American Tobacco Australasia Limited and Ors v The Commonwealth of Australia* [2012] HCA 43, S409/2011 & S389/2011), the subsequent BIT arbitration in Hong Kong, and the Australian government’s recent decision not to include arbitration clauses in future bilateral investment treaties, it is understandable why some in the arbitration community might have been waiting anxiously for the decision in *TCL Air Conditioner*. It is this context that helps explain why TCL saw merit in questioning the constitutional permissibility for Australian courts to be conscripted to endorse the legal and factual content of an arbitral award. On its face, the appeal of this argument is stripped of its veneer, when one considers the distinction between judicial power and arbitral authority; the history of the relationship between domestic courts and international arbitral tribunals; international conventions and laws dealing with international commercial arbitration agreements; and the drafting documents for those conventions and laws.

As a matter of Australian constitutional law, the Decision was unsurprising and unremarkable. Indeed, it should be noted that the Attorneys-General for the Commonwealth, New South Wales, Victoria, South Australia, Queensland and Western Australia (as well as the Australian Centre for International Commercial Arbitration Ltd, the Institute of Arbitrators and Mediators Australia Ltd, and the Chartered Institute of Arbitrators (Australia) Ltd) supported Castel’s submission that “the curial recognition and enforcement of arbitral awards has long been an unexceptional exercise of judicial power.” (Decision at ¶58)

Nonetheless, the constitutional law explanation warrants some added context as well. In a pre-*Totani* world (*South Australia v Totani* (“Totani”) (2010) 242 CLR 1; [2010] HCA 39), the *Kable* doctrine (*Kable v Director of Public Prosecutions (NSW)* (“Kable”) (1996) 189 CLR 51; [1996] HCA 24) explained that courts could not be conscripted and forced to rubber stamp the decisions of the executive arm of government. In practice the *Kable* decision was, however, in essence a toothless tiger confined to the facts of a very specific case. Indeed, *Kable* and *Totani* involved the State executive branch denying and restricting the liberty of individuals and then forcing State courts to provide those executive decisions with judicial legitimacy via court orders. The effect of *Totani* was to provide *Kable* with teeth in a context where a State court was “enlisted or co-opted

by the executive to perform a task which did not engage the court[‘s] independent judicial power to quell controversies.” (Decision at ¶105; *Totani* (2010) 242 CLR 1 at 63 [131] per Gummow J) *TCL Air Conditioner* provided a square peg to the round hole that is *Totani* and *Kable*. The decision of Justices Hayne, Crennan, Kiefel, and Bell acknowledges this, and provides a powerful refutation of the argument that a competent court is merely acting as a rubber stamp without any judicial discretion when it is performing the functions described in both the Act and the Model Law.

What is important for the international arbitration community is that the High Court filtered out both the policy and constitutional noise. The impact of the Decision is to ensure the efficient and effective recognition and enforcement of international arbitration awards, subject to one wrinkle.

Although Chief Justice French and Justice Gageler expressly dismissed the application of any common law exception to the general rule that parties must abide by their agreement to accept an arbitrator’s determination, the other four justices provided a more comprehensive consideration of this common law argument, even though it gives little guidance on the scope of the common law jurisdiction to set aside or remit an award on the ground of error of law on the face of the award, as discussed in *Westport Insurance Corporation v Gordian Runoff Ltd* (2011) 244 CLR 239. (Decision at ¶81-99) For the purpose of this point, it is worth noting that former Justice Heydon did not participate in the judgment because he retired in early 2013; his Honor’s replacement (Justice Keane) was not yet on the High Court; and Justice Hayne will be retiring in the near future. It remains to be seen how these changes in the Court’s composition will impact judicial policy, although it is unlikely that the Court will reverse course on its pro-arbitration approach.

Regardless of what some commentators might suggest about the Australian government’s decision not to include arbitration clauses in future BITs and FTAs, the Court has not bought into any of this, nor should it have. The Court has now provided direction as to the constitutionality of the task that judges of the FCA will more frequently be asked to perform. The Decision demonstrates that Australian courts are not hostile, but rather, will embrace the policy, intent and substance of the Act, Model Law, and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. This is undeniably another welcome step towards making Australia a more attractive hub for international arbitration in the Asia-Pacific.

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