

International Arbitration Update

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The Construction of Arbitration Clauses by Australian Courts: What's Covered and What's Not

In *Walter Rau Neusser Oel und Fett AG v Cross Pacific Trading Ltd* [2005] FCA 1102 (15 August 2005), the Federal Court of Australia again looked at the issues of the proper construction of arbitration clauses governed by the *International Arbitration Act 1974 (Cth)* (the IA Act). The decision of *Allsop J*, which calls into doubt the correctness of an earlier decision of the Full Court of the Federal Court, highlights some uncertainty still prevailing in Australia in relation to the scope and application of arbitration clauses.

Applications for the stay of claims pursuant to the *International Arbitration Act*

The IA Act was Australia's domestic legislative response to its international obligations under the United Nations Conference on International Commercial Arbitration and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, commonly known as the New York Convention.

Section 7 of the IA Act creates a regime for the mandatory stay of proceedings dealing with disputes the

subject of arbitration. Section 7(2) provides that where:

- court proceedings are pending in relation to a dispute between parties to an arbitration agreement in respect of which the IA Act applies; and
- the court proceedings involve the determination of a matter that, in accordance with the arbitration agreement, is capable of settlement by arbitration;

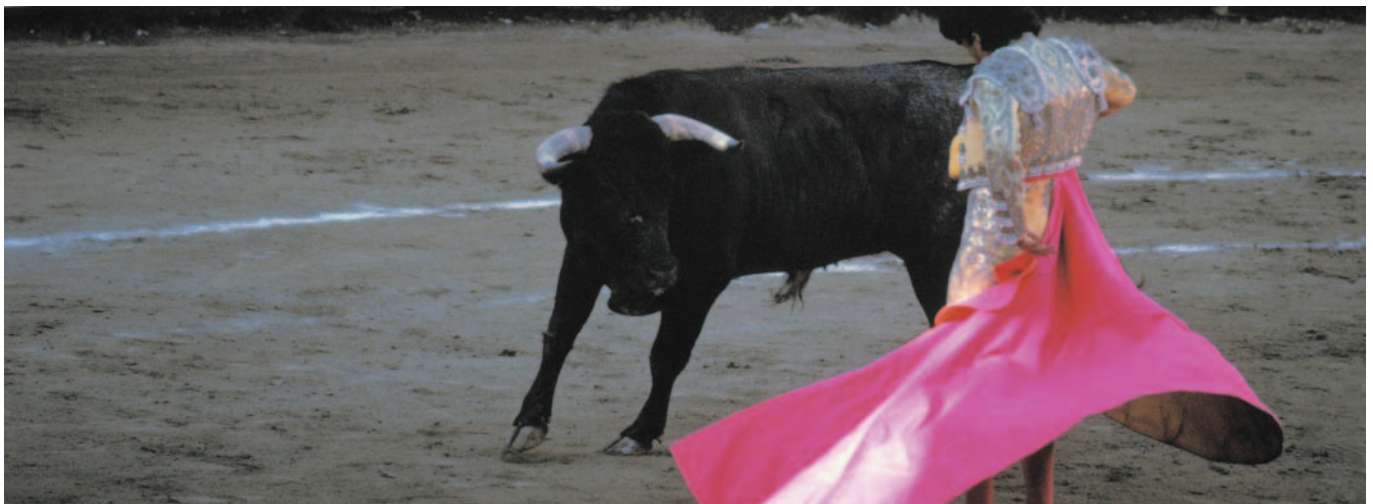
the court must, on the application of a party to the agreement, stay the proceedings (or so much of the

In brief

- Parties who enter into contracts which incorporate arbitration clauses need to know what disputes will or will not be referred to arbitration.
- The decision of *Allsop J* highlights the ongoing uncertainty in Australia in relation to the scope of arbitration clause. That uncertainty may be clarified on appeal.

proceedings as involves the determination of that matter) upon such conditions as it thinks fit and refer the parties to arbitration in respect of that matter.

An exception to the mandatory stay regime is found in section 7(5): a court shall not impose a stay on proceedings if it finds that the arbitration agreement is "null and void, inoperative or incapable of being performed".



The Federal Court proceeding

In September 2003, the applicant (Walter Rau) and the first respondent (Cross Pacific) entered into a contract for the purchase and sale of copra. The contract between Walter Rau and Cross Pacific was subject to the standard clauses of a contract for oil seeds in bulk. The standard form of contract contained an arbitration clause in these terms: "Any dispute arising out of this contract, including any question of law arising in connection therewith shall be referred to arbitration...".

Walter Rau commenced proceedings in the Federal Court of Australia alleging, among other things, that Cross Pacific and several other parties were involved in the making of a series of representations to Walter Rau which were false and misleading, in contravention of the *Trade Practices Act 1974* (Cth) (TPA).

Those representations were to the effect that Cross Pacific was an incorporated entity authorised to carry on business as a company, that the second and third respondents were directors of Cross Pacific, that Cross Pacific had a contractual entitlement to purchase copra from the sixth respondent, and that the fourth respondent had sufficient unencumbered assets to meet its obligations under its guarantee of Cross Pacific's contractual obligations to Walter Rau. Some of those representations were alleged to have been made fraudulently. Walter Rau alleged that it was induced by each of those representations to enter into the contract with Cross Pacific.

The relief sought as a result of the various contraventions included damages and orders setting aside or declaring void the contract of sale and the arbitration agreement within the contract. Walter Rau also asserted that the arbitration agreement was null and void.

Six of the respondents to the Federal Court proceeding including Cross Pacific made an application to the Court seeking orders pursuant to section 7 of the IA Act and Article 8 of the UNCITRAL Model Law that Walter Rau's claims be stayed pending the determination of so much of those matters as were arbitrable pursuant to the arbitration agreement set out in the contract between Walter Rau and Cross Pacific. Walter Rau, in turn, made an application seeking orders that Cross Pacific be restrained from invoking or taking any steps under the arbitration agreement.

Scope of the arbitration clause

Although Allsop J's decision focused on a number of issues, the focus of the decision was on the scope of the arbitration clause in the contract between Walter Rau and Cross Pacific. His Honour noted that a liberal approach to the meaning of arbitration clauses should be taken, although all arbitration clauses should not be given an identically broad meaning. In His Honour's view, the Court must construe arbitration clauses by giving meaning to the words chosen by the parties and by giving liberal width and flexibility to "elastic and general words" used in arbitration clauses. His Honour accepted that it must be

It must be presumed that the parties did not intend to suffer the inconvenience of having disputes between them being heard in two different places, possibly involving two different legal systems.

presumed that the parties did not intend to suffer the inconvenience of having disputes between them being heard in two places, possibly involving different legal systems.

The respondents argued that the words used in the arbitration clause should be construed as saying that any dispute arising out of the contract, including any question of law arising *in connection with the contract* were to be submitted to arbitration. Allsop J rejected this construction of the words. His Honour considered that the disputes submitted were those arising out of the contract. These disputes include any question of law arising in connection with such disputes, but not in connection with the contract.

Allsop J then undertook an examination of the cases dealing with the meaning of the phrase "arising out of" in the arbitration context. His Honour noted that two divergent approaches had been adopted by Commonwealth Courts in relation to the proper construction of the phrase.

Allsop J considered that the weight of persuasive authority in New South Wales, Queensland, New Zealand, England and South Africa favoured the broad interpretation given to the words "arising out of" by Hirst J in *Ethiopian Oilseeds & Pulses Export Corporation v Rio Del Mar Foods Inc*

[1990] 1 Lloyd's Rep 86 (*Ethiopian Oilseeds*). In *Ethiopian Oilseeds*, Hirst J expressed the view that it was very difficult to make any distinction between the words "arising out of" and "arising in connection with". The two phrases appeared to Hirst J to be "virtually synonymous". As such, Hirst J held that, in the arbitration context, the phrase "arising out of" should be given a wide interpretation covering all disputes other than a dispute as to whether the contract itself exists, so as to give effect to the parties' presumed intention not to have two separate sets of proceedings.

In subsequent cases analysed by Allsop J, the phrase "arising out of" was considered to be wide enough to encompass claims which were not contractual in nature, but which had a close association with the contract or were incidental to the contract. Allsop J noted that *Ethiopian Oilseeds* was referred to with unqualified approval by the New South Wales Court of Appeal in *Francis Travel Marketing Pty Ltd v Virgin Atlantic Airways Ltd* (1996) 39 NSWLR 430.

Despite the weight of authority favouring a broad interpretation of the words "arising out of", Allsop J considered himself bound by the Full Federal Court's decision in *Hi-Fert Pty Ltd v Kiukiang Maritime Carriers Inc*

(1998) 90 FCR 1 (*The Kiukiang Career*). In *The Kiukiang Career*, Emmett J (with whom Branson and Beaumont JJ concurred) ascribed a narrow construction to the phrase "arising from". Emmett J considered the phrases "arising from", "arising out of" and "arising under" to be equivalent to each other, and narrower than phrases such as "arising out of or related to", "arising thereunder or in connection therewith" and "in relation to". By adopting a narrow construction to the phrase "arising from", Emmett J found that disputes under the TPA and other non-contractual claims which were based on conduct before the formation of the contract fell outside the arbitration clause.

Consistent with the approach of Emmett J in *The Kiukiang Career*, Allsop J held that representations and misleading and deceptive conduct which were said to have occurred prior to the entry into the contract between Walter Rau and Cross Pacific fell outside the phrase "arising out of". However, Allsop J stated that if he were free to deal with the matter in accordance with *Ethiopian Oilseeds*, he would have found those matters to be closely connected with the formation of the contract and thus within the arbitration clause.



Conclusion

In light of Allsop J's criticism of the approach adopted by the Full Federal Court in *The Kiukiang Career*, it is unsurprising that the respondents have been given leave to appeal against the decision. In granting leave to appeal, Allsop J recognised that the matters raised by his decision are of considerable importance both as to how arbitration clauses should be interpreted by the Federal Court and in relation to the operation of an important piece of federal legislation dealing with international commerce.

Parties who enter into contracts based on standard forms of contracts (which, in certain markets, invariably incorporate arbitration clauses) demand legal certainty at the negotiation stage as to what it is that they are agreeing to. Against that background, the decision of Allsop J highlights the need for clarification in relation to the scope and application of arbitration clauses.

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