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Damian Sturzaker

Megan Valsinger-Clark

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## From the courts

# Oil Basins v BHP: Blurring the line between arbitration and litigation?

Damian Sturzaker and Megan Valsinger-Clark

It's not often that one feels sorry for large gas exploration companies. However one can't help feeling a little sorry for Oil Basins following the decision of the Victorian Court of Appeal in *Oil Basins Ltd v BHP Billiton Ltd*.<sup>1</sup>

Unfortunately for Oil Basins, BHP was successful in its bid to have an award against it set aside, both in the Supreme Court and in the Court of Appeal.

Arbitration is designed to be both fast and final. In the *Oil Basins* case, arbitration has been neither. The real question is could this problem have been avoided?

## So what was it all about?

In 1960 BHP concluded a royalty agreement with Oil Basins relating to the production of hydrocarbons from the 'Blackback' field (Blackback) in the Bass Strait off the coast of Victoria. The royalty agreement was governed by New York law and contained a clause requiring the parties to resolve any disputes by way of arbitration in Australia.

Production of hydrocarbons from Blackback commenced nearly 40 years later in 1999. In 2002 Oil Basins commenced arbitration proceedings against BHP seeking the payment of royalties under the 1960 royalty agreement.

The parties concluded a Deed of Submission to Arbitration which recorded the parties' 'agreed goal of efficient resolution of the Dispute' and their agreement to use their best endeavours to facilitate the making of an award by the arbitrators 'expeditiously and without undue delay' and that any interim award be made in writing, as soon as reasonably practicable, stating the reasons for making the award, and be final and binding upon the parties.

The arbitral tribunal was composed of two retired Australian judges (of the Federal and Supreme Courts) and an American lawyer. The chairman (the retired Federal Court judge) and the other Australian arbitrator formed the majority, finding in favour of Oil Basins and ordering BHP to pay royalties under the royalty agreement. In doing so the majority made findings of fact as to New York law.

## BHP's bone to pick ...

Needless to say, BHP wasn't happy with the award. BHP made an application to have the award set aside on the bases that:

1. The reasons given in the interim award were so manifestly inadequate as to constitute an error of law on the face of the award (s 38 of the *Commercial Arbitration Act* (NSW) (the Act)).
2. The majority arbitrators had so much failed to consider and adjudicate upon substantial and serious submissions and evidence relied upon by the respondents as to amount to technical misconduct (ss 42 and 44 of the Act).

Section 38(5) of the Act provides:

The Supreme Court shall not grant leave [to appeal] under subsection (4)(b) unless it considers that—

- (a) having regard to all the circumstances, the determination of the question of law concerned could substantially affect the rights of one or more parties to the arbitration agreement; and
- (b) there is—
  - (1) a manifest error of law on the face of the award; or
  - (2) strong evidence that the arbitrator or umpire made an error of law and that the determination of the question may add, or may be likely to add, substantially to the certainty of commercial law.

Sections 42(1) and 44 of the Act provide:

- 42.(1) Where—
  - there has been misconduct on the part of an arbitrator or umpire or an arbitrator or umpire has misconducted the proceedings; or
  - (a) the arbitration or award has been improperly procured—
  - (b) the Court may, on the application of a party to the arbitration agreement, set the award aside either wholly or in part.
- ...  
44. Where the Court is satisfied that—
  - (a) there has been misconduct on the part of an arbitrator or umpire or an arbitrator or umpire has misconducted the proceedings;
  - (b) undue influence has been exercised in relation to an arbitrator or umpire; or
  - (c) an arbitrator or umpire is incompetent or unsuitable to deal with the particular dispute—
    - the Court may, on the application of a party to the arbitration agreement, remove the arbitrator or umpire.

The trial judge in the Supreme Court concluded that the arbitral tribunal had failed to give adequate reasons for making the award and that this was both an error of law on the face of the award within the meaning of s 38 of the Act and technical misconduct under ss 42 and 44 of the Act.

The trial judge in the Supreme Court ordered that the award be set aside and the arbitration remitted for determination before a differently constituted arbitral tribunal. Not surprisingly, Oil Basins appealed.

## What the Court of Appeal thought about BHP's argument

The Court of Appeal dismissed the appeal and left the orders of the trial judge intact, holding that the failure to



give sufficient reasons constituted an error of law and misconduct within the meaning of the Act.<sup>2</sup>

With respect to the standard of reasoning to be expected of an arbitral award, the Court of Appeal held that

... in arbitration, the requirement is that parties not be left in doubt as to the

reasoned to a judicial standard. This is primarily because the award does not become precedent, which would justify the imposition of a requirement for clear and comprehensive reasoning.<sup>7</sup> It can further be attributed to the overriding aim of efficiency and minimisation of costs in arbitration.

**Interestingly, the Court of Appeal, while saying that the experience of the arbitral tribunal was not relevant in determining the standard of reasoning to be expected, held that the nature of the dispute (including the parties' choice of arbitrator) was relevant in determining the standard of reasoning expected of the arbitral tribunal.**

basis on which an award has been given. To that extent, the scope of an arbitrator's obligation to give reasons is logically the same as that of a judge.<sup>3</sup> The Court of Appeal went on to say: As with reasons which a judge is required to give, the extent to which an arbitrator needs to go in explaining his or her decision depends on the nature of the decision.<sup>4</sup>

The Court of Appeal noted that a lesser standard would be expected of a matter that 'turned on a single short issue of fact'.<sup>5</sup>

Interestingly, the Court of Appeal, while saying that the experience of the arbitral tribunal was not relevant in determining the standard of reasoning to be expected, held that the nature of the dispute (including the parties' choice of arbitrator) was relevant in determining the standard of reasoning expected of the arbitral tribunal.<sup>6</sup>

### **Is this a new standard for arbitral reasoning?**

The requirement to give reasons will generally be determined by considering the agreement between the parties. Often, the law and/or rules governing arbitration proceedings will require the arbitral tribunal to provide a 'reasoned' award.

Traditionally, arbitral tribunals have not been expected to produce an award

Notwithstanding the above, arbitral awards are generally required to contain sufficient reasoning to allow the courts to determine any appeal under the applicable law, whether that applicable law contains broad or narrow grounds for appeal.<sup>8</sup> This means that the standard expected of arbitral awards varies, depending on the nature and complexity of the dispute.

English courts have set a fairly low standard of reasoning, the court in *Poyser and Mills Arbitration* holding that arbitral awards are required to:

... provide reasons that will not only be intelligible, but will deal with substantial points that have been raised.<sup>9</sup>

Australian courts adopted a similar standard, requiring arbitral awards to:

... indicate to the parties why the arbitrator reached the conclusion or conclusions which he did as the foundation of his award.<sup>10</sup>

However, the Court of Appeal in *Oil Basins* applied a stricter standard, holding that:

The judicial obligation to give reasons is not based solely on rights of appeal. Ultimately, it is grounded in the notion that justice should not only be done but be seen to be done. And in point of principle, there is not a great deal of difference between that idea and the imperative that those who make binding



decisions affecting the rights and obligations of others should explain their reasons. Each derives from the fundamental conception of fairness that a party should not be bound by a determination without being apprised of the basis on which it is made. So, in arbitration, the requirement is that parties not be left in doubt as to the basis on which an award has been given. To that extent, the scope of an arbitrator's obligation to give reasons is logically the same as that of a judge.<sup>11</sup> Contrary to the view expressed by the Court of Appeal, it is the authors' view that there is a great deal of difference between the principle that 'justice should be seen to be done' (the open justice principle<sup>12</sup>) and the imperative for an explanation of reasons.

Insofar as the open justice principle applies to arbitration, it is the authors' view that an award can meet the imperative for an explanation of reasons without subscribing to the rigorous requirement that justice should not only be done, but be seen to be done.

This is particularly so given the emphasis of arbitral theory on the private resolution of disputes in a timely manner. Parties that agree to opt out of the court system in favour of an efficient party-driven dispute resolution process should not be in a position to insist upon an award of the same standard as a judgment produced by a court that is driven by the imperatives of precedent.

The Court of Appeal's comments may be more relevant to investment treaty arbitration, which involves substantially different considerations to those present in international and domestic arbitration. In particular, the public policy considerations present in investment treaty arbitration may justify the application of a higher standard of reasoning to investment treaty awards.<sup>13</sup> Further parties to investment treaty arbitration may not be considered to have freely agreed to the arbitration process in the same way as parties to private arbitration have.

Notwithstanding this, it is the authors' view that the imposition of a judicial standard of reasoning to arbitral awards, being a combination of the open justice principle and the

imperative for an explanation of reasons, is not as straightforward as the Court of Appeal suggests, and should not be adopted in the interpretation of the state-based Commercial Arbitration Acts.

From a practical perspective, it is noted that there is the possibility that an appeal conducted on the basis that the arbitral tribunal has failed to give reasons for its award will raise questions of both law and fact, which is arguably a broader interpretation than that intended by the wording of s 38 of the *Commercial Arbitration Act* (NSW).

### **Why is *Oil Basins* so important?**

The imposition of a judicial standard of reasoning in combination with the right to appeal for insufficient reasoning has the potential to drastically increase the likelihood of appeal under the state-based Commercial Arbitration Acts.

Broadened rights of appeal have the potential to severely impact on the efficiency of arbitral proceedings, which relies in part on the finality of arbitral awards. Amongst other things, if this decision causes a broadening of appeal rights under the state-based Commercial Arbitration Acts it may make it easier for a party with deep pockets to engage in tactical arbitration-by-attrition.

This is demonstrated by the facts in *Oil Basins*. Arbitration proceedings were commenced in mid-2002 and the interim award was handed down in September 2005. The first appeal of the interim award was decided in November 2006 and the second appeal was decided in November 2007.

Three years for the resolution of a large and complex technical claim between intransigent parties is fairly reasonable. What is less reasonable is two years spent appealing the arbitral award in the courts, with the result that the matter is remitted to a differently-constituted arbitral tribunal to be completely re-heard.

Parties are entitled to expect arbitrators to give proper reasons for their decisions. But the standard expected of arbitrators needs to be balanced against the importance of

ensuring that arbitration remains a fast and final way of resolving disputes.

### **Preventing arbitration-by-attrition**

Arbitration-by-attrition can be prevented by an agreement between the parties to apply the *International Arbitration Act* (Cth), which has much narrower appeal rights than the state-based Commercial Arbitration Acts.

An award can be appealed under the *International Arbitration Act* where, for example, the subject matter of the award is not capable of being referred to arbitration (like criminal matters) or where the award offends public policy (where the making of the award was induced by fraud, etc).

The application of the *International Arbitration Act* is particularly appropriate in a situation like the one in *Oil Basins*, where you have a dispute involving an international party, arising from an agreement relating to the production of hydrocarbons in Australia and governed by the law of New York.

If the parties prefer domestic arbitration, but want to exclude the appeal rights under the state-based Commercial Arbitration Acts, it is possible to do so by concluding an exclusion agreement once arbitration proceedings have commenced (see, for example, s 40 of the *Commercial Arbitration Act* (NSW)).

In doing so, parties can ensure that arbitration remains what it is intended to be; a method for the fast and final resolution of disputes. ●

*Damian Sturzaker is a partner at Marque Lawyers specialising in the areas of cross-border litigation and arbitration. He is an adjunct lecturer at UNSW on International Commercial Arbitration and is the Australian representative on a number of international committees related to international arbitration. He can be contacted at <[damians@marquelawyers.com.au](mailto:damians@marquelawyers.com.au)>.*

*Megan Valsinger-Clark is a solicitor in the Commercial Litigation Group at Gadens Lawyers, Sydney. She can be contacted at: <[mvalsingerclark@nsw.gadens.com.au](mailto:mvalsingerclark@nsw.gadens.com.au)>.*



## Endnotes

1. *Oil Basins v BHP Billiton* [2007] VSCA 255.
2. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [62].
3. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [56].
4. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [54].
5. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [57]; applying the standard in *Soulemezis v Dudley (Holdings) Pty Ltd* (1987) 10 NSWLR 247.
6. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [58] and [59].
7. P Gillies, and N Selvadurai, 'Reasoned Awards: How Extensive Must the Reasoning Be?' (2008) 74 *Arbitration* 126.
8. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [56]; above n 7, 128.
9. *Poyser and Mills Arbitration* [1964] 2 QB 467 at 478.
10. *Gordon and Gotch Australia Pty Limited v Horwitz Publications Pty Limited* [2007] NSWSC 960 at [56].
11. *Oil Basins v BHP Billiton* [2007] VSCA 255 at [56].
12. The Hon J J Spigelman, 'Seen to be Done: The Principle of Open Justice', Keynote address to the 31st Australian Legal Convention, Canberra (9 October 1999).
13. See the comment of the ICSID Arbitral Tribunal in *Libananco Holdings v Turkey* that 'it is not enough that justice should be done, it must manifestly be seen to be done' with respect to the use by Turkey of state powers to conduct surveillance on Libananco Holdings during investment treaty arbitration proceedings relating to electricity generation and distribution concessions by Turkey, paragraph 79 ARB/06/8 'Decision on Preliminary Issues' dated 23 June 2008; 'Libananco Tribunal Rules on Intercepted Emails', (11 July 2008) *Global Arbitration Review*.

## Mediation and panelwork

The Accord Group are appointed by the Federal Minister for Small Business as the Mediation Adviser under the Franchising Code of Conduct. In this role they administer the appointment of mediators for franchise disputes across Australia, appointing from a national panel of approximately 150 mediators.

To be eligible for inclusion on the panel mediators must:

- (1) have completed at least 28 hours of mediator training;
- (2) provide evidence of satisfactory assessment as a mediator;
- (3) be prepared to carry out any mediations referred by the Office of the Mediation Adviser for a maximum recommended rate of \$275 per hour (including GST) with a maximum of \$825 (including GST) for pre-mediation time;
- (4) be prepared to conduct the mediations in accordance with the procedures the Mediation

Adviser has established and in accordance with the Franchising Code of Conduct; and

- (5) show adequate knowledge of franchising issues as an adviser, franchisee, franchisor or mediator or have attended an appropriate franchise mediation conversion course.

In regards to Criteria 5, this requirement can be met by attending a franchise specific training day. The next course available is in Sydney on 3rd December 2008.

Interested mediators may wish to explore this further by applying to the OMA for an application letter <[office@mediationadviser.com.au](mailto:office@mediationadviser.com.au)> or by visiting their website <[www.mediationadviser.com.au](http://www.mediationadviser.com.au)>.

For further information on the training day please contact Bianca Keys, Mediation Manager, The Accord Group Australia at <[biancakeys@accordgroup.com.au](mailto:biancakeys@accordgroup.com.au)>.