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Hui v Esposito Holdings Pty Ltd [2017] FCA 648

In *Hui v Esposito*,[1] Justice Beach of the Federal Court of Australia set aside a partial award in an international arbitration and removed the arbitrator on the grounds of procedural unfairness and bias. This case modifies Australian law on arbitrator bias and serves as a reminder of the risks of preliminary hearings in international arbitrations.

Facts

Background

The subject matter of the arbitration concerned a share sale agreement executed on 11 December 2013 between Esposito Holdings Pty Ltd (the vendor) and UDP Holdings Pty Ltd (the purchaser) in relation to shares in 5 Star Foods Pty Ltd. Hui acted as guarantor for UDP. On 30 October 2014, Esposito served a notice of arbitration on UDP, 5 Star Foods and Hui claiming the unpaid balance of moneys pursuant to the UNCITRAL Arbitration Rules. UDP and 5 Star Foods in response claimed that Esposito had breached certain warranties under the share sale agreement. On 10 November 2014, the holding company of UDP and 5 Star Foods entered into receivership.[2]

The preliminary hearing

Esposito filed an application for a preliminary hearing seeking a partial award on the liability of multiple unpaid instalments. At the directions hearing, UDP and 5 Star Foods objected to the making of such an award on the basis that their case involved a set-off defence or cross-claim for breaches of warranty by Esposito, and the preparation of this had been delayed by Esposito delaying production of materials that had been requested. The arbitrator directed, at Esposito's insistence, that the preliminary hearing could deal with Esposito's claims without determining any set-offs or cross-claims, which could instead be dealt with as a 'phase two'.[3]

At the hearing on 3 June 2015, UDP and 5 Star Foods did not make appearances, firstly because the companies were in administration and receivership, rendering Esposito's claims of little economic significance, and secondly because they understood that their arguments on set-offs would not be heard within the scope of the preliminary hearing.[4] Counsel for Hui argued against the making of a partial award based on the *existence* of possible set-offs, but made no pleadings on their merits. Throughout the hearing, the arbitrator stated that he would accept that there were claims for a set off for the purposes of the preliminary hearing, but make no judgment on the merit of those claims.[5]

On 25 September 2015, the arbitrator issued reasons determining in favour of Esposito's claims, but also against the availability of the warranty claims as set-offs. This was not considered to be within the scope of the preliminary hearing, and little to no submissions were made on those issues by either side. The arbitrator then asked parties to make submissions on whether his reasons were 'wrong'. Beach J noted that this was a "curious invitation given that the arbitrator appeared to have already made up his mind on such matters."[6] To this, Hui, supported by UDP and 5 Star Foods, challenged the arbitrator's reasons on procedural fairness and requested his withdrawal from the

[1] *Hui v Esposito Holdings Pty Ltd* [2017] FCA 648 (9 June 2017).
[2] Ibid [8]-[14].
[3] Ibid [19]-[25].
[4] Ibid [26]-[65].
[5] Ibid [126]-[170].
[6] Ibid [78].

matter. On 15 April 2016, the arbitrator rejected the application and issued a partial award giving effect to his reasons. Accordingly, on 12 September 2016, the arbitrator issued a partial award declaring the unpaid sums against Hui, UDP and 5 Star Foods, and a second award dismissing the application that he withdraw.[7]

Federal Court judgment

Hui sought to set aside the partial award under Article 34 of the UNCITRAL Model Law, on the grounds of reasonable opportunity to present case and public policy,[8] and an order to remove the arbitrator under Article 12 for bias.[9]

Justice Beach began his analysis of the case by recognising the objects of efficiency and expedition in international arbitration and the need for judicial restraint as outlined in s 2D of the *International Arbitration Act* and the judgment in *TCL v Castel*.[10] He considered the exchanges between the parties up to and during the preliminary hearing and found that the arbitrator had made clear numerous times that the availability and merits of set-off defences were not within the scope of the hearing. Following *TCL*, Beach J found that 'real unfairness or real practical injustice' had been caused in this case by the denial of a reasonable opportunity for Hui to present its case, and the reasoning of the arbitrator which was not 'reasonably foreseeable' by a reasonable person in Hui's shoes.[11] He also noted that there was an 'exceptional' and 'egregious' breach of the rules of natural justice under Australian public policy.[12]

Bias test

As for the challenge to the arbitrator, Beach J reconsidered his interpretation of the s 18A 'real danger of bias' test in *Sino Dragon* and endorsed an interpretation closer to the prevailing *Porter v Magill* test used in the UK and Hong Kong.[13]

In *Sino Dragon*, Beach J had accepted that under the test in *R v Gough* as enacted by s 18A, it was for the court to be satisfied whether there was a real danger of bias rather than a reasonable person.[14] However, Beach J has now determined in *Hui v Esposito* that the correct perspective should be from the reasonable bystander.[15] In addition, he held that a 'real possibility' of prejudgment can establish the 'real danger test'.[16] From this it appears that the formulation to satisfy s 18A more closely resembles the accepted test for arbitrator bias in the UK and Hong Kong, which is whether a 'fair-minded and informed observer would conclude that there was a real possibility that the tribunal was biased', a revised version of the *Gough* test adopted by the House of Lords in *Porter v Magill*.[17]

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[7] Ibid [97]-[98].
[8] *International Arbitration Act 1974* (Cth) ss 18C, 19.
[9] *International Arbitration Act 1974* (Cth) s 18A.
[10] *International Arbitration Act 1974* (Cth) s 2D; *TCL Air Conditioner (Zhongshan) Company Ltd v Castel Electronics Pty Ltd* (2014) 232 FCR 361.
[11] *Hui v Esposito* [2017] FCA 648 at [179]-[199].
[12] Ibid [229].
[13] *Sino Dragon Trading Ltd v Noble Resources International Pte Ltd* [2016] FCA 1131; *Porter v Magill* [2002] 1 All ER 465, adopted in Hong Kong in *Suen Wah Ling v China Harbour Engineering Co.* [2007] BLR 435 HKCA.
[14] *Sino Dragon Trading Ltd v Noble Resources International Pte Ltd* [2016] FCA 1131 at [197].
[15] *Hui v Esposito* [2017] FCA 648 at [241].
[16] Ibid [240].
[17] *Porter v Magill* [2002] 1 All ER 465

Although Beach J noted that the change in perspective may not make much practical difference, a similar conclusion to that reached in the English judgment of *Locabail*,[18] it is significant in that it is a modification which has led to the explicit rejection of the *Gough* formulation in favour of *Porter* in the UK. In *Sino Dragon*, Beach J was prepared to apply the original *Gough* test as propounded by Lord Goff of Chievely and follow the reasoning given in the explanatory memorandum to the International Arbitration Amendment Bill 2009 which inserted s 18A.[19] However, his decision now to depart from that test and interpret the words 'real danger of bias' closer to the formulation in *Porter* (which the legislature could have and decided not to embrace in s 18A) demonstrates the Court's inclination to take into account the consistency and harmony of international jurisprudence in this area.

Preliminary hearings

The chain of events that occurred in the arbitration of *Hui v Esposito* highlight the procedural risks of preliminary hearings in arbitrations. Though it appeared from the transcript of the preliminary hearing that all parties understood that the scope of the hearing would not involve the availability or merits of the set-off defences,[20] it is clear from the outcome that misunderstandings had occurred as to the parties' real intentions. Indeed, part of the outcome of this matter seems attributable to an attempted translation of a procedural principle normally applied in courts to arbitral proceedings, which is that a counter-claim can be treated as a set-off defence.[21]

Counsel for Hui, framing the warranty claims as set-off defences, submitted that a partial award should not be made because a determination on liability was not feasible without a hearing on the merits of the defences.[22] Counsel for Esposito, on the other hand, was of the view that a partial award should be made on the unpaid monies claim without hearing the set-offs, submitting that the warranty claims could be brought as 'phase-two' counter-claims instead.[23] And finally, the arbitrator in his (illegitimate) reasoning ruled against the availability of the warranty claims both as set-offs or counter-claims.[24]

Though Beach J recognised that greater latitude is given to arbitral procedures than curial proceedings, he ultimately put the problems in the arbitration down to 'questionable procedural choices' urged on the arbitrator by Esposito, 'hiving off and determining incomplete separate questions… where various issues between parties had not been properly crystallised'.[25] Authors have noted the benefits to time and cost of utilising preliminary proceedings, but also the dangers inherent in attempting to isolate or disentangle intertwined issues, such as when they are often employed to determine separately issues of liability and quantum.[26] *Hui v Esposito* is another case

[18] *Locabail v Bayfield Properties Ltd* [2000] QB 451 at [17].
[19] *Sino Dragon Trading Ltd v Noble Resources International Pte Ltd* [2016] FCA 1131 at [197]; International Arbitration Amendment Bill 2009 (Cth).
[20] *Hui v Esposito* [2017] FCA 648 at [144]-[148].
[21] See e.g. *Civil Procedure Act 2005* (NSW) s 21.
[22] *Hui v Esposito* [2017] FCA 648 at [146].
[23] Ibid [154], [159].
[24] Ibid [172].
[25] Ibid [7].
[26] See e.g. Alan Redfern, *Law and Practice of International Commercial Arbitration* (Sweet & Maxwell 2004), 374, and Francis Hornyold-Strickland and Duncan Speller*, Preliminary Determinations – Path to Efficiency OR Treacherous Shortcut?* (21 April 2016) Kluwer Arbitration Blog, <http://kluwerarbitrationblog.com/2016/04/21/preliminary-determinations-path-to-efficiency-or-treacherous-shortcut/>.

highlighting the potential for preliminary hearings to be "treacherous shortcuts",[27] and the need for practitioners to be duly careful when trying to seek expedition of matters through preliminary hearings and partial awards at the expense of clarity and finality.

Conclusion

In the face of a line of decisions refusing to set aside arbitral awards in international arbitrations, *Hui v Esposito* demonstrated the exceptional level of breach of natural justice that must be found to invalidate an arbitral award and tribunal, and that significant flaws in arbitral process, despite being a result of commercial choices of contracting parties, will warrant judicial intervention. Nevertheless, the Court's conservative approach was displayed in Beach J allowing parties to make further submissions as to how remaining issues of the arbitration should be decided,[28] and ultimately only setting aside the parts of the award infected by Article 34 grounds in a manner to achieve a commercial result reflecting the parties.[29] Finally, *Hui v Esposito* also leaves open s 18A as a matter for interpretation in future decisions of the Court, given the sole conflicting approaches taken by the same judge in *Sino Dragon* and *Hui*.

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[27] A phrase used by Lord Scarman in *Tilling v Whiteman* [1980] AC 1 about the use of preliminary proceedings in law.
[28] *Hui v Esposito* [2017] FCA 648 at [259].
[29] *Hui v Esposito Holdings Pty Ltd (No 2)* [2017] FCA 728 (26 June 2017).