IN THE COURT OF APPEAL OF NEW ZEALAND

CA437/2012
[2013] NZCA 11

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

Hearing: 18 October 2012

Court: Harrison, Wild and Ronald Young JJ

Counsel: M G Ring QC and A V Foote for Appellant
J G Miles QC and P J Dale for Respondents

Judgment: 15 February 2013 at 10 am

JUDGMENT OF THE COURT

A The appeal is allowed and the judgment of the High Court is set aside.

B The respondents' application to set aside the partial arbitration award is dismissed.

C The partial award is reinstated.

D The proceeding is remitted back to the High Court to determine the respondents' appeal or alternatively their application for leave to appeal on a question or questions of law.

E The respondents must pay costs to the appellant for a standard appeal on a band B basis and usual disbursements. We certify for two counsel.

REASONS OF THE COURT

(Given by Harrison J)

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Introduction

[1] This appeal raises the issue of whether the High Court correctly set aside an arbitral award in circumstances where the agreement to refer to arbitration included an invalid and unenforceable right of appeal on questions of fact.[1] Underlying that issue are questions about the legal principles governing rights of severance of contractual provisions and the Court's residual discretion to set aside an award. Subsidiary issues also arise about whether the award should have been set aside on other grounds and whether leave to appeal on questions of law should have been granted.

Background

[2] The relevant circumstances are undisputed and can be stated briefly.

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1 *Carr v Gallaway Cook Allan* [2012] NZHC 1537, [2012] 3 NZLR 97.

[3] The first respondent in this appeal, Ewan Carr, was formerly in a substantial commercial partnership with Rodney Humphries and associated entities. Differences arose between them. Litigation followed in the High Court. Mr Carr obtained summary judgment against Mr Humphries for specific performance of an agreement to sell shares.[2] Mr Humphries filed but abandoned an appeal to this Court.

[4] In May 2007 the parties entered into an amended settlement agreement (the ASA) for the purpose of settling their differences. The Humphries interests agreed to transfer to Mr Carr farming and hotel properties in the Maniatoto Basin in Central Otago for a substantial sum. Settlement was agreed for 4 pm on 31 May 2007, time being of the essence. The settlement process was extremely complex and involved a number of parties. Mr Carr was unable to settle on time and the Humphries interests cancelled the ASA. The appellant in this appeal, Gallaway Cook Allan (GCA), acted for Mr Carr on the transaction.

[5] Mr Carr challenged the validity of the Humphries' cancellation of the ASA. He issued proceedings in the High Court at Dunedin. Randerson J dismissed the application.[3] This Court dismissed Mr Carr's appeal.[4] Associated litigation followed. An appeal by Mr Humphries against a subsequent decision involving another property was dismissed by this Court.[5]

[6] Mr Carr later received advice from another firm of solicitors. As a result, he notified GCA that he held the firm responsible for his failure to settle the ASA on time. He alleged that the firm had breached its contractual duties in a number of respects. He quantified his loss flowing from GCA's alleged negligence at $12.698 million. GCA denied negligence and liability. On 28 September 2010 the parties signed an agreement to refer their differences to the Hon Dr Robert Fisher QC as sole arbitrator.

[7] The arbitral agreement was the culmination of lengthy negotiations between the parties. Clause 1.2 of the agreement contained this relevant provision:

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2 *Carr v Humphries* HC Dunedin CIV-2006-412-513, 16 November 2006.
3 *Frost v Carr* HC Dunedin CIV-2007-412-507, 29 February 2008.
4 *Carr v Frost* [2008] NZCA 391.
5 *Humphries v Carr* [2011] NZCA 314, [2012] 1 NZLR 742 (leave refused in *Humphries v Carr* [2011] NZSC 115).

> 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).
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> (Italicising, inverted commas and "emphasis added" included in the original document).

[8] The arbitration hearing occupied a total of 10 days in November 2010. Mr Carr's counsel filed four separate applications to amend his allegations of negligence – the fourth in the course of closing submissions. And after the hearing concluded, Mr Carr's counsel applied for leave to withdraw a concession. Numerous memoranda were exchanged up until 6 April 2011. Delivery of the award was delayed as a result.

[9] In a comprehensive partial award issued on 9 May 2011 the arbitrator dismissed Mr Carr's claim. While satisfied that GCA was negligent in a number of respects, he was not satisfied that its breaches of duty had a causative effect. On what he called the most complex counterfactual analysis he had experienced in litigation, the arbitrator found that irrespective of any negligence by GCA Mr Carr would have been unable to settle by 4 pm on 31 May 2007. His conclusion was based primarily on findings of fact. In delivering the judgment under appeal, Ellis J succinctly captured the effect of the arbitrator's findings on Mr Carr in these words:[6]

> Thus, from the perspective of the Carr interests, seven minutes lay between them and a successful claim for $12 million. Their immediate instinct was to exercise the appeal rights that had been agreed and which had been expressed in cl 1.2 of the arbitration agreement.

High Court

[10] Mr Carr appealed to the High Court on questions both of law and fact arising out of the partial award. GCA opposed on the ground that the Arbitration Act 1996 limits rights of appeal to questions of law;[7] and the relevant statutory provisions

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6 At [17].

7 Arbitration Act 1996, sch 1, arts 5 and 34; and sch 2, cl 5.

could not be extended by contract.[8] So Mr Carr filed an amended appeal and applied to set aside the partial award on the ground that it was invalid. That was because the parties had agreed to submit their differences to the arbitral jurisdiction on the express basis that, contrary to law, each would have a right to appeal against factual findings. Alternatively, Mr Carr sought to set aside the award under the Contractual Mistakes Act 1977 on the ground that the parties submitted to the arbitral jurisdiction under a common mistake of law. Alternatively, also, leave was sought if necessary to appeal on a number of questions. GCA responded by applying for an order dismissing, staying or striking out Mr Carr's appeal.

[11] In the High Court counsel focussed on the primary issue of invalidity and severability. Ellis J recited their agreement that either (a) the arbitral agreement could be saved by severing the words "and fact" from cl 1.2 or (b) it must fail in its entirety, presciently observing that "[t]here, however, the agreement (and any simplicity) ends."[9]

[12] The Judge referred primarily to the Privy Council's decision in *Carney v Herbert.*[10] She was satisfied that the arbitration agreement as a whole was invalid under New Zealand law and that inclusion of a right of appeal against findings of fact was "a fundamental part of the exchange of promises between the parties".[11] In reaching this conclusion, she referred to the content of cl 1.2,[12] the importance to both parties of a right to appeal on findings of fact[13] and correspondence exchanged between the parties' lawyers before the agreement was entered into.[14]

[13] The rationale for Ellis J's decision is found in these passages:

> [47] I accept that it would be a simple enough "blue pencil" exercise to excise the words "and fact" from cl 1.2. The agreement would make perfect sense without them. But, for the reasons I have given, I consider that the inclusion of those words formed a fundamental part of the exchange of

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8 *Methanex Motunui Ltd v Spellman* [2004] 3 NZLR 454 (CA) at [105] and [116]; see also *Guangzhou Dockyards Co Ltd v ENE Aegiali I* [2001] EWHC 2826 (Comm) and *R v Moore, ex parte Australian Workers Union* (1976) 11 ALR 449 (HCA) at 453.

9 At [30].

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

11 At [47].

12 At [44].

13 At [45].

14 At [46].

> promises between the parties. As I have said, that conclusion is borne out by the terms of the clause itself. The underlying factual matrix also supports it. While the agreement is, indeed, at its heart an agreement to arbitrate a dispute, it can also reasonably be inferred that there would have been no such agreement at all, had those words not been included.
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> [48] More fundamentally, it would, I think, be wrong in principle (and contrary to the thrust of the cases I have discussed) to order severance where that order would not only diminish, but would actively better, the contractual position of the party who seeks it. Justice does not obviously lie in permitting Gallaways to take advantage of a windfall illegality by ordering severance here.
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> ...
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> [50] Accordingly, and for all the above reasons I consider that the words "and fact" cannot be severed from cl 1.2 and that (as the parties have in that event agreed) the arbitration agreement as a whole is therefore not valid under New Zealand law.
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> [51] In terms of any residual discretion as to setting aside under art 34, I do not discount the time, money and effort expended by both parties on the arbitration process to date. Those matters weigh heavily with me. But ultimately, in my view, unless setting aside is ordered Gallaways will reap the very substantial benefit of a mistake for which it was, at least in part, responsible. Without that mistake the arbitration would not, in my view, have taken place at all. Through no fault of the arbitrator, the arbitration misfired from the start.

[14] Ellis J recorded that this primary finding allowing Mr Carr's application to set aside the arbitration award was decisive in his favour. But, in what she described as "an attempt to facilitate what I perceive to be the almost inevitable appeal",[15] she found that his alternative claim for relief under the Contractual Mistakes Act had no prospect of success.[16] That was because any common mistake did not result in an unequal exchange of benefits "at the time of the contract". Accordingly GCA was entitled to summary judgment on that aspect of Mr Carr's claim.

[15] The Judge dismissed another of Mr Carr's alternative claims that the award should be set aside on the ground that the inclusion of the offending words rendered it contrary to public policy.[17] She also dismissed his estoppel argument.[18] And while not determining Mr Carr's alternative application for leave, she indicated that even though many of the questions posed were of mixed fact and law, she would have

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15 At [52].
16 At [63]–[66].
17 At [55]–[57].
18 At [58]–[62].

granted leave if Mr Carr were able to identify discrete questions of law in the event the dispute was referred back to the High Court.[19] Mr Carr does not cross-appeal against any of these adverse findings.

Decision

(a) Jurisdiction

[16] Article 34(2) of sch 1 of the Arbitration Act confers jurisdiction on the High Court to set aside an arbitral award only if:

> (a) The party making the application furnishes proof that –
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> *(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*
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> (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
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> (iii) The award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions 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
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> (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
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> (b) The High Court finds that –
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> (i) The subject-matter of the dispute is not capable of settlement by arbitration under the law of New Zealand; or

[19] At [68]–[72].

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

(Emphasis added.)

[17] Article 34 continues:

> (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.
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> ...
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> (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 – …
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> (a) The making of the award was induced or affected by fraud or corruption; or
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> (b) A breach of the rules of natural justice occurred –
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> (i) During the arbitral proceedings; or
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> (ii) In connection with the making of the award.

[18] Mr Carr's application to the High Court was made under art 34(2)(a)(i). That provision envisages a two stage enquiry. At the first or threshold stage, Mr Carr must satisfy the Court that the arbitration agreement was invalid under New Zealand law. At the second stage, "only if" invalidity is established, the Court must then exercise its discretion about whether to set aside the award.

[19] We shall approach GCA's appeal by sequential reference to both stages.

(b) Invalidity

(i) General principles

[20] The primary question at the first stage is whether the provision purporting to grant either party a right of appeal on questions of fact is severable from the rest of the arbitration agreement. If so, the agreement would be valid; if not, it would be

invalid. The difference between counsel is captured by summarising their competing propositions about the nature of the agreement: Mr Ring QC for GCA contends that the instrument is an agreement to arbitrate with an ancillary right of appeal; Mr Miles QC for Mr Carr contends that it is an agreement to arbitrate to which a right of appeal on questions of fact is integral.

[21] Both counsel referred extensively to authority. As a general observation, most of the authorities are in the area of illegality where a provision is void at common law on grounds of policy or is contrary to a statutory prohibition. Examples are restraint of trade cases or where, as in *Carney v Herbert*, a collateral security is tainted. These contracts differ from those of a more reprehensible nature, such as an agreement to commit a crime.[20] Ellis J rightly placed the offending provision in the first, or more benign, category.[21]

[22] Before us counsel treated *Carney v Herbert* as the leading Commonwealth authority. In that case the Privy Council dismissed an appeal directly from the Supreme Court of New South Wales, the Court of first instance. In delivering the Board's judgment, Lord Brightman approved observations made by Jordan CJ in *McFarlane v Daniell*[22] in these terms:

> Jordan CJ said (at 345):
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> > "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 contract, the valid promises are severable … If the substantial promises were all illegal or void, merely ancillary promises would be inseverable."
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> He added later (at 346):
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> > "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

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20 See the discussion in John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (4th ed, LexisNexis, Wellington, 2012) at [13.2.2].

21 At [55].

22 *McFarlane v Daniell* (1938) 38 SR (NSW) 337. *McFarlane* was a restraint of trade case.

> severable, if contained in a contract one of the terms of which provided for assassination."
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> 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; second, whether, despite severability, there is a bar to enforceability arising out of the nature of the illegality.

[23] Both counsel subjected *Carney v Herbert* to careful analysis. However, its facts are far removed from this case. A party who had pursuant to an agreement for sale and purchase acquired and on-sold at a profit shares in a company without paying the full purchase price sought to defend the vendor's claim on a personal guarantee for the unpaid balance. The purchaser relied on the existence of an illegal collateral security which he had arranged – a mortgage given by a company contrary to a statutory prohibition against providing financial assistance in connection with the purchase of its shares or those of the holding company.[23]

[24] It is hardly surprising that the Board treated the sale agreement, the guarantee and the mortgage as concurrent steps in a single though composite transaction. The illegal security was ancillary to the overall contract. As a result, the mortgage could properly be severed from the balance. The parties' primary obligations remained unchanged. The whole transaction was not tainted.

[25] In *Carney v Herbert* the Board noted that there are no set rules for determining severability; tests applied in deciding one class of case are not always applicable to other kinds,[24] and to an extent each case depends on its own circumstances and in particular the nature of the illegality.[25] Self evidently, perhaps, the reference point for the inquiry is the date the contract was entered into.[26] Except for its authoritative restatement of the relevant principles, and in one other respect to which we shall return shortly, the judgment provides no particular guidance in this case.

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23 The relevant provision was the equivalent of s 62 of the Companies Act 1955, since repealed.
24 *Carney v Herbert*, above n 10, at 309.
25 At 310.
26 At 316.

[26] In *Humphries v Proprietors of Surfers Palms North Group Titles Plan 1955*[27] the High Court of Australia considered whether a provision in a management agreement between a body corporate and the manager was outside the scope of the body corporate's statutory power and, if so, whether it was nevertheless severable; if not, the manager would be unable to recover his annual lump sum entitlement. The Court unanimously found that the relevant provision was unlawful and inseverable. In a joint judgment Brennan and Toohey JJ[28] refused severance because, construed as a whole, the management agreement did not allow the agreed consideration to be apportioned between the two separate services provided by the manager – one enforceable and the other unenforceable. Both Judges applied *Carney v Herbert*. Deane and Gaudron JJ delivered a brief concurring judgment.[29]

[27] In a separate, more extensive, judgment McHugh J distinguished *Carney v Herbert.* That was because provision of the mortgage security was for the exclusive benefit of the vendor of the shares[30] and the purchaser was not prejudiced by enforcement of the transaction in its absence. McHugh J then said this,[31] in a passage upon which Ellis J placed particular weight:[32]

> *Goodinson*, however, is not readily distinguishable from the present case. It is an authority for the proposition that, if part of the consideration for the promise of a payment is void but not illegal, the promise is enforceable as long as the void consideration was not the main consideration for the promise. But if this proposition was applied generally, it might often lead to injustice. In many cases, without the void consideration, the defendant might not have entered into the agreement or promised to pay the amount of money in question. *It is not just that the defendant should have to perform a promise or promises which would not have been given but for the giving of the void consideration.*
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> In my opinion, in cases 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 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*

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27 *Humphries v Proprietors of Surfers Palms North Group Titles Plan 1955* (1994) 179 CLR 597.
28 At 604–606.
29 At 609.
30 At 620.
31 At 621–622 (footnotes omitted).
32 At [40], [43] and [47].

> *intention not to make a contract which would operate without it", the invalid promise should be treated as inseverable from the contract*.
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> (Ellis J's emphasis.)

[28] In *Atrium Management Ltd v Quayside Trustee Ltd*[33] this Court referred to *Humphries* and summarised a submission by counsel based upon McHugh J's judgment without submitting its reasoning to scrutiny. The factual circumstances and statutory framework in *Atrium* bore a close similarity to *Humphries.* By applying orthodox principles this Court was similarly satisfied that severance was inappropriate.[34] Among other things the consideration was not apportionable between the valid and invalid promises and severance would have destroyed the essence of the agreement by requiring the Court to embark upon a rewriting exercise.

[29] Ellis J construed the cited passages from McHugh J's judgment in *Humphries* as allowing a "but for" test. In apparent acceptance of Mr Miles' argument to this effect her decisive finding was that there would have been no arbitration agreement without inclusion of the words "and fact".[35] However, on appeal Mr Miles concedes that *Carney v Herbert* and *Atrium* both exclude as a relevant test the question of whether the parties would have entered into the bargain without the offending provision. In *Carney v Herbert* the Privy Council notably disapproved of the "but for" test[36] and of the supporting observations by the Full Court of the Supreme Court of Victoria in *Brew v Whitlock (No 2)*[37] upon which McHugh J relied in *Humphries* when formulating his test to the contrary.

[30] We agree with Mr Miles that the common law does not contemplate what he accepts is a subjective inquiry into one party's intentions when determining severability. McHugh J's adoption of this approach in *Humphries*, which was not endorsed by the other members of the Court, illustrates its flaw. The Judge had earlier endorsed the conventional severance principles based on *Carney v Herbert*,

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33 *Atrium Management Ltd v Quayside Trustee Ltd* [2012] NZCA 26, (2012) 13 NZCPR 69 at [41] and [42].

34 At [43].

35 At [35].

36 At 316.

37 *Brew v Whitlock (No 2)* [1967] VR 803 (VSC) at 811–812. (In *Humphries* McHugh J cited the passage from *Brew v Whitlock* at 813 but that passage was the conclusion based on the Court's reasoning which started at 805.)

describing as the "crucial question" whether deletion of the offending provision changed the extent only or the nature of the agreement.[38] He then, nevertheless, introduced the "but for" analysis, taking into account and relying on the manager's evidence at trial. That was extraneous to the contract and inadmissible,[39] and introduced a wider and more problematic inquiry than was permissible on the speculative rationale that without it an injustice might arise.

[31] In these circumstances Mr Miles seeks to support Ellis J's reasoning and result on a different legal basis. He submits that in effect the Judge correctly applied, and we should likewise apply, the principles adopted in determining whether a contractual term was essential. He relies on the authority of *Mana Property Trustee Ltd v James Developments Ltd*.[40]

[32] We do not accept Mr Miles' submission. *Mana* was decided on a disputed cancellation of an agreement for sale and purchase of a commercial property. The Supreme Court applied the statutory test provided by s 7 of the Contractual Remedies Act 1979. The question in that context is whether the parties had expressly or impliedly agreed that performance of the breached term was essential to the party exercising the right to cancel; if so, on an objective assessment, the innocent party is entitled to cancel regardless of the importance of the term or the significance of its breach. The focus is solely from the perspective of the innocent party.

[33] So, contrary to one of the critical elements of the severance inquiry, the question when determining essentiality is not whether the character or nature of the agreement is affected by the relevant provision. We are satisfied that different legal principles apply when questions of severance and essentiality are at issue. There is no basis for importing the statutory criterion into the common law of severance where the issue is not one of breach but of statutory invalidity.

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38 At 619.

39 *Goodinson v Goodinson* [1954] 2 QB 118 (CA) at 120 per Somervell LJ.

40 *Mana Property Trustee Ltd v James Developments Ltd* [2010] NZSC 90, [2010] 3 NZLR 805.

(ii) Excess of jurisdiction

[34] Counsel did not refer to any Commonwealth authorities on the issue of statutory invalidity arising from an agreement to confer a non-existent jurisdiction. Even though it involved an agreement purporting to oust the Court's jurisdiction, which is the converse of this case, the English Court of Appeal's decision in *Goodinson v Goodinson*[41] provides some analogous assistance. An estranged husband and wife entered into an agreement whereby he agreed to pay her and the children weekly sums of maintenance. In consideration she agreed to indemnify him against all debts to be incurred by her; not to pledge his credit; and not to issue matrimonial proceedings (the offensive provision). The husband defaulted but challenged his wife's right to issue proceedings. He argued that, if the only consideration moving from one side is an unenforceable promise, there is nothing to support an undertaking on the other in respect of which that unenforceable promise purported to be consideration.

[35] The Court rejected that submission. It accepted that the wife's promise not to issue proceedings was unenforceable and in that sense illegal because it purported to oust the Court's jurisdiction.[42] However, that limited statutory illegality did not vitiate the whole agreement. As Romer LJ emphasised, the promise not to sue was not the principal consideration moving from the wife; consideration was still present and survived excision of the unenforceable provision.[43] She was therefore entitled to enforce the maintenance obligations under the balance of the agreement.

[36] Mr Ring relies upon this Court's decision in *Methanex Motunui Ltd v Spellman*.[44] There an arbitration agreement excluded rights of appeal against the decision of an independent expert except where it was induced or affected by fraud or corruption. Methanex applied to the High Court for an order setting aside the award for breach of natural justice. The respondent oil exploration companies contended that Methanex had contracted out of its rights of review. This Court,

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41 *Goodinson v Goodinson*, above n 39.

42 Section 11(1)(b) of the Illegal Contracts Act 1970 preserves the common law position on contracts ousting the Court's jurisdiction – such provisions are void and ineffective.

43 At 126.

44 *Methanex Motunui Ltd v Spellman*, above n 8.

upholding Fisher J, was satisfied that the parties could not by contract exclude the statutory right to set aside an arbitral award for breach of natural justice under arts 34(2)(b)(ii) and 34(6)(b).[45]

[37] Mr Ring submits that we should infer that the only possible interpretation of the *Methanex* judgment is that the Court effectively severed the invalid term. However, the decision does not deal explicitly with this threshold question of contractual invalidity and severability and thus does not assist materially.

[38] Ellis J found support from *Crowell v Downey Community Hospital Foundation*,[46] a decision of the Californian Court of Appeal. The arbitration agreement at issue provided a right of judicial review of an award on the merits. Like this case, that agreement was in excess of the statutory jurisdiction. The majority concluded that this invalid provision was so integral to the agreement that it could not be properly severed; it would lead to an entirely new agreement to which neither party had assented. However, *Crowell* is distinguishable on a number of grounds, not the least of which is that the arbitration agreement was largely executory. The application for a declaration as to invalidity was made two years after the submission to arbitration when neither party had taken any steps.

[39] Mr Ring refers to other American authority, pointing in a different direction. One influential example is *Kyocera Corporation v Prudential-Bach Trade Services Inc.*[47] There the United States Court of Appeals, Ninth Circuit, allowed severance in circumstances similar to these. The parties had agreed to refer a dispute to arbitration. Following a hearing, the arbitrators awarded Prudential damages in excess of USD 243 million. Kyocera applied to set aside the award.

[40] In dismissing Kyocera's application, the Court decided in summary that:

(a) The arbitration agreement purported to confer jurisdiction on an appellate Court to vacate, modify or correct any award where the

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45 At [116].

46 *Crowell v Downey Community Hospital Foundation* (2002) 95 Cal App 4th 730, 115 Cal Rptr 2d 810.

47 *Kyocera Corporation v Prudential-Bach Trade Services Inc* 341 F 3d 987 (9th Cir 2003).

findings of fact were not supported by substantial evidence or if the arbitrator's conclusions on law were erroneous.

(b) Congress has prescribed a narrow role for Federal Courts reviewing arbitral decisions. The relevant statutory provisions did not empower a Court to interfere with an arbitral award on the grounds agreed by the parties. They could not contract for judicial review of the award because federal jurisdiction could not be created by contract. The extra-statutory jurisdiction provision was invalid.

(c) However, this invalidity did not render the entire arbitration reference unenforceable. The invalid provision did not taint the central purpose of the agreement to arbitrate; at best it was collateral and was severable. Its excision left the rest of the agreement intact. It did not amount to a re-writing.

[41] Moreover, the arbitration agreement had been fully performed. The scope of the arbitration had not been affected. Kyocera would gain an undeserved benefit from a finding that the agreement was invalid when the arbitration itself did not suffer from an infirmity. This result was consistent with the interests of justice.

(iii) Summary

[42] Our survey of the leading authorities, influenced in particular by the decisions in *Carney v Herbert*, *Goodinson* and *Kyocera*, confirms that there are no set or absolute rules for determining whether severance of an invalid provision from the balance of an agreement is appropriate. The primary inquiry must focus on the contractual provisions within their factual or statutory setting and the nature of the invalidity. However, certain principles have emerged and provide guidance in this case. In particular:

(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

(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.

(iv) Arbitration agreement

[43] Against this background, our analysis commences with the arbitration agreement itself. The operative part comprises two elements. The first provides:

> 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 cl 1.2).

The "dispute" is described as differences between the parties arising from a professional negligence claim brought by Mr Carr. Counsel filed detailed particulars of negligence but they were not produced on appeal.

[44] The second operative element is cl 1.2. We repeat its terms here for ease of reference:

> 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).
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> (Italicising, inverted commas and "emphasis added" included in the original document).

[45] By this means the parties expressly incorporated the applicable provisions of the Arbitration Act. Clause 5 of the Second Schedule provides as follows:

> **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—
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> (a) If the parties have so agreed before the making of that award; or
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> (b) With the consent of every other party given after the making of that award; or
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> (c) With the leave of the High Court.
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> (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 one or more of the parties.

(3) The High Court may grant leave under subclause (1)(c) on such conditions as it sees 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.

(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 36 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.

[46] This statutory provision is particularly material. In *Gold & Resource Developments (NZ) Ltd v Doug Hood Ltd*,[48] in the context of an application for leave under cl 5(1)(c), a Full Court of this Court affirmed Parliament's intention in the Arbitration Act to give effect to finality in arbitral awards where there had been no departure from settled principles of law or breach of natural justice. The legislative purpose was to limit judicial intervention in reviewing and setting aside awards where the parties have chosen arbitration.[49]

[47] The parties must have known that only two alternative dispute resolution mechanisms were available to them: they could either issue proceedings in the High Court or go to arbitration. As we shall explain, the parties had committed in principle to the arbitration process many months before the agreement was signed. Both parties are taken to have known that the arbitration process, confirmed by the statutory framework, was directed to achieving finality, as cl 1.1 of the agreement acknowledged. So, even if they had agreed to arbitrate in accordance with the rights of appeal allowed by cl 5 of the Second Schedule, there was no certainty that either party would be able to challenge the award. The introduction of cl 5(10) of the Second Schedule in 2007 further proscribed the nature of the right.

[48] We are satisfied that the words "and fact" should be severed from the balance of the agreement for these reasons:

(a) This was in substance an agreement to submit a dispute to arbitration for a final and binding determination, as Ellis J recognised,[50] including an express undertaking to carry out any award. That subject matter and the parties' primary obligations would remain essentially unchanged by excision of the words "and fact". Such a deletion alters

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48 *Gold & Resource Developments (NZ) Ltd v Doug Hood Ltd* [2000] 3 NZLR 318 (CA).
49 *Downer Construction (NZ) Ltd v Silverfield Developments Ltd* [2007] 1 NZLR 785 (HC) at [44].
50 At [47].

only the extent of an ancillary right of appeal but not the nature and character of the agreement to arbitrate. The offending words are not so interconnected with the remaining provisions as to form an indivisible whole. The parties' undertaking to carry out the award is enforceable without adoption of the offending phrase.

(b) The underlying mutual promises remain valid. The primary consideration passing from each party was the agreement to submit to arbitration. Each party stood equally to gain or to lose from performance of the agreement by completion of the arbitral process and delivery of the award. The invalid promise to allow each party to exercise a right of appeal on fact stands apart from the underlying promises.

(c) The invalidity arises from a statutory prohibition, not from a more reprehensible cause such as being contrary to public policy, and does not taint the agreement as a whole.

(d) The parties have now performed their mutual promises by following the agreed procedure provided by cl 3. The relevant issues were carefully identified, considerable evidence was produced and detailed submissions made. Each party made a significant contribution at considerable cost in money and resources. They have got what they bargained for. The Arbitrator has issued a partial award as required by cl 4. It was, if we may say so without commenting on the merits, a careful and comprehensive analysis of the evidence within the appropriate legal framework. This fact counts powerfully in favour of severance.

(e) In this context we note, and give weight to, the principle endorsed by both counsel that the law's policy is to give effect to a contractual relationship wherever possible despite the existence of a vitiating factor. That principle applies all the more where parties have substantially performed an agreement and there is no suggestion that

one party caused or was responsible for the common error on rights of appeal.

[49] It follows that we respectfully disagree with each of Ellis J's critical conclusions. First, we are satisfied that she erred by applying the "but for" test propounded by McHugh J in *Humphries*. In this respect she took into account the pre-agreement correspondence passing between the parties and their solicitors to support a conclusion that GCA in particular would not have agreed to arbitrate without inclusion of a right of factual appeal.

[50] The Judge's attraction to the "but for" test is understandable. But her findings illustrate the anomalies arising from its application. Mr Miles observes that in March 2010 the parties had agreed in principle to follow the path of arbitration. From the outset, they apparently misunderstood the nature and scope of appeal rights from an arbitral award. Various draft agreements were exchanged. On 30 June 2010 GCA produced a draft adding the words "questions of law and fact". As noted, the agreement was eventually signed on 28 September 2010. The parties had by then participated in three conferences with the arbitrator and the arbitration process was well advanced.

[51] Ellis J found that the parties would not have agreed to arbitrate without the right of factual appeal. Plainly, however, the only alternative was litigation. The Judge did not identify how on an objective analysis of the agreement it would support the necessary consequential inference that on 28 September 2010 the parties would have abandoned the arbitral process which was already well in train and gone instead to trial if either or both had understood that a right of factual appeal was not available.

[52] Second, Ellis J erred in her equally decisive conclusion that it would be wrong in principle to order severance, and contrary to justice, where such an order would actively promote the contractual position of its proponent. With respect, we repeat that the inquiry is of an objective nature, requiring an assessment of the relevant provisions at the time the agreement was entered into. Thus the question is not whether, after performance of the agreement, severance would give GCA the

benefit of a "windfall illegality"[51] or of a mistake for which it was partly responsible.[52] Equally, if this was the proper approach, it could be said that the High Court judgment setting aside the award has deprived GCA of a carefully reasoned award and allowed Mr Carr the corresponding benefit of impugning an adverse decision by a collateral means, without successfully challenging the merits. On balance, this factor was, we think, neutral.

[53] What was more important, in our judgment, but was not given sufficient weight by the Judge, was that the agreement to arbitrate was fully performed without the scope of the arbitration being affected by the invalidity in any respect.

[54] Accordingly, we respectfully conclude that Ellis J erred in her application of the principles of severance to the facts of this case.

(v) Statutory provisions

[55] Mr Ring submits that Ellis J's conclusion against severance is inconsistent with the purpose of other relevant statutes such as the Contractual Mistakes Act, the Contractual Remedies Act and the Illegal Contracts Act 1970 and the wider legal context.

[56] We agree that the Judge's refusal to sever the offending words is inconsistent with her dismissal of Mr Carr's alternative claim for setting aside on the ground of a mutual mistake in terms of s 6(1) of the Contractual Mistakes Act. She was satisfied in terms of s 6(1)(a) that the parties were influenced in their respective decisions to enter into the arbitration agreement by their shared mistake as to the right of appeal on questions of fact.[53] But she was satisfied that the mistake did not result in a substantially unequal exchange of benefits at the time of the contract as required by s 6(1)(b).[54] Mr Carr has not cross-appealed against this finding.

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51 At [48].
52 At [51].
53 At [64].
54 At [65].

[57] The Contractual Mistakes Act is a statutory codification of the principles applying to cases of mutual mistakes of law. It is common ground that these parties were mutually mistaken about their rights of appeal when signing the arbitration agreement. This fundamental mistake is surprising given that both sides had the benefit of independent legal advice. Both counsel proceeded on the premise that an enquiry into severance survives the Contractual Mistakes Act. However, both enquiries must be centred upon an assessment of the parties' positions at the time the contract was entered into. As Mr Ring submits, when entering into the contract each party was in exactly the same position, and gave and received exactly the same value, benefits, obligations and consideration. However, by expressly recognising and taking into account the inevitability, to which we have referred, that ultimately after performance of the agreement the result would be of greater value to one party than the other, the Judge has introduced an irrelevant or erroneous factor.

[58] Mr Ring also submits that the decision is inconsistent with the cancellation provisions of the Contractual Remedies Act. That is because Mr Carr effectively cancelled the arbitration agreement in circumstances where ss 7 and 8 of the Contractual Remedies Act did not allow that course. We are unpersuaded that these circumstances fit within the framework of the Contractual Remedies Act. Similarly we do not see how this case fits easily within the framework of the Illegal Contracts Act.

(vi) Nature of statutory invalidity

[59] We add for completeness that it was common ground, as Ellis J noted, that the second of the two elements included in the severability enquiry was not an issue. The nature of the statutory invalidity did not give rise to a barrier to enforcement of the arbitration agreement.

[60] Mr Ring submits, however, that this second element is more than just an exclusionary test. Where a case involves invalidity in a statutory context, consideration is required of whether the severability decision serves the purpose and policy of the enactment. In our judgment this issue should be considered within the separate discretionary exercise required by art 34.

(vii) Conclusion

[61] It follows that we would grant severance of the invalid provision by excising the words "and fact" from the arbitration agreement. As a result the agreement is treated as being valid in terms of art 34(2) of sch 1 of the Arbitration Act.

(c) Discretion

[62] However, if we are wrong in our threshold conclusion in favour of severance, with the result that the arbitration agreement is invalid, we must consider whether it would nevertheless be appropriate to exercise our discretion to set aside the award.

[63] As noted, Ellis J dealt with this question briefly. She found:[55]

> In terms of any residual discretion as to setting aside under Art 34, I do not discount the time, money and effort expended by both parties on the arbitration process to date. Those matters weigh heavily with me. But ultimately, in my view, unless setting aside is ordered Gallaways will reap the very substantial benefit of a mistake for which it was, at least in part, responsible. Without that mistake the arbitration would not, in my view, have taken place at all. Through no fault of the arbitrator, the arbitration misfired from the start.

[64] We agree with the Judge that weight should be given to the time, money and resources expended by the parties on the arbitration process. But, as noted, we disagree with her reliance on the substantial benefit available to GCA from a mutual mistake, especially where she later found that the mistake did not give rise to any unequal exchange of benefits at the time the agreement was entered into.

[65] When considering whether to exercise our statutory discretion to set aside, we are entitled to take into account events outside the contractual matrix. In an affidavit sworn on 12 December 2011 in support of his application to the High Court, Mr Carr outlined the deliberate nature of his decision about the appropriate dispute resolution mechanism. In summary he deposed that:

(a) He was fully advised by independent solicitors from 2009 onwards.

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[55] At [51].

(b) He was aware of and placed weight on the prospect that an arbitral hearing would occur promptly whereas he was likely to face a delay in obtaining a fixture for a two or three week trial in the High Court. On 31 July 2009 his solicitors had advised that there was no certainty of obtaining a priority fixture whether in Dunedin or Christchurch.

(c) Following a recommendation that Dr Fisher be appointed, he instructed his solicitor to research Dr Fisher's decisions delivered when he was a High Court Judge in any relevant area particularly on professional negligence. He took account of advice that Dr Fisher was regarded as a "black letter" lawyer but was unaware of any concerns about his qualifications to conduct this arbitration.

(d) At an earlier stage in the negotiations about arbitration he was advised by his solicitor that there was little difference between rights of appeal against an arbitral award and a High Court judgment.

(e) He was aware from a relatively early stage that his claim against GCA would be closely contested and that it would be complex both factually and legally.

[66] The discretion vested by art 34 is of a wide and apparently unfettered nature. We are satisfied it must be exercised in accordance with the purposes and policy of the Arbitration Act. Two specific purposes are to encourage the use of arbitration as an agreed method of resolving commercial and other disputes;[56] and to facilitate the recognition and enforcement of arbitration agreements and arbitral awards.[57] The principles and philosophy behind the statute are party autonomy within its framework, equal treatment, reduced court intervention and increased powers for the arbitral tribunal.[58] Parliament has clearly stated its intention that parties should be bound to accept the arbitral decision where they have chosen that method of resolution.[59] The recognised benefits of arbitration include speed, economy, choice

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56 Section 5(a).
57 Section 5(e). *Hickman v Turner & Waverley Ltd* [2012] NZSC 72 at [148].
58 *Pathak v Tourism Transport Ltd* [2002] 3 NZLR 681 (HC) at [21]–[24].
59 *Gold & Resource Developments (NZ) Ltd v Doug Hood Ltd*, above n 48, at [52].

of forum, anonymity and finality, the last by allowing the parties to limit their rights of appeal even though they cannot contract out of art 34.[60]

[67] The statutory principles and philosophy, when considered in the context of this case, plainly favour validation of the agreement. In our judgment it would be inappropriate within the exercise of our statutory discretion to set aside the award. In addition to those factors which support severance, in particular the fact of performance of the agreement, we emphasise that:

(a) The parties made conscious and informed decisions to submit to arbitration in preference to litigation through the High Court and beyond. As noted, they must be taken to have known of the statutory purposes and policy governing this choice. Each party made its decision with the benefit of independent legal advice.

(b) It would be contrary to the legislative intention to allow one party to take what he perceived to be the benefits of following the arbitration course but then to set aside an adverse award, not on its merits but in reliance on an error for which he must bear his own independent responsibility.

[68] Another material factor is our satisfaction that this result does not cause an injustice. The effect of severance is to diminish but not deprive him of his appeal rights. Mr Carr retains his statutory rights of appeal against the partial award according to arts 33 and 34 of the First Schedule and cl 5 of the Second Schedule; they are expressly recognised within the operative clause. In particular he can appeal on questions of law, subject to resolution of the scope of his appeal. That is necessary because, as noted, Mr Carr alternatively sought leave to appeal under cl 5(1)(c) of the Second Schedule on a number of what were described as questions of law.

[69] Clause 1.2 of the agreement is ambiguous in that it is unclear whether the parties were purporting to expand the operative part of cl 5(1) of the Second

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[60] *Downer-Hill Joint Venture v Government of Fiji* [2005] 1 NZLR 554 (HC) at [62].

Schedule – that is, to grant rights of appeal on questions of law and fact subject to the conditions contained in cl 5(1)(a), (b) and (c) – or whether they were agreeing to confer a right of appeal on questions of law and fact in accordance with cl 5(1)(a). Whatever is the case, at the least the party appealing an award would have to identify a question arising out of it. Or, on another interpretation, leave would be required.

[70] Ellis J did not determine Mr Carr's application for leave given her primary finding, which is understandable. The result of our decision to allow the appeal will be that Mr Carr's application to set aside is dismissed. Accordingly the High Court must now determine his leave application in accordance with the statutory and common law principles which we have earlier discussed.

Result

[71] GCA's appeal is allowed and the judgment of the High Court is set aside. As a result, Mr Carr's application to set aside the partial arbitration award is dismissed. The partial award is reinstated. The proceeding is remitted back to the High Court to determine Mr Carr's appeal or alternative application for leave to appeal on a question or questions of law.

[72] Mr Carr must pay costs to GCA for a standard appeal on a band B basis and usual disbursements. We certify for two counsel.

[73] This appeal was argued very ably on both sides and we record our appreciation for the quality of counsels' submissions.

Solicitors:
Duncan Cotterill, Christchurch for Appellant
GCA Lawyers, Christchurch for Respondents