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Review of Arbitrators' Exercise of Power in English Law: The House of Lords Decides

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Introduction

The decision of the House of Lords in the case of *Lesotho Highlands Development Authority v Impregilo SpA*¹ has prompted a re-examination of the law in relation to challenges to arbitrators' awards in the courts. The authors' initial consideration of the decisions of the courts below² focussed on the extent of arbitrators' powers, but the pronouncements of the Law Lords raise even more fundamental questions about whether the exercise of those powers is to be reviewed at all.

Background

The article referred to above contains a fuller account of the Lesotho Highlands Water Project from which the dispute arose. It is sufficient here to say that the scheme, chiefly funded by the World Bank, included the construction of the 1950 million m³ Katse Dam, which was begun in 1991 and reached the point of issue of a Taking Over Certificate in February 1998. The dispute was between the client, the Lesotho Highlands Development Authority (LHDA) and the contractors, a consortium of international firms known as Highland Water Venture (HWV) and was largely concerned with claims by HWV for extra labour costs and other expenses under

an amended version of FIDIC 4th edition, which incorporated the ICC Rules of Arbitration. The arbitration hearing was held in London in October 2001 before a panel of experienced London-based lawyers. The tribunal, in its award of January 2002, found in favour of HWV on three of its seven claims, with a total awarded of £1.6 million plus €5.96 million plus interest.

LHDA challenged the award in the English courts under ss. 67 and 68 of the Arbitration Act 1996 on the grounds that it was made in excess of the arbitrators' substantive jurisdiction and/or was the result of a serious irregularity. LHDA alleged that the arbitrators had exceeded their powers in respect of i) the currency in which the award was made and ii) interest on the sums awarded.

The courts below

Morison J in the Commercial Court gave his decision on 15 November 2002³. He found for LHDA on both currency and interest points: "With great respect to the tribunal, I consider that they did not have the power to make an award in a currency different from that provided for in the contract."⁴ "for the same reasons as applied to the currency of the award,

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I consider that the tribunal have exceeded their powers under section 68 of the Arbitration Act and the issue of interest will have to be re-considered by them having regard to the terms of this judgment.”⁵

HWV appealed to the Court of Appeal, which gave its judgment on 21 July 2003⁶. The unanimous view of the judges was expressed by Brooke LJ in dismissing the appeal on both grounds. At the heart of the Court of Appeal's decision was the finding that the arbitrators ought to have interpreted the parties' contract in accordance with the applicable law and not departed from what the parties' agreement provided:

“I therefore agree with the judge that the arbitrators exceeded their powers when they thought that section 48(4) of the 1996 Act⁷ gave them any power to depart from what the parties had agreed”⁸ “The arbitrators therefore exceeded their powers when they had recourse to what would have been their discretionary powers in section 49(3) to resolve a matter to which they should have applied the substantive law of the contract”⁹.

The appeal to the House of Lords

The appeal to the House of Lords took a quite different turn from the proceedings in the courts below, partly because of the way in which it was argued.

In effect, the Law Lords were persuaded to regard the crucial issue as not so much the exercise of the power to award the interest or to make awards in particular currencies, but whether the award should be subject to this kind of challenge at all.

The arbitration clause under FIDIC 4th¹⁰ provided for arbitration under the rules of the ICC¹¹, under which the parties agree, so far as they are allowed to do so, to forego any right of appeal to the courts¹². Therefore an appeal on a point of law under the English Arbitration Act¹³ would be excluded. ICC Rules could not, however, exclude a challenge on the ground of serious irregularity under the Act in the form of excess of powers”¹⁴.

This had been considered with varying degrees of thoroughness by the courts below. Morison J in the

Commercial Court referred¹⁵ to the “interesting” submission of HWV's counsel that the application “was an attempt to avoid the provisions of the ICC Rules which excluded the operation of section 69”.

Morison J noted¹⁶ that “The court is astute to ensure that what is, in substance and reality, a section 69 challenge, for which permission is required, is not dressed up as a challenge under section 68 or 67”. He was satisfied that it was not.

By contrast, there was very little explicit reference to the section 69/section 68 issue in the Court of Appeal. Brooke LJ, in the only judgment, concentrated on the question as to whether or not the arbitrators were entitled to exercise their powers on interest and currency as they had done, which was, of course, necessary if an excess of power under s.68(2)(b) was to be shown. The only real express reference to s.69 came in the Building Law Reports Commentary¹⁷, in which the BLR Editors harked back to the point raised by HWV's counsel at first instance: “Section 69 of the Act permits a challenge to an arbitrator's award on a mistake of law, providing the permission of the court is obtained. The ICC rules do not permit such a challenge ... it is often difficult to characterise whether something is an error of law, or an excess of jurisdiction.”

The House of Lords were encouraged to take this point head-on and it dominated the body of the main speech, given by Lord Steyn.

Lord Steyn distinguished between an excess of jurisdiction and an excess of powers. The issue for the purposes of the challenge under s.68(2)(b) of the Arbitration Act is the latter. Lord Steyn considered that the courts below had been wrong in categorising an error of law as an excess of jurisdiction. He quoted with approval from the leading text-book by Lord Mustill and Stewart Boyd QC¹⁸: “If ... [the arbitrator] applies the correct remedy, but does so in an incorrect way – for example by miscalculating the damages which the submission empowers him to award – then there is no excess of jurisdiction and this is so whether his decision is on a matter of substance or jurisdiction”.

As Lord Steyn himself explained this: “If it is merely a case of erroneous exercise of power vesting in the tribunal no excess of power under section 68(2)(b) is involved”.

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Indeed, he examined section 68 "in its textual setting", as he put it. The provision so far as relevant reads as follows:

- "(1) A party to arbitral proceedings may ... apply to the court challenging an award in the proceedings on the ground of serious irregularity affecting the tribunal, the proceedings or the award.
- (2) Serious irregularity means an irregularity of one or more of the following kinds which the court considers has caused or will cause substantial injustice to the applicant -
- (b) the tribunal exceeding its powers (otherwise than by exceeding its substantive jurisdiction)".

A number of conclusions could then be drawn:

"nowhere in section 68 is there any hint that a failure by the tribunal to arrive at the 'correct decision' could afford a ground for challenge under Section 68." Furthermore, "By its very terms section 68(2)(b) assumes that the tribunal acted within its substantive jurisdiction. It is aimed at the tribunal *exceeding its powers* under the arbitration agreement, terms of reference or the 1996 Act. Section 68(2)(b) does not permit a challenge on the ground that the tribunal arrived at a wrong conclusion as a matter of law or fact. It is not apt to cover a mere error of law ... a mistake in interpreting the contract is the paradigm of a 'question of law' which may in circumstances specified in section 69 be appealed unless the parties have excluded that right by agreement ... it would be strange where there is no exclusion agreement, to allow parallel challenges under section 68(2)(b) and section 69".

What the House of Lords decided

Although Lord Steyn gave the principal speech¹⁹ on behalf of the majority²⁰, not all his findings were approved by his colleagues. Whereas the Court of Appeal (and the Commercial Court) had held that the arbitrators had misinterpreted their powers by reference to the underlying contract in relation to currency and interest respectively, Lord Steyn did not believe that they had. He based this on what he called "The radical nature of the changes brought

about by the Arbitration Act 1996". Key among these for these purposes was that "It is in the arbitration agreement, read with the curial law, in this case the Arbitration Act 1996 that the powers of the tribunal are to be found and not in the underlying contract". It therefore followed, in Lord Steyn's view, that "The power of the tribunal under section 48(4)²¹ was unconstrained and was available to the tribunal".

Similarly, Lord Steyn thought that the courts below had been wrong on interest. The tribunal would have its general powers to award interest under s.49(3) of the Arbitration Act, subject only to agreement to the contrary, which would have to be in writing. Although the arbitrators had not followed the law of Lesotho on this point, "the law of Lesotho is not an agreement to the contrary in writing".

However, the other Law Lords could not follow Lord Steyn so far. They did not believe that the tribunal had been correct in the exercise of its powers. He had considered this as a hypothetical possibility in Paragraph 23 of his speech: "Contrary to the view I have expressed, I will now assume that the tribunal committed an error of law ... the highest the case can be put is that the tribunal committed an error of law". As mentioned above, on Lord Steyn's view, that would not constitute an excess of power.

The other three majority Law Lords made few points, averaging a mere 13 lines each of findings. However, each declined to follow Lord Steyn in finding that the arbitrators had made no error. Lord Hoffmann thought that "it is very likely that the arbitrators did make an error of law in calculating the sums awarded in the way in which they did", adding somewhat mischievously: "I prefer to express no opinion on that point". Lord Scott of Foscote considered that "it might well be that the selection by the arbitrators of historic exchange rates rather than the current ones constituted an error of law" and Lord Rodger of Earlsferry also preferred Paragraph 23 of Lord Steyn's speech to his findings on the legality of the arbitrators' exercise of their powers.

Lord Phillips, who dissented from the overall findings of the majority, was clear that the arbitrators were wrong: "the arbitrators have adopted an approach to currencies that departs from English law ... The concept of an excess of power that is not an excess of jurisdiction is not an easy one, but I find that it applies

to the arbitrators' conduct in this case. They expressly stated that section 48(4) gave them a discretionary power which they did not in fact enjoy and then proceeded to purport to exercise that power".

So the overall finding of the majority of the Law Lords was that the arbitral tribunal had been wrong in the exercise of its powers, but that this did not constitute an excess of power amounting to a serious irregularity.

It is convenient here to make further reference to the dissenting speech of Lord Phillips of Worth Matravers, who in 2005 replaced Lord Woolf as Lord Chief Justice, having formerly been Master of the Rolls²². On the issue of currencies he observed that Lord Steyn had taken a radical view of s. 48(4) of the Arbitration Act as replacing the existing body of substantive law and "leaving it open to arbitrators to approach the currency of their awards, and any questions of currency conversion, in accordance with their discretion as to what is appropriate in all the circumstances", which "is what the arbitrators in the present case have done". Lord Phillips saw two possible interpretations of s. 48(4): the existing body of substantive law which "does no more than make it plain that arbitrators have the procedural power to make an award in any currency" or the "radical change to English substantive law" preferred by Lord Steyn. Lord Phillips derived support from two of the leading English arbitration texts. Mustill and Boyd²³ simply say that s. 48(4) does no more than "restate the old law". Russell on Arbitration²⁴ reminds readers that "The tribunal should make the award in the proper currency of the contract under which the dispute arose unless the parties have expressly or impliedly agreed otherwise in writing". Lord Phillips was "not able to accept that section 48(4) has had the radical effect of empowering arbitrators to disregard the substantive law in relation to foreign currency obligations". The arbitrators, in his view, had arrogated to themselves a power which they did not have and purported to exercise it. This was acting in excess of their powers and was a procedural irregularity, although, since he was outvoted, Lord Phillips did not determine whether there had been 'substantial injustice' as required by the Act. He did, however, suppose that, if the value of the Maloti, the currency of Lesotho, had deteriorated (as it had), the appellants (HWV) "received a windfall for which I can see no justification" due to the currency element of the award.

The ICC dimension

Under the ICC Rules of Arbitration²⁵, as has been mentioned, there is provision for exclusion of rights of challenge of the tribunal's award:

"The parties undertake to carry out any Award without delay and shall be deemed to have waived their right to any form of recourse insofar as such waiver can validly be made".

Under the English Arbitration Act²⁶, "a party to arbitral proceedings may (upon notice to the other parties and to the tribunal) appeal to the court on a question of law arising out of an award made in the proceedings". This is, however, subject to the reservation "Unless otherwise agreed by the parties", which is one of a number of examples of the legislature's intention to give the parties autonomy to proceed in accordance with their own preferences.

The effect of the combination of the two provisions is to exclude the right of challenge on a point of law, because, by opting for the ICC Rules, the parties have "otherwise agreed". The challenge for serious irregularity²⁷ is not subject to contrary agreement by the parties and is thus mandatory; the ICC Article 28 waiver of rights cannot validly be made to cover that. It may be noted in passing that the London Court of International Arbitration (LCIA) has a similar provision in its Rules²⁸; the parties "waive irrevocably their right to any form of appeal, review or recourse to any state court or other judicial authority insofar as such waiver may validly be made".

However, there is no such restriction on challenge to an award on a point of law (e.g. under s.69) if the arbitration is not conducted within institutional rules which contain such waivers. For example, arbitral awards under UNCITRAL Rules would be subject to s.69 challenge in the event of an alleged error of law. It must be kept in mind that *LHDA* is an ICC case and not one with equal impact on all international arbitrations, a point which has received little emphasis in most of the commentaries so far published on the case, which seem to regard international arbitration as homogeneous, and thus equally affected. A member of the ICC Court avoided such an error by observing the distinction in a recent paper to the Society of Construction Law in London "Whilst the ascendancy of the UNCITRAL Rules has meant that a number of

construction arbitrations are ad hoc UNCITRAL ones, the ICC caseload has continued to grow"²⁹.

The parties to an agreement specifying the ICC as the arbitral institution will presumably have normally been advised that, although judicial scrutiny of errors of law is excluded (although not judicial scrutiny of serious irregularities), there is an additional review mechanism for awards. This is one of the functions of the ICC Court of Arbitration. The Arbitral Tribunal is required³⁰ to submit its award in draft form to the Court. The scope of the Court's review powers are of great interest and merit reproduction in full.

"The Court may lay down modifications as to the form of the Award and, without affecting the Arbitral Tribunal's liberty of decision, may also draw its attention to points of substance. No Award shall be rendered by the Arbitral Tribunal until it has been approved by the Court as to its form".

What this means in practice is the subject of different opinions by commentators. Paul Friedland³¹ notes that "ICC scrutiny tends to promote the enforceability of ICC awards" (although he notes that "it also adds time") and that "the ICC, unlike other institutions, scrutinizes awards for completeness, adherence to its Rules and the governing national law, and internal consistency, before authorizing their issuance".

Writing in 1998, Derains and Schwartz³² noted that some 30% of the 200 Awards per year scrutinised are returned to the arbitrators with comments. As well as 'defects of form', they remark that the Court "may call the arbitrators' attention to substantive aspects of their Award that the Court may find confusing, insufficiently reasoned, inconsistent or contrary to provisions of applicable law. The Court's concern in making such comments is to assist the arbitrators in producing an Award that will be of the highest possible quality and that the parties will be more likely to accept and carry out voluntarily as a consequence".

Although the Court cannot force the arbitrators to take account of its comments with respect to substance, arbitrators usually do, at least to some extent. Derains and Schwartz laud the scrutiny of awards as apt to "avoid the much longer delays that might result if an Award were set aside due to a defect that would not otherwise have been noticed ... in many cases, the general quality of the Awards is positively affected"³³.

Perhaps the best-known commentators on the ICC arbitration regime, Craig Park and Paulsson, have explained the scrutiny role of the Court of Arbitration as follows³⁴:

"What is studied is the award itself ... The Court does not attempt to substitute its own appreciations for those of the arbitral tribunal as final trier of issues of fact and law. It must, however, assume that what appears to be an erroneous finding of fact (in contradiction with other findings of the award) or a conclusion as to the parties' obligations which is in opposition to clear contractual terms, may make the award unenforceable in national courts. Accordingly, it has the duty to bring such points to the attention of the arbitral tribunal for its consideration" (emphasis supplied).

Russell on Arbitration³⁵ refers merely to "checking the award for clerical and similar errors" which gives a somewhat different emphasis to Redfern and Hunter's conclusion that "The ICC prides itself on the overall quality of ICC awards, and the scrutiny process acts as a measure of quality control"³⁶.

The *LHDA* case had been through an ICC arbitration hearing and the draft award had been approved by the ICC Court of Arbitration. Subsequently, the award was considered by nine English judges³⁷, of whom eight were apparently of the view that the arbitrators had gone wrong in law on the extent and exercise of their powers. Five of the nine were of the view that the challenge to the award should be allowed. Against this background, it is interesting to note the comments of the then Steyn J in *Bank Mellat v GAA Development Co*³⁸, (quoted in Craig Park and Paulsson)³⁹ "it is regarded as the first imperative of the ICC system that the awards under it should be enforceable ... The system of scrutiny of awards by the Court contributes to the enforceability of ICC awards". A party which had opted for ICC arbitration might have hoped that a significant legal error in an award would have been identified and the arbitrators asked to reconsider their finding. This may be unrealistic, if the Russell on Arbitration description of "checking the award for clerical and similar errors" characterises the work of the Court of Arbitration, rather than the Secretariat. But if it were unrealistic to expect the ICC Court of Arbitration to identify such an error, that would leave the courts as the only means of putting right that error.

The impact of the House of Lords decision in *LHDA*

Some journalists and commentators in the construction industry press have seen in the decision of the House of Lords a message which will attract additional arbitration business to English venues. "Praise the Lords" was the clarion headline in *Building* magazine⁴⁰, "Arbitration in England strikes right balance" was the enthusiastic tag to an article in *Construction News*⁴¹. So far as finality under a regime like ICC is concerned, the prevention of challenge on a point of law in England will undoubtedly shut the door more firmly. But it might also be thought that the parties to an arbitration agreement do not usually regard finality as the sole criterion in choosing an arbitral regime. They are also, presumably, normally hoping and expecting that it will be decided by the arbitrators properly exercising their powers in accordance with law. If finality were the sole criterion, it is difficult to see why ICC awards go through the mechanism of submission to the ICC Court of Arbitration, which has a cost, including a time cost, and which may disturb the arbitrators' decision. If finality were the sole criterion, it is difficult to see why Parliament included s.68 in the Arbitration Act. It is there to put right situations where arbitrators have gone wrong and the parties are not able to contract out of it by using a particular arbitral regime. But the majority of the Law Lords characterised the particular errors into which the arbitrators had fallen as immune from challenge.

Let us consider for a moment the position of a (hypothetical) party which has agreed to an ICC arbitration. It does so in the knowledge that ICC arbitrators, being human, like any others, may make mistakes. The party will have confidence that there are mechanisms in place to deal with errors, namely the ICC Court and the domestic courts. If it is the position that there is actually *no* mechanism which protects that party against legal errors by the arbitrators in the exercise of their powers, it seems at least possible that that confidence may be diminished. If the party had sustained substantial losses because of errors which could not be put right, might it not be less than enthusiastic about repeating the experience?

The party may have supposed that it was protected against such an eventuality by a combination of the scrutiny of the ICC Court of Arbitration and the s. 68

jurisdiction of the English courts, or one of them. The House of Lords has exposed the illusion of that protection in such cases.

Whether the outcome of the case will undermine confidence of parties deciding how to provide for the resolution of disputes remains to be seen. Some of the partisans of its beneficial effect have warned that any other decision would have inflicted grave harm on London as a centre of commercial arbitration. The period between the decision of the Court of Appeal and that of the House of Lords was almost exactly two years: the Commercial Court decision had been a further eight months previously. The advocates of the theory that London has now been saved from catastrophe need to demonstrate, with evidence, the extent of the loss suffered during the period when the challenge was upheld. Perhaps this can be done, although thus far the authors have seen no compelling evidence of collapse during that period or since.

Conclusion

The most likely scenario is that nothing much will happen as a result of the House of Lords decision in *LHDA v Impregilo*. In cases where arbitrators make errors of law in the exercise of their powers where there is no exclusion of a s. 69 challenge, such as under the UNCITRAL Rules (or the UK's JCT contracts), there will be no change. The courts can there offer redress. In any cases, including ICC cases, where the arbitrators' errors fall within ss. 67 or 68, there will be no change; the errors can be challenged and redress obtained.

In ICC cases where the errors committed are of such a kind as the ICC Court of Arbitration can identify, it will continue to identify them and notify the arbitrators accordingly and there will be no change. Many arbitrations, in London and elsewhere, will continue to be decided without errors of law as before and there will be no change.

What *LHDA v Impregilo* has actually decided is that certain arbitral errors will escape scrutiny by the English courts under ICC Rules. This may add to the burden of expectation on the ICC Court of Arbitration, in its role as scrutineer of awards. If that expectation is misconceived, the parties on the receiving end

of the errors will be without protection or recourse. The overall effect of the House of Lords decision is not likely to be great, except for those individuals. But it seems a curious basis for celebration of a general victory for arbitration in London, which has always sought to balance certainty with protection for the parties.

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1 [2005] UKHL 43
2 ICLR [2004] Vol 21 Part 2 pp 140-152
3 [2003] BLR 98
4 at p. 107
5 at p. 109
6 [2003] BLR 347
7 The (UK) Arbitration Act 1996
8 at p. 355
9 at p. 358
10 As in subsequent editions
11 The International Chamber of Commerce
12 Rule 28.6
13 Arbitration Act 1996 s. 69
14 s. 68 (2)(b)

15 at p. 106
16 at p. 107
17 at p.348
18 Mustill and Boyd Law and Practice of Commercial Arbitration in England 2nd ed 1989 p. 555.
19 The opinions of the Law Lords are delivered as speeches rather than as judgments as in lower courts. The distinction is historical and does not go to anything of substance.
20 As is discussed further below, Lord Phillips of Worth Matravers gave a dissenting view, but was, in effect, outvoted 4-1 on the outcome of the appeal.
21 Section 48 of the Arbitration Act 1996 provides that the tribunal may order payment of a sum of money in any currency, unless otherwise agreed by the parties.
22 Head of the Court of Appeal
23 op cit. 2001 Companion Volume p. 330
24 op cit p. 263
25 Article 28
26 s. 69(1)
27 s. 68 Arbitration Act
28 Article 26.9
29 Robert Knutson 'Recent treatment of construction awards by the ICC International Court of Arbitration'. Society of Construction Law, London, 3rd Feb 2004.
30 Article 27
31 P. Friedland. Arbitration clauses for International Contracts (2000) pp. 30 and 32
32 Y. Derains and E. Schwartz. A Guide to the New ICC Rules of Arbitration (1998) p. 292
33 Derains and Schwartz op cit at p. 292
34 W. Craig, W. Park and J. Paulsson, International Chamber of Commerce Arbitration (3rd ed 1998) p. 379
35 D St. John Sutton and J. Gill Russell on Arbitration (22nd ed 2003) p. 77
36 A. Redfern and M. Hunter Law and Practice of International Commercial Arbitration (4th ed 2004) p. 403
37 Morison J in the Commercial Court, Brooke and Latham LJJ and Holman J in the Court of Appeal and Lords Steyn, Hoffmann, Phillips, Scott and Rodgers in the House of Lords.
38 [1988] 2 Lloyds Law Reports 44
39 op cit at p. 383
40 N. Gould, Building 22nd July 2005, p. 58
41 J. Winter, Construction News 14th July 2005, p. 114