SUPPLEMENTARY EVIDENCE FROM THE LAW SOCIETY OF SCOTLAND

INTRODUCTION

1. The Society restates its welcome for a Bill which seeks to reform the Scots law of arbitration. The Society considers that the evidence it submitted, which reflects decades of experience of many practitioners acting on behalf of users and potential users of arbitration in Scotland, was submitted with a genuine desire to improve the legislation which should, where possible, offer something new and cutting edge specifically tailored to address the problems of the past and meet the future needs of Scotland in both domestic and international arbitration.

The Society notes that Supplementary Evidence has been submitted on behalf of the Chartered Institute of Arbitrators (CIArb) Scottish Branch which purports to comment upon the evidence already submitted on behalf of the Society.

The Society considers it is necessary to respond to the comments made on behalf of CIArb.

The numbering used below reflects the numbering of the original paragraphs in the evidence submitted on behalf of the Society to which the CIArb referred. The numbered paragraphs below provide a detailed response. The main points in summary are that the Society believes as follows:-

(a) The case for repeal of the use of the UNCITRAL Model Law has not been persuasively made out.
(b) Provisions of the Bill which have retrospective effect concerning agreements to arbitrate entered into before the legislation comes into force are not justified. There was no consultation on such an important change.
(c) Rule 40 was not supported by a large majority of the responses in the consultation process and will not assist in meeting the current objectives of arbitration.
(d) The current wording of Rule 50 should be reconsidered to reflect the different types of award which fall within the phrase 'provisional award' and to clarify the limited circumstances in which such awards are appropriate.
(e) Rule 67 does not take account of Scottish Arbitration practice and procedure and should be re drafted with a much simpler, clearer test

DETAILED RESPONSE

2. Paragraph 7. The observations of CIArb do not contain a proper reason for the repeal of the legislation which incorporated the UNCITRAL Model Law into Scots law for international arbitrations. Taking the points made in turn the Society would make the following observations:-

(i) CIArb state that "the principles of the Model Law are central to the Bill". This reflects the merits of the Model Law but does not explain why it should be repealed.

This leads to the issue of the perception of possible users of Scotland as a location for international arbitration. The Model Law was promulgated by the United Nations and

is a well established and well known scheme. Its use avoids the possible concern that some users of international arbitration might have regarding national legislation which might be thought to have been enacted in order to move away from the principles contained within the Model Law. Whether as a matter of fact it does so or not may not matter. A prospective user of international arbitration who seeks reassurance is more likely to go to a jurisdiction where it can be clearly demonstrated that the Model Law has been adapted clearly.

(ii) Scotland is not a "common law jurisdiction" as that term is properly understood. It is still a country with law which is based on Civil Law principles.

(iv) There has been no demonstrable failure of the Model Law. The Society questions why this should be contended by CIArb if, as they say, "the principles of the Model Law are central to the Bill". Put another way, if the Model Law is a failure why have its *principles* been adopted?

As has been reflected in other evidence given to Parliament on this issue, the failure to attract international arbitration to Scotland reflects a number of factors:-

(a) Scotland is not a country with a tradition as a centre for international arbitration;

(b) Scottish domestic arbitration law has been in need of modernisation which this Bill will achieve; and

(c) Investment of time and resources marketing Scotland as a venue for international arbitration has not been a high priority. There are no established facilities for hosting international arbitrations such as an international arbitration centre as other countries have done.

(v) It is stated that the Model Law does not feature among the key attributes of "international practitioners" that a successful arbitration jurisdiction must have. This is in conflict with evidence from the Scottish Council for International Arbitration. This does not reflect what potential parties to arbitration may think. The repeal of the Model law will be a negative signal which may create a perception that Scotland is not a supporter of it. It appears that CIArb wish to be able to say that the Bill reflects the principles of the Model Law without giving proper effect to it. The Society does not agree that this is a way to give comfort to potential international users that there is no national bias in the Bill.

(vi) It is submitted that rather than demonstrating that the Model Law fails in assisting to attract international arbitration, all that the successful venues referred to by CIArb indicate is that they are successful for other reasons such as those referred to in paragraph (iv) above. This is supported by the fact that the majority /all of the "major and successful arbitration venues" mentioned were such before the Model Law was approved by the UN.

The Society has indicated that it would drop its opposition to the repeal of the Model Law if the legislation made it clear that the parties to an international arbitration could choose to apply the Model Law to their arbitration. This would mean that the provisions requiring all arbitrations to be subject to the mandatory rules would need modification.

Regarding the issue is as to whether retaining the Model Law might create discrimination which would be subject to challenge under EU law. The Society is not persuaded of the logic of this argument. The Scottish Government are well placed to provide an opinion as to whether this is the case given that currently the Model Law does apply to international arbitrations governed by Scots Law. Is there a suggestion that, at the moment, Scots law is non- compliant with EU law?

3. Paragraphs 8 - 10

CIArb submit that the Law Society's "suggestion" is both misconceived and seriously wrong". That is not correct for the following reasons.

The Society's position arises out of the clear, widely recognised and long established principles concerning legislation.

Craies on Legislation (9th Edition, 2008) makes it clear that "the question of the fundamental injustice, as a general rule, of retrospective legislation has exercised the minds of lawyers and Parliamentarians for centuries". It is also stated that "… it is also a principle accepted by successive governments that retrospectivity should be avoided except where necessary.". This principle was re-stated in clear terms in 1999 in the statement by Baroness Hollis of Heigham that "it is a general principle of English and Scottish Law that retrospective legislation should be avoided wherever possible". Craies also makes it clear that "the seriousness with which the notion of retrospective legislation is approached is such that it is generally thought right to bring the retrospectivity to the attention of Parliamentarians and other readers in a prominent way '.

In the foregoing circumstances the Society considers that it was entirely appropriate and correct to point out the potential retrospective effect of the proposed legislation.

The draft Arbitration Bill for Scotland proposed by the government sponsored Report of the Dervaird Committee in 1996 contained the following provisions.

" 33. (1) This Act applies only in relation to arbitration agreements entered into after it comes into force."

(2) The parties to an arbitration agreement entered into before this Act comes into force may, however, agree that this Act is to apply in relation to the Arbitration Agreement. '

The draft Arbitration Bill upon which the Scottish Government consulted contains the following ' transitional provision'.

20 "This Act does not apply to:-

(a) Arbitrations in pursuance of arbitration agreements (other than those comprised in enactments) made before the day on which Section 6 comes into force,

(b) statutory arbitrations begun before that day.'

These two draft Bills contain provisions which the Society considers to be appropriate. The Bill as introduced does not have these provisions.

It would be helpful were the Scottish Government to explain why the Bill as introduced is different. It could be argued that the consultation on this point was inadequate. This is important because legislation should generally speaking not be enacted with retrospective effect which, on the current drafting, will be the case for those parties who have entered into agreements to arbitrate **before** the coming in to force of the legislation.

In relation to the specific matters raised by CIArb the Society would comment as follows:-

4. Paragraphs 8 - 10

(i) This argument does not set out any proper basis for the Scottish Parliament to enact legislation which will have retrospective effect. The Society's position is that the legislation should **not** apply to arbitrations under agreements to arbitrate which were entered into before the coming into force of the legislation unless the parties agree otherwise. The difficulty is that in certain respects the legislation will deprive certain parties of rights they currently have eg. the right to a Stated Case on a point of law.

(ii) The terms of Section 84(2) of the Arbitration Act 1996 which applies to England and Wales is not evidence that what was done there is "standard practice". It is only evidence of one instance and reflects what was considered appropriate for that Act of Parliament applying to England and Wales where there had been very substantial and continuous statutory intervention in the law of arbitration.

The position in Scotland is entirely different. In Scotland there has been minimal statutory intervention in the law of arbitration. It was not thought appropriate in 1996 to incorporate the most substantive provisions of that 1996 Act into the law of Scotland (only 3 out of 110 sections and 2 schedules apply to Scotland). The Society questions how CIArb could support the impact in Scots Law of large parts of that Act. The Parliament has the opportunity to produce something new, attractive to potential users and specifically tailored to the needs of Scotland which will also attract international arbitration.

(iii) This argument is not considered appropriate in the context of arbitration. Legal persons in the United Kingdom do have to deal with changes in the general law to which they are properly subject as members of society. However the position in relation to changes to the law of arbitration are not of this general category because the parties have agreed to take their disputes generally outwith the recognised court system and have them determined by a known arbitration regime something which

Parliament could not force them to do.
The Society's experience is that it is not "common commercial practice" for parties legally advised or otherwise to agree to language such as that referred to in para. 8 – 10 (iii) which might seriously affect their rights and obligations in the future without knowing what such changes to their rights and obligations might be.

(iv) This argument does not assist in justifying legislation with retrospective effect. In the circumstances referred to in this paragraph the parties have agreed as a matter of contract that they would be bound by any changes. If they have they must take the consequences. However, it should be recognised that where a set of Rules is extensive and of long standing (such as those of LCIA) the scope for change might be regarded as relatively small. The position referred to is in sharp contrast with the new proposed legislation for Scotland which is a radical and comprehensive re-writing of the law of arbitration in Scotland.

12. The Society is of the view that its concerns regarding Rule 40 are not "overstated". Rule 40 is, in effect, the provision which applies to England and Wales by virtue of the 1996 Act. What is proposed is a statutory innovation in Scotland where arbiters are appointed to decide matters of both fact and law. If the legislation is designed to:-

a) encourage resolution of disputes by arbitration
b) encourage the view that reference to the court should be the "last resort"; and
c) avoid delay and expense,

then, in the Society's view those aims are not supported by Rule 40.

Further, and very importantly, Rule 40 is not supported by a large majority of responses to the consultation on the draft Bill (see question 21, 13 against / 4 for). In the light of the great majority of responses against such a proposal this Rule should not be included in the Bill.

It is important to recognise that Rule 40 deals with the situation where no decision has been made by the arbiter on the point in question. In the Society's view the proper approach is to determine whether Rule 40 will assist in achieving the objectives of this Bill rather than encouraging references to the court before the arbiter has given a decision on the point. The position is quite different where one is considering court involvement after a decision has been reached by the arbiter and there is thought to be an error in law. That is thought of by many as a necessary 'safety valve' to prevent unnecessary injustice.

14-16. The Society has given detailed reasons in oral evidence about why what is proposed by CIArb would not avoid the process of arbitration being discredited if parties with greater bargaining power are allowed to delete the power to award damages and/or interest.

Paragraphs 14 - 16 state "this is a matter for the parties to agree" but do not explain why these matters should be left to agreement of the parties in the context of:-

(a) the long standing difficulties regarding arbitration in Scotland because of outdated and un-commercial rules in relation to damages and interest; and
(b) that about 25% of the proposed arbitration rules are mandatory.

The Bill as currently drafted recognises that in certain circumstances matters cannot be left to the agreement of the parties where fundamental issues have to be covered especially those which have caused difficulties because of deficiencies in common law. In the Society's view in the light of common law problems regarding awarding damages and interest, these powers should be included in the mandatory rules. However, if this is done the Society recognises that certain changes to the current terms of the rule on interest would be appropriate for example including the compounding of interest.

A matter which arises separately but which is relevant is that a mandatory rule giving an arbiter power to award interest may mean that Muslims could not arbitrate on the basis that Islamic law prohibits *Riba* or the earning of interest for profit. See Scottish Government evidence OR 20 May 2009. col 2137.

The Society takes the view that the mandatory rule will confer a power which needs not be exercised and therefore the provision does not contravene Islamic law. In the Society's view it is highly unlikely that an arbitrator would award interest where interest is not in fact sought eg. by a claimant party who does not wish to claim interest because it might offend a religious belief.

The perceived difficulty might be addressed by providing that the mandatory provision could make it clear that the arbiter will not make an award of interest unless requested to do so.

19. The Society's concerns are properly stated:-

(i) No evidence that a system of provisional awards "works perfectly satisfactorily in England and elsewhere" has been produced. The wording of Rule 50 reflects the Arbitration Act 1996 which applies to England and Wales. There has been no tradition of arbitrators in Scotland making provisional or interim awards because arbitrators have no power at common law to do so and, in practice parties have been very reluctant to confer such a power by agreement.

There is no guidance as to how this wide power is to be operated in practice. There is no differentiation made between “provisional” remedies for example an urgent need to regulate possession of perishable goods which may be the subject of dispute and “interim” awards which would fall within 'provisional award'. The Society remains of the view that great difficulty will be avoided if the provisions in relation to "provisional awards" could be expanded.

Take an example in relation to interim awards which highlights the problem with interim awards which the courts have developed rules to avoid. A claim of £1 million from B on various grounds and produces lots of documentary evidence

which he says supports his claims. He asks the arbitrator for an interim award of £200,000 because he contends that his claim is worth much more than that. The arbiter finds in favour of A on an interim basis and B pays A £200,000. However, six months later after new evidence comes to light and the arguments have been more fully developed the arbiter issues a final decision that none of the claims are worth anything. As soon as the decision is issued, A is placed in liquidation. B has no prospect of recouping the money from A.

(ii) The comparison with adjudication under the Housing Grants, Construction and Regeneration Act 1996 is not appropriate. Those interim but binding decisions are the subject of very detailed statutory provisions. This is unlike the current scheme under the Bill which is lacking in detail.

22. The Society believes that Rule 51 should be revised to make it clear that if it is made mandatory the rule will only expect part awards to be issued in appropriate circumstances.

24. The Society considers that, here again, the aim of all concerned should be to produce a Bill which provides a modern, up-to-date law of arbitration in Scotland and which will foster the best aspects of Scottish practice and procedure which would differentiate it from what is offered in other jurisdictions.

The Society does not consider that this is best achieved by adopting Section 69 of the Arbitration Act 1996 which applies in England and Wales. This is perhaps best illustrated by an example.

The Society believes that an arbitrator need not hold lengthy and expensive hearings at which evidence is take from witnesses if it is clear that either the claim advanced or the defence to it has no proper basis in law. The traditional term used in Scotland for the procedure under which a question of law might be determined is a "debate" and is a hearing at which only legal issues are debated.

The advantages of such a procedure are clear. It can save days if not weeks of wasted legal expense, management time and other costs by deciding a dispute without the necessity of a lengthy hearing at which evidence or ‘proof’ is heard.

While the ability of an Arbiter to reach such a decision may not be possible in all cases and he or she may have to hear evidence from witnesses, it is a principle of Scots Arbitration Law that an Arbiter can without hearing evidence dismiss a claim or a defence if it has no basis in law. That principle has been disputed by those who argue that it is always necessary for an Arbiter to hear evidence from witnesses before a decision can be made.

However, the principle that this approach was not Scots law and that an arbiter could dismiss a claim or defence which had no basis in law without hearing evidence has recently been reinforced in an as yet unreported decision Apollo Engineering v James Scott in the Inner House of the Court of Session issued on 21st May 2009. In that case an Arbiter dismissed a very considerable claim after a debate because he considered that the claim had no proper

basis in law. Arbitrators have been slow to dismiss claims after a debate because of residual doubt concerning their ability to do so at common law but this case will resolve that issue.

This approach is important in considering proposed Rule 67 which deals with appeal on a point of law after an award has been issued by the Arbitrator. It contains provisions which set out the various requirements a party **must** meet in order to satisfy the Court that an appeal on a point of law may proceed.

*"A legal error appeal may proceed only if the Outer House is satisfied … (c) that**, on the basis of the findings in fact in the award,** the Tribunal's decision on the point (1) was obviously wrong; or (2) where the Court considers the point to be of general importance, is open to serious doubt and (d) that it is just and proper for the Court to decide the point despite the parties' agreement to resolve the dispute by Arbitration"* ***(emphasis added)***

Rule 67 only allows a legal error appeal if a party can satisfy the Court on paragraph (c) above. If a debate takes place there will be no "findings in fact in the award" because there has been no hearing of evidence. In Scotland, a debate would only proceed on the basis that the Arbiter assumes that any facts alleged by one party can indeed be proved but that is of no consequence if there is no proper basis for the claim or defence in law.

The Society understands that the wording of Rule 67 reflects the practice in England and Wales, not the practice in Scotland. In the view of the Society, a party wishing to make an error of law appeal following upon an award made after a debate should not be prevented from doing so by virtue of paragraph (4)(c) which does not recognise debate procedure which is currently recognised under the law of Scotland.

Another issue is that there is no express recognition in the Bill of a power of an Arbitrator to conduct a hearing on legal issues only and thereafter to dismiss a claim or defence if it has no proper basis in law. This may give rise to arguments as to whether or not an Arbitrator has such a power under the new legislation.

The Society considers that Rule 67 will encourage an argument that an Arbitrator has no such power under the new legislation. It will be contended that in the most obvious case where one would expect to have a right of appeal based on legal error (after a debate dealing with a point of law only) a party can only proceed with such a legal error appeal if it meets the requirements of paragraph (4)(c) which requires the Court to take into account the findings *of fact* in the award. However under this process there will be no such findings of fact.

Accordingly the potential appellant will not be able to comply with paragraph (4)(c). The argument will be made that Parliament did not intend such hearings to take place because there is no provision for an appeal from them and because there will be no findings in fact which a court must consider before allowing an appeal to proceed.

The Society considers that steps should be taken to avoid such an outcome and that is why the Society urges the Committee to reconsider the nature and structure of Rule 67.

In relation to the survey referred to by CIArb, a significant proportion of respondents, 20%,

indicated that the terms of Section 69 of the Arbitration Act 1996 were too restrictive. The report on the survey 'was not without sympathy' with that view but decided that change to the legislation would not be progressed on the basis that 'discussions with the Judiciary might give rise to a less restricted interpretation of the words 'and any need for a slightly more liberal approach can be met by pragmatism on the part of the court'. It is clearly desirable that the legislation should reflect what the legislation is intended to achieve. It should not be left to a hoped for ‘more liberal approach'. Judges will construe and apply the words. The statute should ensure that its terms reflect Parliaments’ intention. In the circumstances the Society considers that new legislation for Scotland should avoid that which the English legislation has encountered. It should offer something different from that available in other jurisdictions rather than adopting the wording of the 1996 Act.

While the Society recognises that there are good reasons for limiting the opportunity of parties to appeal on a point of law to prevent appeals which are designed just to cause undue expense and delay, the Society does not agree that it is the function of any such rule to "severely limit the likelihood of any such appeal succeeding". The Court should decide if the appeal should succeed because that is the true objective of allowing the appeal on errors of law. The comment quoted by CIArb may indicate the views of their constituency but contradicts the view of the large majority of the Respondents to the consultation who supported an appeal on questions or errors of law in an award (question 22 - 14 for/4 against). The success of an appeal on an error on point of law should depend on the Court deciding whether the arbitrator got the law correct or not. The Society cannot support a rule which 'severely limits the likelihood of any such appeal succeeding'.

In the view of the Society the legislation dealing with appeal on questions or errors of law in an award should reflect the view of the vast majority of consultees. Such a process should be available whilst containing appropriate judicial safeguards against appeals which are merely designed to cause delay and additional cost. Rule 67 as currently drafted does not meet those requirements and should be redrafted. Rule 67 in its current form is likely to dissuade a substantial number of possible users of arbitration from employing arbitration because they want a simpler more effective mechanism where, on the rare occasions it does occur, the Arbitrator fails to apply the law correctly. Those parties who wish to accept an Arbitrator's decision whether correct in law or not (rarely the case in practice for commercial disputes) merely have to delete Rule 67 which is a default provision.

It is very unlikely that a court will decide the issue of whether or not to allow an appeal to proceed without hearing the parties. This is likely to take as long a period of time as it would take the court just to answer the point of law from the arbitration.

The Law Society of Scotland
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