Is Arbitration Damaging the Common Law?

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In March this year the Lord Chief Justice, the Right Honourable, the Lord Thomas of Cwmgiedd presented his opinion that the development of the common law was being hindered by the widespread use of arbitration.[1] This article looks at the challenges facing the English courts and arbitral institutions in the coming years through the prism of Lord Thomas' criticisms of the current position. It assesses the challenges identified, their severity, and Lord Thomas' proposed solutions in the light of the factors that are important to parties in choosing between arbitration and litigation.

Based on this analysis, it seems the route to having more disputes decided by the English courts lies not in changing the laws relating to arbitration but in further improvements to the court system itself and improvements in the enforceability of court decisions through co-operation with other nations and courts. Mandatory changes to the right of appeal from arbitral decisions would be likely to benefit other leading arbitral centres such as Paris, New York or Singapore by driving arbitration business away from London rather than bringing additional cases before the English courts.

The challenges identified by Lord Thomas

Lord Thomas stressed the importance of the development of a clear and predictable framework of law, and its ability to develop in a principled manner. He noted that prior to 1979, the development of the law of England and Wales was effected through claims appealed from arbitration, as well as through court litigation. This situation changed with the much more limited right of appeal under the 1979 Arbitration Act and its interpretation in *The Nema*, because it was perceived that the effective right of appeal under the previous legal framework had been too broad and damaging the attractiveness of London as a centre for arbitration. The right of appeal was further narrowed in the 1996 Act.

Lord Thomas argued that, although hailed as a pragmatic compromise at the time, these developments risked a stagnation in the common law, particularly in areas of business that routinely favour arbitration over litigation. In his view, the present position which results in relatively few appeals from arbitral awards is reducing the volume and diversity of precedent created. He elaborated on three functions of public court decisions which he considered risked being undermined as a consequence:

1. They enable the law to develop in the light of reasoned judgment, refined and tested by the judiciary, through the creation of precedent.
2. They enable public scrutiny of the law as it develops, facilitating commercial or public debate and consequently facilitating the process by which an issue might be brought either back to the courts, or to Parliament if necessary
3. They ensure that the law's development is not hidden from view, permitting a public understanding of the law and enabling markets and market actors to organise their affairs accordingly. Lord Thomas thought the lack of openness in arbitration prevented individuals and lawyers from understanding how the law has been interpreted and applied, reducing individuals' ability to fully understand their rights and obligations.

In support of this, Lord Thomas pointed to real concern expressed to him about the lack of case law on some standard form-contracts and on changes in commercial practices in certain industries including: construction, engineering, shipping, insurance and commodities.

How serious are the issues identified?

On the face of it, the issues identified by the Lord Chief Justice are perturbing. It certainly would be a concern if the common law's development was being obstructed. Few people would deny that a key attraction of London as a centre for dispute resolution (whether via the courts or arbitration) is the quality of English law. Continuing development must be vital to maintain this position. However, as concerning as these issues are in abstract, they must be weighed against the benefits that the approach to the 1996 Act has delivered. Their seriousness should be measured in pragmatic terms by reference to the extent of the problem and the immediacy of the consequences foreseen: serious damage to the common law and damage to London's place as the premier destination for dispute resolution.

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[1] Fourth BAILII Lecture, 9 March 2016.

Extent of the damage

Lord Thomas cites figures from the report produced by Lord Mance's advisory committee on s.69 of the 1996 Act to demonstrate a dramatic decline in appeals to the Courts from arbitral awards: 300 "Special Cases" (the equivalent of an appeal) in 1978, compared to an average between 2006–2008 of only 50 s.69 appeals.[2] However, the same report indicates that prior to the widespread abuse of the Special Case regime as a delaying tactic (from 1973 onwards), which in part prompted the changes in the 1979 Act, the number of Special Cases was between 20 to 30 per year.[3] The fair comparison would therefore appear to be 20–30 Special Cases prior to the 1979 Act compared with 50 s.69 references in 2006–2008, which suggests that the figures cited by Lord Thomas may not be as damning as they appear. The statistical evidence necessary to investigate these matters further is not available at present.

While, absent reliable statistical evidence, the extent of the issue is somewhat unclear, Lord Thomas' broad point that there are more arbitrations today and fewer appeals to the Courts will ring true for some practitioners. Anecdotally, in relation to specific industries which favour arbitration there is some evidence that holes have appeared in the common law. For example, in the reinsurance sector the meaning of 'event' for aggregation purposes has been well-explored in relation to natural perils, but its meaning is unclear in the context of man-made losses such as fraud or acts of terrorism. Indeed, the reinsurance sector is a good example where much of the case law is old and its application to modern fact patterns and policy wordings can be difficult. However, this is not to say that the reinsurance industry would welcome reform to arbitration, as it prizes the confidentiality available in arbitration.

This example is illustrative of a fundamental difficulty at the heart of seeking a solution to the issues identified. If parties in a market habitually agree to arbitration in full knowledge of the issues this may create, is there a sufficient public policy imperative to justify interference with this freedom?

It is the case that in the same period in which the relevant developments in arbitration have taken place, there has been a large increase in the proportion of cases that settle before trial. This has been encouraged by the courts through promotion of ADR and changes to the CPR. The effect of this on the number of trials and the number of appeals is likely to be greater than that of the changes in arbitration.

Despite this, the courts actively encourage parties to settle disputes wherever possible, as indeed they should. The interests of the individual (or company) cannot simply be ignored in deference to the interests of the common law and the wider market. Parties should not be required to spend time and money or endure delay litigating if they prefer to resolve the dispute by another means. Similar arguments can be made in defence of parties' rights to have disputes finally determined in arbitration.

It is also worth noting that in many markets that rely heavily on arbitration, the participants and the practitioners who advise them are well aware of how particular issues are likely to be decided based on their own experience and information regarding arbitral decisions that becomes available through general market knowledge. The supervisory jurisdiction of the court also results in a substantial number of decisions being made public as part of enforcement proceedings. There is therefore a great deal of knowledge available to participants in such markets in order to inform their actions, albeit it is not as widely available as court decisions nor is it binding on subsequent tribunals.

Ultimately, what is clear is that a delicate balance must be struck between competing priorities. The lack of empirical evidence makes it difficult to predict whether and how soon Lord Thomas' fears of an ossified common law and London being damaged as a dispute resolution centre could become reality.

What solutions has Lord Thomas proposed?

Broadly speaking, Lord Thomas made three suggestions for remedying the issues he identifies:

1. Revision of the criteria for appeals. This would involve the reintroduction of a more flexible test for permission to appeal under s.69 of the 1996 Act, in a form similar to that which existed prior to 1979, particularly for legal questions of public importance.
2. Encouraging parties to make use of the power under s.45 to refer points of law to the courts. This consultative procedure could allow the courts to rule publicly on points of law thereby adding to the common law. This would seem to be particularly useful in circumstances where there are common issues across multiple arbitration proceedings.
3. Improvements to court litigation. Greater use of the courts should be encouraged by making court litigation more attractive. This would pull the right cases into the courts rather than seeking to push them out of arbitration.

Why do people choose arbitration rather than litigation?

An assessment of Lord Thomas' proposed solutions naturally leads one to consider why people choose arbitration over litigation at present. This is fundamental

[2] *First Interim Report on the Workings of s.69 of the 1996 Act in regard to Maritime Arbitrations in London* (2009).
[3] Citing Mustill & Boyd, *Commercial Arbitration*, (1982) p.406, fn.18.

to considering whether such proposals would cut across the key benefits of arbitrating in England and/or the extent to which the English Courts can realistically adapt to seek to attract more of the important cases about which Lord Thomas is concerned.

The 2015 International Arbitration Survey[4] provides a clear picture of the most valuable characteristics of arbitration as perceived by users:

(i) Enforceability of awards
(ii) Avoiding specific legal systems/national courts
(iii) Flexibility
(iv) Selection of arbitrators
(v) Confidentiality and Privacy
(vi) Neutrality
(vii) Finality

In considering these factors and Lord Thomas' proposals, it is important to recognise that many of the disputes which find their way into English arbitration have little connection to England and consequently would not, if arbitration were unavailable, naturally be litigated in the English Courts. It is also important to recognise that considerations such as avoiding specific legal systems or national courts and neutrality are likely to be factors that on balance draw international parties to the English courts as well as to arbitration. The key perceived advantages of arbitration over English litigation, for these purposes are therefore enforceability of awards, flexibility, selection of arbitrators, confidentiality and finality.

In order to assess Lord Thomas' proposed changes to arbitration and improvements to litigation, we must also keep in mind the complaints commonly made about arbitration[5]:

(i) Cost
(ii) Lack of effective sanctions during the arbitral process
(iii) Lack of insight into arbitrators' efficiency
(iv) Lack of speed
(v) National court intervention
(vi) Lack of third party mechanism
(vii) Lack of appeal mechanism on the merits

It is clear from a comparison of the categories highlighted above that, as one would expect, there is a difference of opinion amongst users regarding the most valuable characteristics of arbitration. The clearest example is the conflict between the desire for finality but also for an appeal mechanism on the merits.

In some of the areas highlighted above, significant efforts have been made by the English courts to improve their competitiveness when compared with arbitration. On costs and timing, a number of measures have been introduced such as cost budgeting, more flexible disclosure procedures and the introduction of shorter and more flexible trial procedures. Measures such as the specialist Financial List and Financial Markets Test Case Scheme have also been introduced and may in time go some way to addressing the perceived advantage inherent in selecting specialist arbitrators. Strong case management and the willingness and ability to impose effective sanctions, together with good mechanisms for joining third parties and managing related claims remain strengths of the English courts.

It is also relevant to consider that serious issues that cause parties to favour arbitration over foreign courts are not significant issues when comparing arbitration with the English courts. This is testament to the strength of the English system. Examples include the consistent quality of the judiciary, the limited availability of exemplary or punitive damages and the conservative approach to class actions in the English courts.

As Lord Thomas notes, there are some areas where it will be far more challenging, or even impossible for the courts to match arbitration, such as finality, party autonomy, confidentiality and enforcement. Whilst it is important for parties to take a realistic view of these perceived advantages, including factors such as the extent of the confidentiality afforded by an arbitral process in practice and the issues that can and do arise on enforcement of arbitral awards under the New York Convention, it is clear that arbitration offers significant potential benefits in these areas at present.

In other areas such as speed and cost, the strides made by the courts in these areas and the increasing popularity and caseload of leading arbitrators and institutions mean that the benefits of arbitration versus litigation may be much more finely balanced, certainly in relation to substantial cases.

To what extent do the issues identified and their proposed solutions impact upon the very reasons parties choose arbitration?

Revision of the criteria for appeals

The 2015 International Arbitration Survey shows that finality is a key factor for parties choosing arbitration. Indeed, even though there does seem to be a desire among some users to have an appeal mechanism, more than half of the survey's respondents thought that any appeal mechanism should be implemented within the system of international arbitration, not through the courts. This would not address any of the concerns raised by Lord Thomas.

Where, to take Lord Thomas' example, there is a dispute over the interpretation of a standard-form contract, permission to appeal under the current s.69 criteria ought to be achievable. In practice, however, this is often restricted by a standard waiver of appeal rights in the rules of the chosen arbitral institution, for example in relation to ICC and LCIA arbitrations. In light of the

[4] *2015 International Arbitration Survey*, published by the School of International Arbitration at Queen Mary University, London.
[5] *2015 International Arbitration Survey*.

evidence provided by the 2015 survey and the consensual nature of arbitration, this should be viewed as an indicator of the general strength of parties' desire to have finality, to avoid interference by national courts which would extend the dispute and interfere with the parties' desire to maintain confidentiality.

A change to the criteria for appeals would therefore cut across some of the key benefits of arbitration in England. It would consequently be unpopular with a significant proportion of arbitration-users and pose a serious risk to the attractiveness of England as an arbitral seat.

Moreover, it would not follow that there would be many more cases in the courts, because it would be perfectly possible for many parties simply to agree to arbitrate disputes in some other arbitral venue with less restrictive rules regarding appeals, rather than submit to the jurisdiction of the English courts.

Section 45 of the 1996 Act

It is very hard to see how parties could be encouraged to make greater use of s.45 references without a similar interference with the key benefits of arbitration. A change that fettered parties' autonomy in this regard would be likely to be unpopular with a significant proportion of arbitration users. Having chosen arbitration to resolve their dispute, parties are understandably reluctant to give up the perceived benefits of arbitration in order to put an important decision in the hands of the courts. Any attempt to increase the number of cases in which a s.45 reference is practical is likely to fall foul of the propensity of litigators to use such a reference as a tactical tool in the way which dogged the historic Special Case procedure.

Consequently, as with the changes to the criteria for appeals, changes to s.45 would seem to pose a very significant risk to arbitration in England with no guarantee that further business would be generated for the English courts.

Improvement of court litigation

While Lord Thomas' first two proposals advocate increasing the flow of cases to the courts at the expense of arbitration, his third proposal encourages the improvement of litigation without the corresponding restriction of the benefits of arbitration. Such a situation is clearly the most desirable outcome so one must address the question of whether sufficient changes to have an impact on the balance between litigation and arbitration are realistic.

As discussed above, confidentiality and finality are areas in which there will always be a difference between arbitration and the courts, and great strides have been made in relation to speed and cost such that the relative benefits are quite dependant on particular circumstances. This leaves the focus on areas such as enforcement, procedural flexibility and party autonomy.

On procedural flexibility and party autonomy, whilst significant improvements have been made by the courts, more could clearly be done. In general, parties in arbitration still have much greater control over their timetable, and despite the Jackson reforms there is still a significant difference between the mindsets of parties towards disclosure as a result of the different default approaches in each process.

Parties to arbitration are also eager to have a say in the selection of arbitrators. This can be matched to some extent by the courts through greater use of specialist lists. Although it cannot be possible to choose your judge, it is possible to ensure greater expertise in the judge you will have. This is ably demonstrated by the new Financial List, in which the judges receive specialist training in financial subjects. There may be scope to introduce similar schemes for other areas.

As for enforceability of awards, efforts are underway through initiatives such as the Hague Convention on Choice of Court Agreements and the development of Memoranda of Understanding or Guidance between Commercial Courts to simplify the process of cross-border enforcement of court judgments. Given that ease of enforceability is identified as the primary benefit of arbitration by users, progress in this area would have a substantial effect on the balance between litigation and arbitration. More generally, the courts could learn a lesson from the arbitral institutions and make efforts to improve the perception of the dispute resolution service offered by the courts. Arbitral institutions by their commercial nature must market themselves effectively in order to expand the use of arbitration and win users, and the courts would benefit from similar promotion by participants in the dispute resolution field of the areas where English litigation compares favourably with arbitration.

Conclusions

Ultimately, London is in the enviable position of being a global centre for both court litigation and arbitration.[6] Whilst the foundation of this position is the quality of English law which must consequently be protected, one must be wary of reintroducing the problems which previously undermined London's attractiveness as a centre for arbitration.

The Lord Chief Justice has identified some potentially concerning issues which those interested in the English justice system and the pre-eminence of English law for international business and disputes should consider carefully. However, at present there is no clear evidence that the issues identified are sufficiently serious or immediate to justify substantial changes to the treatment of arbitration under English law that would put at risk London's dominant position. This is not least because the issues which Lord Thomas identifies have the

[6] In the *2015 International Arbitration Survey*, London is both the most-used and the most-preferred choice for seat of arbitration.

potential to affect other significant legal systems which might compete with English law to a similar extent as well.

Nevertheless, English lawyers should not be complacent and further research regarding the effects identified would be welcome. At present, a continuing focus on improving the features of court litigation so that it competes more strongly with arbitration would seem to be the best solution. This is likely to have a gradual impact on the problems cited by Lord Thomas without the detrimental effects of some of the more drastic solutions available. One would hope this would allow these challenges to be overcome and ensure the development of the common law is safeguarded.