COMMERCIAL INSTITUTE OF ARBITRATORS IN AUSTRALIA

CANBERRA, 25 JUNE 1976

THE LAW & COMMERCIAL ARBITRATION

Hon Mr Justice M D Kirby

June 1976

INTRODUCTION

I shall endeavour to perform an extraordinarily difficult task - to talk about the Law & Commercial Arbitration and make it scintillating.

I propose to look at the history of arbitration and its relationship with the courts of law; plug lawyers participation in arbitration, talk about developments in law reform in the field, and finally discuss an arbitrator's liability in negligence.

These parts fit together because they relate to the interrelationshi of dispute resolution by arbitration vis a vis the formal court system. My purpose is to look at some of the problems stemming from the interrelationship and suggest some possible developments.

HISTORY OF ARBITRATION

The notion of people with common interests banding together to establish courts tailored to their own particular needs leads us back into the very growth of the common law. The first courts of law were established in this way. The commercial courts of the middle ages, the court of pie-powder and maritime courts of sea port towns "sitting on the seashore from tide to tide" are examples.

These specialty courts were in time swallowed up by the common law courts and the courts adopted many of the mercantile rules applied by the earlier courts. However, the application of the rigidity of the court system had the result that the courts inevitably lagged behind commercial practice. This ever-growing gap forced merchants to resort to extra judicial methods of resolving differences. The growing practice of arbitration in an expanding economy could not be indefinitely ignored by the legislature and so in 1698 a statute was passed of which Blackstone wrote:

> "[E]xperience having shown the great use of these peaceable and domestic tribunals, especially in settling matters of account, and other mercantile transactions, which are difficult and almost impossible to be adjusted on a trial at law, the legislation has now established the use of them".

A long stream of legislation followed.

The law has lost its suspicion of arbitration, an attitude engendered by traditional jurisdictional fighting by courts of law. It has

come to see arbitration as a complementary, rather than a threatening, extra channel in conflict resolution.

This aptness and compatibility have been widely recognised. Scrutton L.J. in Re Olympia Oil & Cake v. Mac Andrew Moreland & Co. [1918] 2 K.B. 771, 778 said:

> "Now a great part of the disputes relating to the commercial business of the country is referred to commercial arbitrators, who deal with them according to substance rather than form. In my view it would be very undesirable if many of the odd rules of a somewhat technical character were invoked for the purpose of interfering with decisions of commercial arbitrators where no injury in the matter of substance has been done by the form in which those commercial arbitrators have expressed their decisions. Hence I approach the decision of this case with a desire not to interfere with the award of commercial arbitrators unless I am satisfied that substantial injustice has been done apart from a question of form.

More recently Chief Justice Warren Berger of the United States Supreme Court actively encouraged that more resort be had to arbitration:

> "There are a great many problems that should not come to judges at all and can be disposed of in other ways - better ways. I can suggest one basic way that must be developed more widely in this course, and that is the use of private arbitration ... Many lawyers, including the best lawyers in the country, press their clients in a great many lay business engagements between corporations to agree that all disputes between them will be resolved by private arbitration without any resort to courts and without any judicial review. This is one area we have to enlarge. The labor movement developed this technique more than a century ago and uses it constantly. We must use this highly acceptable device that in the long run is probably less expensive and at least as

efficient as any judicial process."
[Forbes Magazine, vol. 108, July 1, 1971,
at 21-23.]

In the united States there has been for some time a willingness by the courts to accept arbitration. Judge Jerome Frank put aside the limitations imposed by the common law and urged a new orientation. He said

> "[I]t is our obligation to shake off the old judicial hostility to arbitration. Accordingly, in a case like this, we should not follow English or other decisions which have narrowly construed the terms of arbitration agreements or arbitration statutes."
> (Kulkundis Shipping Co. v. Armstrong Trading Corp. 126 F.2 at 978).

However we should not imagine that arbitration and the judicial system are always on honeymoon. Judge Frank later in his opinion saw fit on behalf of the court to caution, if not to chide, the "more enthusiastic" sponsors of arbitration against regarding it "as a universal panacea". "We doubt", he emphasized, "whether it will cure corns or bring general beatitude. Few panaceas work as well as advertised."

Indeed we should recognise that courts still maintain the upper hand: their jurisdiction cannot be wholly ousted by agreement between the parties.

ADVANTAGES OF ARBITRATION

It would be merely repeating a litany to list the advantages of arbitration to this body. Amongst the advantages of arbitration over court process are:

(1) speed; especially considering the present backlog of cases.
(2) the application of expertise in a technical field: and
(3) cost. (This, of course, goes hand in hand with speed).
(4) privacy of the proceedings.

A ROLE FOR LAWYERS

Considering these advantages I would like to comment briefly on the role of lawyers in the arbitration system. With the increasing popularity of the arbitrial approach to dispute-settling - a pace which will be quickened now that this Institute is established - and the numbers of law

trained people now being produced, the arbitration system will have to acknowledge the fact that lawyers, being what they are, will begin knocking at the door of arbitration.

There is a broad view that lawyers are not necessary to satisfactorily handle arbitration. This may be so and I would not propose that they are necessary; but it is my opinion that the arbitral process can benefit substantially by the application of lawyers' skills. A proper legal framing should enable a person to be a good "issue posters" i.e. he should be able to isolate the basis of the dispute between the parties.

The court system not only has trained "issue posters" making up its complement of personnel but it also has rules of evidence and procedure designed to narrow a dispute to the issues. With these mechanisms and the training of the judges and practitioners, the court system normally works substantial justice by assuring that the real issues of dispute are reached and disposed of. I would argue that rules of evidence and procedure must be used in arbitration, but that they must be geared to it. If this is done it will help the tribunal to isolate the issues.

Let me hasten to add that I do not propose that arbitration become another province of the lawyers; to do so would destroy the many benefits of arbitration. Nor do I propose a set of rigid rules of procedure and evidence; this has been expressly advised against by the A.C.T.L.R.C. But what I propose are aids to "issue spotting" and through this a way of strengthening the arbitral process.

It seems to me that if lawyers are to play their role, there must be a grounding given to them in the training . Perhaps the Institute could foster this in the Law Schools and Colleges of Law. Exposure to arbitration at this stage will reap great benefits for the arbitral system and the lawyers.

Moves for Reform

Anyone charged with the task of reforming the law on arbitration should keep in mind that there are at least two quite different distinct sets of circumstances in which a dispute might arise to be determined by arbitration.

One set of circumstances is where two parties, at arms length, freely or voluntarily negotiate an agreement to submit their dispute to an

arbitrator who is mutually chosen by them as the appropriate tribunal. In such a case, since the parties deliberately and with a perfect freedom and equality avoid the ordinary judicial processes for the determination of their dispute and genuinely intend to submit such dispute to arbitration, it may be readily acceptable that the only legislation required to assist such parties should be of a directory but flexible character (and subject to contractual variation) to facilitate the proceedings before the arbitration and the enforcement of any award subsequently made by him.

On the other hand, there is a second and quite different set of circumstances which commercially has become quite common, arising not from a submission, strictly so-called. Parties frequently enter into a commercial contract which contains a so-called "arbitration clause". Frequently, the clause is contained in a specified printed set of conditions imposed by one contracting party on the other. In many such cases, no real consideration is given by the contracting parties as to the effect of the clause, either because it is hoped and believed that it will never become operative or, alternatively, because the desire on the part of the party upon whether the specified terms are imposed to enter into the principal transactions transcends all caution as to the nature of the arbitration clause. Indeed, in many cases, as for example, in insurance policies, a party at the time of negotiating the contract may never have had his attention drawn to the term of the contract which provided for arbitration, until some dispute was raised on a claim subsequently made by such party. In these set of circumstances, there should be statutory safeguards, including a provision to enable the court to intervene to ensure justice is done.

Many attempts have been made recently to update the whole law of commercial arbitration in the light of modern conditions of the development of new commercial practices. The importance of the subject was recognised by the Standing Committee of Attorneys-General which, at its meeting in February 1974, authorised investigation into the possibility of a uniform law of arbitration for the whole of Australia. To that effect, the Standing Committee set up a committee of officers and Parliamentary Counsel to propose a model uniform bill.

In addition most Australian law reform agencies have published a report or working paper on the subject. It is perhaps unfortunate for the cause of uniform law reform that each of the Commissions favoured entirely different approaches with regard to a number of key questions. I think that it is plain that a uniform code would be of great utility. There is a realization of the desirability of uniform law in tackling areas of national concern, witness the A.L.R.C. references on uniform defamation law for Australia.

The present disparate approach can be illustrated by considering the question whether parties to a contract should be able to 'contract out' of the provisions of any proposed arbitration legislation, on which the N.S.W.L.R.C and the A.C.T.L.R.C. took divergent views. The N.S.WL.R.C. recommended that a distinction must be made between contracts freely made and 'contracts of adhesion'. The term "contract of adhesion" which is novel to English law is a translation of the French 'contract d'adhesion' coined by Salilles in about 1901. A contract of adhesion is, for the purposes of the N.S.W. draft Arbitration Bill, a contract with provision for arbitration of future differences, a contract in a standard form (so far as concerns the arbitration clause at least) put forward by one party, made in the course of business as regards him, and acceded to by another party in circumstances in which a reasonable man would not regard the terms of the arbitration clause as open to material change by negotiation. The N.S.W.L.R.C. in its W.P. on Commercial Arbitration recommended that that 'contracting out' should be impermissible in the case of 'contracts of adhesion' containing arbitration provisions, but allowed in contracts which were not 'contracts of adhesion'.

The A.C.T.L.R.C., on the other hand, declined to adopt the special category of contracts of adhesion in which contracting out should be impossible. The Commission thought that little harm would be done by the law's insistence that all, or nearly all, arbitration agreements should be subject to the provisions of arbitration legislation without the possibility of 'contracting out' and not merely those contained in contracts of adhesion.

This question was not directly adverted to in the reports of the other law reform bodies, and many of the provisions of the draft Bills

prepared by the Queensland Law Reform Commission, South Australian Law Reform Commission and the Western Australian Law Reform Commission were expressed to operate subject to contrary intention expressed in the agreement to arbitrate.

Another question that has occupied the minds of law reformers related to the well-known Scott v Avery clause in contracts of arbitration. By this term is meant a clause which commonly occurs in the arbitration provisions of a contract, to the effect that the obtaining of an award of an arbitrator shall be a condition precedent to a cause of action in the courts, in respect of a matter to which the arbitration agreement applies. If a party brings an action on his claim before the award is made, the action must be stayed, and even if it is not stayed, the Scott v Avery clause is a complete defence. The possibilites of injustice are obvious, and they are magnified by the fact that a high proportion of contracts containing arbitration clauses are contracts in which one party has no opportunity of objecting to any of its terms, for example, insurance policies and building contracts.

Although all law reform bodies were of opinion that the effect of a Scott v Avery clause should be limited, they adopted different approaches in mitigating the vigour of such a clause. The Queensland Law Reform Commission recommended that the power to stay proceedings in Court is to be exercised to the same extent and in the same manner where there is a Scott v Avery clause as where there is not, and that the clause is to be treated as an agreement to arbitrate, and is not to prevent the accruing of any cause of action. This recommendation was given effect to by S.10(2) of the Arbitration Act 1973 (Qld). A similar recommendation was adopted by the Victorian Chief Justice's Committee and the A.C.T. Law Reform Commission. The Western Australian Law Reform Commission, on the other hand, has recommended that a provision be included in the legislation of that State which simply makes a Scott v Avery clause void. The New South Wales Law Reform Commission, however, suggested that the clause be effective except in a contract of adhesion. It should also be noted at this juncture that under the United Kingdom Arbitration Act of 1950, the Court is given power in certai circumstances to order that the arbitration agreement shall cease to have effect with respect to a particular dispute between the parties, and may then order that a Scott v Avery clause shall also cease to have effect (s.25(4).

Another provision frequently encountered in an agreement to arbitrate is the so-called Atlantic Shipping Clause which makes lapse of a specific time a bar to further procedural or substantive rights. This stipulation has on a number of occasions given rise to oppressive results. As early as 1950, the United Kingdom Arbitration Act gave the High Court power to extend any such time limitation for such a period as it thinks proper if the Court is of opinion that in the circumstances of the case undue hardship would otherwise be caused. (s.27). All the Australian law reform agencies with the exception of the New South Wales Law Reform Commission have recommended the adoption of this provision. On the other hand the New South Wales Law Reform Commissio espousing the somewhat old-fashioned doctrine of freedom of contract, recommended that the Atlantic Shipping Clause should be effective according to its terms, except in a contract of adhesion.

Problem encountered

These are some of the technical legal questions that may arise out of an agreement to arbitrate. It would now be instructive to refer to some of the problems that would be encountered by arbitrators in settling an arbitration. The first relates to the Arbitrator's duty to apply the law. It has been suggested that if the parties to an arbitration so agree, there is no reason why the arbitrator should not be free to determine the dispute according to equity and good conscience or whatever other phrase is devised to exclude a duty to apply the law. It is clear, however, that the law at present is otherwise It has been categorically stated in a number of cases that it is the duty of the arbitrator to apply the law and that he is not permitted to decide the matter according to his own motions of justice even if the parties have agreed that he should be free to do so. One court went so far as to say that if in a purported contract the parties provide that their rights and objections shall not be decided in accordance with the law, but in accordance with some other criterion (such as what the arbitrator considers to be fair and reasonable) then it is doubtful whether there is any contract, as the parties did not intend it to have legal effect. Only the A.C.T. Law Reform Commission adverted to this

question in its report on Commercial Arbitration. It recommended that the duty of the arbitrator to apply the law ought to be expressly spelled out in statute. However, the Commission went on to say that arbitrators should not be unduly burdened by the fear of correction by the courts. The Commission therefore recommended that, although, it is the duty of the arbitrator to apply the substantive laws governing the rights of the parties, arbitrators should not be bound by the rules of evidence. It was th ought better to allow arbitrators a sensible discretion within the general duty to act fairly between the parties. It follows that an arbitrator should be authorised to receive and act upon relevant material even though not admissible under the normal rules of evidence. However, there should be a duty on an arbitrator to receive relevant matter admissible under the law of evidence.

Closely allied to the question whether the law of evidence should apply, is the feeling of arbitrators and commercial man generally that an arbitration should not be determined, as do court proceedings, by the mere failure of a party to prove, by technical standards of proof, what is probably the truth of the matter. It is said that the adversary system of litigation is not suited for arbitration. Both the A.C.T. Law Reform Commission and the New South Wales Law Reform Commissio agreed with this view advanced by businessmen and arbitrators and recommended that arbitrators should act fairly between the parties and need not be bound by strict procedural and evidentiary rules in their conduct of the proceedings. Rules adopted should reflect the requirement of the arbitration in reaching a just solution.

In its report on Commercial Arbitration, the A.C.T. Law Reform Commission has made a number of unique recommendations. Three suggestions are worthy of mention:

First, it was proposed that a register of arbitrators, conciliators and experts be established, to be maintained by the Registrar of the Supreme Court. The object of the register would be to reduce delay by having readily available details of persons of experience, expertise and trade of professional qualifications,

prepared to act as arbitrators or conciliators or experts in disputes arising from commercial agreements.

Secondly, it was thought that disputes requiring reference to arbitration may be expeditiously resolved if they were first submitted to conciliation. Despite the difficulties inherent in this proposal, e.g., its use as a delaying tactic, the Commission thought that the procedure was worth trying on an experimental basis. It was also proposed that the procedure should not be mandatory but be available at the request of a party. Furthermore, the Commission was of opinion that disputes could be resolved expeditiously by reference to an expert in the trade or profession in which the difference has arisen, rather than by the parties becoming involved in protracted and costly arbitration or litigation. Although such a procedure has always been available, the Commission recommended that specific mention be made of it in any proposed legislation so that attention will be specifically drawn to this facility.

Finally, but most importantly, the A.C.T. Law Reform Commission recommended that legal aid should be made available to a party involved in arbitration proceedings where, if the proceedings were court proceedings, he would qualify for legal aid. Because of the inequality of the parties in many instances of arbitration clauses, for example clauses in an insurance contract between a large company and a person of small means, the heavy costs of arbitration may deter the weaker party from pursuing his rights, so that the possibility of legal aid will contribut towards mitigating the inequality of his position.

You will see that the Australian Law Reform Agencies have given very close consideration to Commercial Arbitration. Whilst there is not great consistency in approach, much thought and analysis has been devoted to the problem areas of commercial arbitration. A positive factor in the diverse approaches adopted is that the different results may be monitored, and out of this a consensus reached on the most desirable reforms of the law.

Having highlighted some of the reform suggestions, I would like to mention briefly the question of the arbitrators liability in

negligence. In recent years the law has witnessed the drawing under the umbrella of liability for negligent advice, professionals - accountants, solicitors, doctors, architects. The case I wish to discuss illustrates that arbitrators, when acting in a "non judicial" manner are subject to an action in damages for negligent advice.

The Liability of Arbitrators in Negligence

The case was Arenson v Arenson. The persistence of the appella in this case was laudable. He failed at first instance and in the Court of Appeal but found his reward in the House of Lords. The various courts did not deal with the merits of the case but with a purely legal question - did the Plaintiff have a right of action? It was only once this question was decided in the affirmative by the House of Lords that the courts were able to go ahead and look at the substantive issues. (Donoghue v Stenvenson; snail in bottle, went to House of Lords on demurrer). Perhaps this drawn out litigation is the best advertisement for the benefits of arbitration!

The Facts

Briefly the facts were that the Plaintiff was brought into his uncle's business and given a bundle of shares. A written agreement provided that if the Plaintiff ceased to be employed in the business, he would sell the shares to his uncle at a "fair value" - to be determined by the Company's Auditors. The shares were valued at £4,916.13.6. The company shortly after "went public". The Plaintiff contended that this transaction disclosed that the same shares were worth £29,500.0.0 i.e. six time the valuation placed on them.

The Plaintiff brought an action in negligence. The Defendants applied for an order that the Plaintiff's statement of claim be struck out on the ground that it did not disclose a cause of action.

The Holdings

Brightman J at first instance granted the order, finding that the claim was misconceived and bound to fail. The following

passage stated the basis of his Honour's finding -

> "...where a person (although not an arbitrator) is in a position of an arbitrator, with a duty to hold the scales evenly between two other parties for the purposes of resolving by the exercise of his own judgment a matter that is not agreed between them, it is not expedient that the law should entertain an action against the opinion-giver alleging an error, whether negligent or not".

The Court of Appeal agreed with this in slightly different language:

> "...where a third party undertaking the role of deciding as between two other parties a question, the determination of which requires the third party to hold the scales fairly between the opposing interests of the two parties, the third party is immune from an action for negligence in respect of anything done in that role".

The symbolism employed reminds me of the emblem of the Institute. The different language is important. Buckley L.J. formulation requiring "opposing .. interests" while Brightman talks of "a matter not agreed between them".

The House of Lords reversed the Court of Appeal. Their Lordships reasoned that very good grounds must be shown to avoid the general rule of public policy that where there is a duty to act with care with regard to another person and that duty is breached, an aggrieved person owed the duty should be able to sue for damages.

The Principles

It was common ground that if an arbitrator were carrying out a "judicial function" he is immune from an action in negligence. The crux question then becomes what constitutes a "judicial function".

It is clear from the decision that to fall into the protected zone an arbitrator must do more than decide a question (the respondent's contention) but must decide a dispute. In the words of

Lord Simon there must be a "formulated dispute" between the parties which is required to be resolved by the arbitration.

Lord Wheatley thought the indicia of a judicial type function were that:

(a) there is a dispute or difference between the parties which can be formulated in some way or other;

(b) the dispute or difference has been remitted by the parties to the person to resolve in such a matter that he is called on to exercise a judicial function;

(c) where appropriate, the parties must have been provided with an opportunity to present evidence and/or submissions in support of the respective claims in the dispute; and

(d) the parties have agreed to accept his decision.

A further indicium of the judicial function is the giving of a reasoned judgment for a particular finding. (See Lord Simon).

In essence, the House of Lords has narrowed the immunity which arbitrators had from actions in negligence. The test is one of whether the arbitrator was carrying out a judicial type of function, the basic ingredient of which is the settling of a formulated dispute.

Implications of the Decision

The decision of the House of Lords does not give definitive guidance to the arbitrator. There is a problem in deciding what is meant by "formulated dispute" and how far the absence of any of the other indicia will militate against immunity from negligence. In the Arensen case there would not seem to be a "formulated dispute" but merely a question to be answered. However, if the initial agreement had stated that the value of the shares was to be agreed upon by the parties but failing agreement the Auditors were to value the shares, the Auditors may have been immune. If the indicia referred to above were required of the arbitrator then it would seem certain that immunity would apply.

Arbitrators will have to keep this decision closely in mind. It will be necessary to draw arbitration clauses carefully if immunity is to be ensured.

Conclusion

Commercial Arbitration under the auspices of this Institute and ever growing economy must become increasingly important in dispute resolution. It is important that those who administer the law understand the role of Commercial Arbitration. This is one of your most pressing tasks. I have attempted to trace some of the law's responses to the implications of Commercial Arbitration. If the court system has not responded adequately in the past I think the deficiency can be partly rectified by the efforts of your Institute.