Introduction

The Scottish Law Commission (“SLC”) consulted us before issuing its Report and we are in agreement with its content other than as relates to certain parts of the wording of the draft Bill in relation to arbitration.

In this submission, we will highlight (in unembellished font) certain statements made in the Policy Memorandum, the Statement of Legislative Competence, the Financial Memorandum, the Bill itself and the Notes accompanying the Bill and we will comment thereon in bold italic font. Note that we limit our submission to arbitral matters and do not purport to comment in any detail concerning other provisions of the Bill but we record a general observation that we are in a high degree of agreement with the detailed commentary by the Faculty of Advocates on the non-arbitral sections of the draft Bill.

As a simple executive summary of this submission, we are in general agreement with what is being proposed

POLICY MEMORANDUM

Arbitration
48. The availability of arbitration in the context of third party rights was not included as part of the SLC Discussion Paper. Instead it arose as part of their consideration of whether or not to include provisions relating to the enforcement of third party rights other than in court proceedings as part of the draft Bill.

49. The 1999 Act makes provision for arbitration on third party rights for England and Wales. The Act treats a third party as a party to the arbitration agreement in relation to a contractual term which is enforceable by that third party where there is a provision that a dispute in relation to that term goes to arbitration. In practice this means that whilst a third party can benefit from the arbitration process it must also arbitrate if it wants to enforce its right and therefore any court proceedings would be stayed until the arbitration process was completed or otherwise concluded.

50. The 1999 Act also makes provision in relation to the situation where a term of the contract gives a third party a unilateral right to require the non-performing party to the contract to submit to arbitration and if the third party exercises that right they would be treated as a party to the arbitration agreement. However the third party may choose not to exercise the right. This is the position, generally speaking, in other common law jurisdictions.

51. When the SLC consulted with the legal profession specifically on the issue of arbitration there was a consensus that it would be beneficial and worthwhile to enable any arbitration agreement between the contracting parties to operate in respect of third party rights and that there would also be advantages to the commercial sector trading across the border for the law in this regard to be similar. It was also thought that this could be beneficial in relation to family law matters.

52. The SLC agrees with the commentary [in Dundas and Bartos] that as the law stands in Scotland a third party is not a party to any arbitration agreement contained in the relevant contract.

53. In order to reflect modern arbitration law, and place Scotland on a par with other jurisdictions, the policy approach is to make similar provision to that of the 1999 Act, in Scots law. The Bill implements the SLC recommendation that for the purposes of the 2010 Act a third party will become a party to an arbitration agreement in the following circumstances:

- where a contract contains an undertaking in favour of that third party and an arbitration agreement provides for a dispute on the matter to be resolved by arbitration; or
- where an arbitration agreement provides that one or more descriptions of disputes between one or more of the contracting parties and a third party (other than those covered above) may be submitted to arbitration, and the third party invokes that agreement.

54. However, on the basis that contracts cannot impose duties on third parties without their consent, and in line with other jurisdictions, a third party will not be bound to arbitrate. It needs to be recognised however that in so choosing, a third party may lose a valuable benefit.

D&B Comment: the SLC recommendation covered two scenarios:
(1) where there is a third party right under section 1 and there is an arbitration agreement between the parties to the contract conferring the third party right stating that any difference or dispute in connection with the third party right is to be referred to arbitration; and
(2) where there is no third party right under section 1 but there is an arbitration agreement stating that both the parties to the arbitration agreement and a third party are entitled to submit certain differences or disputes to arbitration.

The first scenario is the more likely in practice, by far. The policy of the SLC is that if the third party wishes to enforce the third party right under section 1, it must do so by way of arbitration. However if a claim is raised by one of the contracting parties, the policy is that is that the third party cannot be forced to arbitrate. It can resist arbitration and choose litigation (SLC report paras. 7.35 and 7.43).

The second scenario is unlikely but possible. The policy of the SLC just mentioned is even more apt in the second scenario. Indeed absent any third-party right under section 1, there can be no question of forcing a person to become party to an arbitration agreement if they do not wish to do so.

We endorse the approach of the SLC. However it is not apparent that this has been given proper effect in the drafting of the Bill.

69. In addition the Scottish Government carried out some targeted consultation on the Report and invited comments from a number of stakeholders - two responses were received. Both were very supportive of the principles of the Bill and offered a range of comments on the Bill itself which have been taken into consideration.

D&B Comment: we are aware that one of the responses was from the Faculty of Advocates. It is not apparent that their comments on the drafting of section 9 have been taken into consideration. Essentially these comments were aimed at achieving the implementation of the SLC recommendations for the two scenarios set out above. The result is that the drafting lacks a clear distinction between the two scenarios. This may cause difficulties of interpretation and understanding in practice.

Human Rights

72. The Scottish Government has considered the effect of the provisions of this Bill on human rights: in particular on (i) Article 6 of the European Convention on Human Rights (the ECHR) (right to a fair trial) and (ii) Article 1 of the First Protocol (A1P1) (protection of property). The Scottish Government has considered the extent to which the provisions on arbitration engage Article 6 ECHR. This Bill enables arbitration in respect of third party rights in the two scenarios provided for in section 9 (see paragraphs 48 to 54 above). Arbitration is a procedure whereby parties agree to submit a dispute between them to an arbitrator who will act as a private tribunal to produce a final and binding determination of the dispute. By agreeing to go to arbitration, the parties voluntarily deny themselves recourse to the courts.

73. Article 6 does not prohibit the use of arbitration as a means of resolving disputes about civil rights and obligation as it is open to parties to waive their Article 6 rights to a public hearing and judgment if the parties freely and unequivocally choose to do so.

74. The Bill does not compel a third party to submit a dispute to arbitration proceedings and therefore does not remove the third party's right to a fair and public hearing by an independent and impartial tribunal established by law. The effect of the Bill is that a third party who takes a voluntary step into the arbitration process, either by initiating it or in responding to a dispute being raised against it, waives the right to a judicial hearing which meets the full requirements of Article 6.

75. This issue is discussed at paragraphs 7.50-59 of the SLC Report.

D&B Comment: D&B2 contains extensive consideration of references to the interface between the 2010 Act and ECHR law. What is critical is that arbitration (other than compulsory statutory arbitration) is a voluntary form of dispute resolution and as such cannot infringe the Art.6 right to a public hearing and judgment by a court.

In scenario (1) above the third party's right is made conditional on arbitration. This means that the third party has a choice: either it accepts the package offered by the contacting parties of the third party right with the obligation to arbitrate as a condition for enforcement or it does not accept the package. That choice is entirely consistent with Art.6.

In scenario (2) the third party also has a choice: either it decides to submit its claim to arbitration (provided that it falls within the arbitration agreement) or it opts for a different dispute resolution process. That choice is entirely consistent with Art.6.

Statement on Legislative Competence
On 31st January 2017, each of the Presiding Officer (Rt Hon Ken Macintosh MSP) and the Cabinet Secretary for Justice (Michael Matheson MSP) made statement in identical language:

“In my view, the provisions of the Contract (Third Party Rights) (Scotland) Bill would be within the legislative competence of the Scottish Parliament.”

D&B Comment: we respectfully agree; law which is purely Scots law cannot be a matter for the Westminster Parliament.

Financial Memorandum

In the Memorandum it is stated that...

... the Bill

➢ provides a mechanism whereby any arbitration agreement between the contracting parties can operate in respect of third party rights;

➢ enables a third party to renounce their third-party right either expressly or implicitly, (the effect of such a renunciation being that the right is extinguished);

D&B Comment: we respectfully agree.

7. There are no financial or resource implications. The legislation will bring some much needed modernisation to the law in this area. The provisions in the Bill are mainly default and permissive and do not place any new obligations on individuals; organisations or business. Indeed if these provisions are used instead of existing tools such as collateral warranties there could potentially be savings to the contracting parties dependent upon the size and complexity of the project.

D&B Comment: we respectfully agree.

The Bill

As stated above, we leave it to others to comment on the Bill other than as affects arbitration

For ease of reference we restate clause 9

9 Arbitration

(1) In relation to a dispute to which subsection (2) or (3) applies, the person who has the third-party right mentioned in subsection (2) or (as the case may be) (3) is to be regarded as a party to the arbitration agreement mentioned in that subsection.

(2) This subsection applies to a dispute if—

(a) the dispute concerns an undertaking being enforced or otherwise invoked by virtue of a person’s third-party right to do so, and

(b) an arbitration agreement provides for a dispute on the matter under dispute to be resolved by arbitration.

(3) This subsection applies to a dispute if—

(a) subsection (2) does not apply to the dispute,

(b) an arbitration agreement provides for a dispute on the matter under dispute to be resolved by arbitration,

(c) a person who is not a party to the agreement has a third-party right to enforce or otherwise invoke the agreement in relation to the matter under dispute, and

(d) the person who has the third-party right has—

(i) submitted the dispute to arbitration, or

(ii) sought a sist of legal proceedings concerning the matter under dispute on the basis that an arbitration agreement provides for a dispute on the matter to be resolved by arbitration.

(4) A person who is not a party to an arbitration agreement is to be regarded as having submitted a dispute to arbitration under the agreement if the person—

(a) has a third-party right to enforce or otherwise invoke the agreement in relation to the matter under dispute, and

(b) has done whatever a party to the agreement would need to do in order to submit the dispute to arbitration.

(5) In this section and section 10(2)—
"arbitration agreement" has the meaning given by section 4 of the Arbitration (Scotland) Act 2010, and "dispute" is to be construed in accordance with section 2(1) of that Act.

D&B Comment: – the drafting incorporates the flaws outlined in the Faculty of Advocates' earlier submission with which we agree.

NOTES on the BILL
As stated above, we leave it to others to comment on the non-arbitral sections of the Bill; the Notes state:

Section 9 – Arbitration
35. Section 9 provides a mechanism by which any arbitration agreement between the contracting parties can operate in respect of third party rights. Arbitration is governed in Scotland by the Arbitration (Scotland) Act 2010. Section 9 creates the conditions necessary so that that Act can apply where appropriate. In doing so, two fundamental features of an arbitration must be borne in mind: first, that only parties to the arbitration agreement can participate in the arbitration (though there are limited exceptions to this) and, secondly, that no party can be compelled to submit to arbitration unless it has signed a valid arbitration agreement.*** The first of these bars the third party (who is, by definition, not a signatory to the arbitration agreement) from participating; section 9(1) overcomes this by deeming such a person to be a party to the arbitration agreement in specified circumstances (as discussed below). The second feature is the requirement for consent.

36. For section 9 to apply at all there must be an arbitration agreement in the contracting parties' contract providing for the submission of disputes to arbitration. The circumstances in which a third party may have an interest in that arbitration agreement are set out in subsections (2) and (3). There are only two of them, and they are mutually exclusive. The circumstances can best be described in terms of the type of dispute which may arise.

37. Subsection (2) covers disputes about a substantive third-party right. This will be the typical situation. For example, the third party may have the right to be indemnified by a contracting party against specific types of claim for which the third party is found liable. If a dispute arises in connection with that indemnity (and the main contract requires contractual disputes, including disputes about the undertaking in the third party's favour, to be submitted to arbitration) then the third party must submit the dispute to arbitration if it wishes to pursue it. Alternatively, if a contracting party raises a court action against the third party in respect of such a dispute, the latter may seek a stay of the legal proceedings. The basis of the third party's ability either to submit to arbitration or to seek a stay is found in subsection (1), by which the third party is to be regarded, in relation to that dispute, to be a party to the arbitration agreement.

38. Subsection (3), by contrast, comprises the relatively rare type of dispute which is not about a third-party right arising from an undertaking in the contract but rather about an independent right i.e. a right created outwith the bounds of the contract. The contracting parties may have provided in their contract that disputes about certain such free-standing rights may be resolved by arbitration. By way of example, a construction contract which envisages the appointment of sub-contractors (i.e. third parties) may specify that certain non-contractual claims involving a third party, such as those arising under delict, can be submitted to arbitration. (It may be that, in addition, the subcontractors are given substantive third party rights under the contract, in which case any disputes about such rights will fall under subsection (2).) In this situation, a delictual dispute involving the third party will fall under subsection (3), which gives the third party the option (but not the obligation) of submitting the dispute to arbitration or seeking a stay in respect of a court action raised against it.

39. Subsections (4) and (5) are interpretation provisions. The former is to be read with subsection (3)(d)(i), and the latter serves to tie section 9 in with the scheme and language of the Arbitration (Scotland) Act 2010.

D&B Comment: – the drafting incorporates the flaws outlined in the Faculty of Advocates' earlier submission with which we respectfully agree.

Hew R Dundas
Chartered Arbitrator, FClArb, DipICArb
International Arbitrator, Mediator & Expert Determiner
Co-Authors of the definitive text "Dundas & Bartos on the Arbitration (Scotland) Act 2010"

David Bartos FClArb
Advocate