Chapter 2
The History, Importance and Modern Use of Arbitration

2.1 The History of Arbitration

Once men begin to live and trade together, inevitably various forms of adjudication emerge. It follows from the above that the submission of disputes to independent adjudication is a form of ordering human society as old as society itself.

Why did arbitration develop as a means of alternative dispute resolution? In order to answer this question, one needs look at the history of arbitration.

2.1.1 England

In England merchants have resorted to adjudication outside the Royal Courts from the first development of national and international trade. Already in the later middle ages, a solid connection between finance and commerce existed. Commercial transactions were commonly done on credit terms, such as bills of exchange, widely accepted at the seasonal fairs which brought together the trading community and provided the basis of this credit system. The character of the Royal Courts was not adapted initially to serve the needs of this trade and traders, firstly because the early courts were primarily interested in disputes over land and conduct detrimental to the King’s peace, secondly because contracts, commercial credits and debts incurred abroad and owed by and to foreigners were almost wholly unenforceable, thirdly because the traditional court procedure lacked the much needed expedition that merchants, passing from fair to fair and so often changing jurisdiction, needed and fourthly because jurisdiction was ousted by the necessity of proving venue in England. Thus, the trading communities relied on special tribunals, i.e. the Courts of the Boroughs, of the Fair and of the Staple, in order to solve the controversies arising in the world of local and international trade. These courts were the predecessors of today’s modern arbitral tribunals in that a predominant feature of their character was that law should be speedily administered in commercial causes, which
in effect led also to a relaxation of the strict procedure in these Courts, and in that, according also to the nature of the dispute, commercial men were also elected to form part of the tribunal. Thus, the Middle Ages saw a diverse system of tribunals dealing with commercial disputes, where it was already acknowledged that people with special knowledge to the related trade would be on some disputes better assessors to arbitrate on it and that the settlement of the commercial cases should be speedy.

Following the discovery of the New World, the international society of the Middle Ages dissolved into nation states and, in this new age, men of commerce begun to look for new institutions to refer their disputes. However, although the habit for arbitration and the desire for its use continued to exist, nevertheless the adjudication of commercial disputes were not anymore exclusively reserved to it for reasons such as the fact that the common law courts developed by the mid-sixteenth century a general remedy in contract and thus gave themselves also jurisdiction over causes involving foreign elements by recognising a notional venue in England, and because at the same time the Admiralty court expanded a jurisdiction over cases in which a foreign merchant was a party. However, the assertion by the traditional courts of a role in the settlement of business disputes was not entirely to the liking of the commercial community, who liked the idea of tribunals in which they also had some share, not least because the predominant notion was that lawyers did not understand commercial problems as well as the notion that the technical and time-consuming character of litigation did not accord with their desire for speed in the resolution of their disputes. In effect, a solution was found in that charters were drafted which tended to incorporate the privilege for company merchants to settle potential disputes between themselves.\(^1\) By the eighteenth century arbitration was solidly entrenched as a means of alternative dispute resolution within which judicial intervention now extensively occurs because of the natural desire of the courts to keep all adjudications within their sphere, or the fear of the growth of a new system of law, but most importantly due to the fact that litigants in arbitrations needed the assistance of the courts who in turn exacted a price for the assistance offered.\(^2\)

In the nineteenth century comes the final fruition in the growth of satisfactory judicial and arbitral modes of resolving commercial disputes. The zenith of the work of absorption and growth which transmuted the practice of commerce into an effective part of the ordinary law and brought the commercial arbitral tribunal under the control of the ordinary courts, is the Common Law Procedure Act 1854 via which, for the first time, the courts were given the power to stay proceedings whenever a person, having agreed that a person’s dispute should be referred to arbitration, nevertheless commenced an action in respect of the matters referred. Secondly, statutory provisions as to the appointment of arbitrators and umpires were formulated to solve difficulties arising on default and, thirdly, the courts were given power to remit an award back to the arbitrator, who was able to state a question of law for the determination of the court.

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Commercial arbitrations were made subject to a systematic code of law by the Arbitration Act 1889 which amended and consolidated all previous practices. Since 1900, the general position has been that a commercial dispute can be speedily and efficiently determined in the courts as well as by arbitration, depending on its nature and what common practice in the particular sector requires, and that the two systems ought indeed to be properly regarded as coordinate rather than rival.3

The Arbitration Acts 1950, 1975, 1979 and 1996 all encapsulate the need for party autonomy as opposed to the previous tradition of judicial intervention. More specifically, the Arbitration Act 1979 was the first legislative instrument to abolish the long-established case stated procedure, whereby the courts were free to review an award if an error of law or fact appeared on the face of the award, and in its place established a structure under which errors of fact could not be the subject of an appeal and errors of law could be appealed only under stringent conditions. The Arbitration Act 1996 is a combination of consolidation and reform of the legal principles enshrined in the previous Arbitration Acts and the common law. It is the closest thing to a definitive code of arbitration law which has ever been enacted in England, although both the common law and decisions on earlier legislation still remain significant, not least as a guide to the interpretation of its provisions. It has managed to move English law far closer to the UNCITRAL Model Law than it was originally anticipated to do.4

2.1.2 USA

In the USA, already from the time of the American colonies, arbitration among merchants was common, since it proved more efficient and effective than the courts during that period. The first US president George Washington himself also served as an arbiter of private disputes before the Revolution.5 However, in the late nineteenth and early twentieth centuries, arbitration enjoyed a not particularly favourable position, as there was some mistrust by the legal establishment on arbitration’s capacity to produce fair results. Moreover it was feared that arbitration, if it proved too successful, could jeopardise the livelihood of all those who relied on the court system. Nowadays the scenery is totally different and arbitration is embraced as a viable alternative to litigating disputes. The tide of hostility towards arbitration began to turn in America with the enactment of modern state and federal arbitration acts and the creation of the American Arbitration Association. In 1920, New York reformed its arbitration law so as to enforce agreements to arbitrate future disputes. The American Bar Association in 1921 developed a draft of a Federal Arbitration Act patterned on the then-existing New York law. The American Bar Association draft was introduced in Congress the

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3Lord Parker of Waddington (1959, pp. 18–24).
4Merkin (2000, pp. 1–10).
5Folberg et al. (2005, p. 454).
following year and, with minor revisions, became law in 1925. During the same
decade the American Arbitration Association was also instrumental in advancing
arbitration, as it sought to promote the arbitral process – via the development of
uniform rules – and it also secured qualified individuals to act as arbitrators.
However, there was still some negativity towards state level arbitration which
was eradicated by the late twentieth century via the adoption of arbitration statutes
in all 50 states, as well as by broad federal court jurisdictional interpretations of
“interstate commerce” under the Federal Arbitration Act.6

2.1.3 France

In France, arbitration always played an important role. Already from the sixteenth
century, the Decree of the Moulins of 1566 made arbitration the sole and obligatory
means of dispute resolution for commercial disputes. Not least, there was in
France a notable mistrust of the capacity of the state’s courts to resolve such
disputes with the same effectiveness as arbitration. This trend is reflected in
article 1 of the Decree of 16–24 August 1790 which stated that arbitration was
to be considered the most reasonable means of dispute resolution between citi-
zens.7 In the nineteenth century arbitration in France declined and only really
revived in the 1960s. The establishment of institutions such as the Chambre de
Commerce Internationale (CCI) was important in this development. In the modern
era, the French law of arbitration is characterised by the existence of both a
domestic and an international procedural system, with domestic arbitrations being
regulated by Titles I–IV of Part IV (articles 1442–1491) of the Civil Code and
with international arbitrations being regulated by Titles V–VI of Part IV (articles
1492–1507) of the Civil Code.8

2.1.4 Germany

In Germany arbitration was from early on practised and recognised as an effective
means of alternative dispute resolution. Prior to the enactment of the German
Arbitration Act 1998, the law was considered anachronistic. The German Arbitra-
tion Act 1998, which came into force on 1 January 1998, was therefore adopted
to better facilitate domestic and international arbitration proceedings in Germany.
It is codified in the German Code of Civil Procedure (Zivilprozessordnung or
ZPO) §§ 1025–1066 and applies on all agreements to arbitrate concluded on or
after 1 January 1998. The German Arbitration Act 1998 was modelled after the

7Guyon (1995, pp. 7–8).
8Devolvé (1982).
UNCITRAL Model Law on International Commercial Arbitration in order to create an arbitration-friendly jurisdiction that would be also attractive to foreign practitioners. The rationale of the German legislation was to favour the creation of a legal structure that would be familiar to the arbitration community as an already accepted international standard.9

2.2 The Importance and Modern Use of Arbitration

In explaining the growth and modern use of arbitration, one need take into account factors such as the desire for secrecy, the attraction of moving to a custom of using industry experts as arbitrators rather than traditional state court judges and therefore also more flexible procedures, the option of selecting trade norms as the rules of decision10 and the economy, speed, secrecy and certainty of the process, as well as the ability given to parties to settle a dispute whilst maintaining business relations.11

2.2.1 The Eminence of Arbitration Over Other Means of Alternative Dispute Resolution

2.2.1.1 In General

Given the increasing importance of arbitration as an alternative to costly litigation, it is critical to understand the role that arbitration plays in encouraging self-negotiated settlements in different settings12 and the reasons why it is more effective, especially in an international commercial context as opposed to other widely used means of alternative dispute resolution, such as mediation and Med-Arb.

Mediation constitutes a process of assisted negotiation in which a neutral person helps the parties to reach agreement. It differs from arbitration in that it is rather more consensual and does not always lead to a final settlement of the dispute. It is cheaper than arbitration and assists the parties to find their own solution to the dispute. Even if no final solution is found it may help them to decide the best further steps for the resolution of the dispute. Although litigants may in some circumstances be compelled to enter mediation – or at least be put under heavy pressure to do so – it is only effective and successful to the extent that disputants find it effective. All the above, and other factors such as the fact that this means of alternative dispute resolution does not fit cases where a disputant is not capable

9Rützel et al. (2005, p. 110).
10Brunet et al. (2006, p. 25).
11Bonn (1972, p. 257).
of negotiating, or feels the need to establish a legal precedent, or requires a court order to control the conduct of an adversary, have resulted in arbitration being more popular and more often chosen and used as a means of alternative dispute resolution.

In the case of Med-Arb, which is an interim form of alternative dispute resolution in that it entails features from both arbitration and mediation, parties may choose, and arbitral institutions may offer, it in order to resolve contractual disputes. In some cases having a single neutral person serving in both the role of arbitrator and mediator saves time and money and may encourage parties to resolve their dispute at the mediation stage, because they know that their mediator will finally render a final and binding decision if disputes are not settled at the mediation stage. Nevertheless, this form of alternative dispute resolution has not evolved and is not used as much as arbitration. There is hostility towards the mixing of the roles of arbitrator and mediator for many reasons. Firstly, the roles are considered distinct and incompatible. Secondly and in contrast with what is used as an argument in favour of Med-Arb, parties may be less candid in communicating with the mediator and, thus, undermine a vivid feature of mediation, if they know that their mediator will in any case decide the dispute should mediation fail. Thirdly, the possibility that the mediator-turned-arbitrator’s view of the issues concerned may have been affected by information imparted confidentially in ex parte discussions, is also a negative factor that may deter the use of this form of alternative dispute resolution. Fourthly, a negative factor that may deter the use of this form of alternative dispute resolution is the fact that many mediators have little or no experience conducting an arbitration hearing and may not be competent to take on the other role. Lastly, there is also the chance, unless there is an express waiver of such a right, for the arbitral award to be challenged on grounds of ex parte communication at the mediation stage.

2.2.1.2 In Relation to Confidentiality

Confidentiality is vital to mediation because effective mediation requires a certain level of candour, secondly because fairness to the disputants requires its preservation, thirdly because it constitutes one of the incentives for choosing to mediate, fourthly because it helps preserve the process and character of mediation as a means of alternative dispute resolution and finally because it helps the preservation of neutrality of the mediator, especially if the latter is involved in a subsequent legal proceeding. However, the preservation of confidentiality in mediation has, for many reasons, proved problematic. Firstly, because the most usual means of protecting it

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14See Township of Aberdeen v Patrolmen’s Benevolent Association, 669 A.2d 291 (N.J.S. Ct., App. Div. 1996) where the arbitral award rendered was struck down by the Court on the basis that the arbitrator had improperly relied on information gained during the course of mediation and not presented during the arbitration process; Folberg et al. (2005, pp. 643–646).
is via a rule of evidence which nonetheless does not always extend this level of protection to all aspects and facets of mediation but is only a valid means of mandatory protection of confidentiality mostly in relation to state courts proceedings. Secondly, because confidentiality is often only impliedly protected or, even where it is protected via a confidentiality provision, still the extent of this protection remains vague and even where confidentiality rules are contained in statutes in the form of legal privileges, the form of such privileges and the subsequent protection of confidentiality under them may differ. Thirdly, even if there are mediation agreements covering confidentiality these bind only the parties entering those agreements and not third-parties that may enter the process of mediation. Fourthly, public policy issues may detect the lifting of the veil of confidentiality. Likewise, the protection of confidentiality may also prove problematic in the case of Med-Arb, for all the above stated reasons, as well as because of the possibility of having ex parte communication at the mediation stage which, as stated above, may put the whole Med-Arb process at stake as the arbitral award can be challenged on such a ground.

2.3 Tentative Observations

It is generally thought that an expectation of confidentiality on the part of participants is critical to the successful conduct of a mediation or Med-Arb process and, as already stated above, candour by the parties can be crucial to a successful mediation or Med-Arb process. Despite its important role, the issue of confidentiality in mediation, which continues to be a hotly debated topic in the courts and among academia, remains still wide open, considering the difficulties of precisely defining such a rule together with all the possible legitimate exceptions and the fact that its protection may depend on several and variable parameters such as the terms of the mediation agreement, the applicable institutional rules, the law governing the mediation agreement, the nature of the information to be disclosed, the extent of allowance of such disclosure and the factors determining the extent of protection of confidentiality even in cases where the latter exists.

However, in contrast to the above, and irrespective of the fact that no final formulation of the confidentiality obligation can be found in case law, it is generally recognised that there is, at least in common law, an enforceable and implied duty of confidentiality arising out of the nature of arbitration whereby the arbitral proceeding must be privately conducted and subject to the duty of confidentiality.

For all the above reasons, we support the argument that arbitration is a much more preferred and widely used means of alternative dispute resolution.

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