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The Applicable Law in International Arbitration Under the New English Arbitration Act 1996

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I. INTRODUCTION

FOR OVER the past 50 years there has been a discernible movement both in public and private international law away from dependence on states. The multiplication of accredited actors in international law and recognized sources of international norms, the increasing autonomy of international law *vis-à-vis* its authors, together with the diminishing importance of sovereignty and a new appreciation of legal pluralism broadening nationalist definitions of what counts as 'law', all mark the decline of the role of the state. This modern trend has been evident in international commercial arbitration where legal phenomena such as the evolution of a new *lex mercatoria*, the use of principles of general application derived from techniques of comparative law, delocalization and the growing recognition of the specificity of international transactions as distinct from purely domestic contracts, can be seen as responses to the limitations of statist conceptions of the definition, sources and interpretation of law in the resolution of international disputes.

Following these developments, the new English Arbitration Act 1996 freed commercial parties from national constraints of procedural law with the result that fundamental English rules no longer necessarily apply in arbitral proceedings in England: discovery, hearsay, parol evidence and rules excluding evidence of pre-contractual negotiations. All the more so in international proceedings involving parties from different legal cultures. The object of these reforms has been, of course, in the words of Lord Saville, 'to reflect generally accepted international views on the proper conduct of the arbitral process'.[1] The new law affords a very high degree of accommodation to the parties' choice of institutional or foreign procedural rules. Apart from a few mandatory

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1 Lord Saville 'The Arbitration Act 1996 and its Effect on International Arbitration in England,' unpublished paper (1996).

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provisions,[2] parties are free to exclude large parts of the Arbitration Act itself in order to adopt procedures they are more familiar with, or which they believe are best suited to the particular circumstances of their dispute. Arbitrators likewise enjoy broad powers to fashion rules of procedure where the parties fail to agree.

II. THE PRESUMPTION IN FAVOUR OF STATE LAW

In its approach to the law applicable to the merits of a dispute, however, the English Arbitration Act 1996 remains resolutely statist.[3] The provisions on applicable law, set out at section 46 of the Act, contain a number of significant departures from the corresponding Article 28 of the UNCITRAL Model Law. A major feature of section 46 is the presupposition that choice of law, either by the parties or the arbitrators, is necessarily a reference to the law of a given state. In both cases, stress is on national law through use of the conventional expression 'the law'. In contrast, Article 28(1) of the Model Law refers to 'rules of law' which parties are free to choose. The expression 'rules of law' is understood to have a much broader connotation than the more traditional reference to 'law'. It encompasses rules developed outside national legal systems, often specifically for international transactions or dispute resolution. It includes principles embodied in a convention or similar legal text elaborated at international level even if not yet in force: custom, trade usages, the rules of business associations, codes of conduct, general principles of law, *lex mercatoria* or rules of law and practice recognized and developed by international arbitral tribunals.[4]

With respect to the determination of a governing law by arbitrators, in the absence of any choice by the parties, the Model Law reverts to the traditional expression 'the law' (Art. 28(2)).[5] The English Act strictly follows the Model Law in this regard and section 46(3) requires arbitrators to apply 'the law' which is 'determined by the conflict of laws rules' the tribunal 'considers applicable'. This wording considerably narrows the arbitrator's field of reference. While arbitrators

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2 These concern essentially the powers of the court to intervene to assist an arbitral process, the general duties and obligations of the arbitral tribunal and the parties and provisions on enforcement.

3 *See*, for example, the comments by Claude Reymond 'L'Arbitration Act 1996: convergence et originalité', (1997) *Rev. de l'Arb.*, 1 at p. 63.

4 H. M. Holtzmann and J. E. Neuhaus *A Guide to the UNCITRAL Model Law on International Commercial Arbitration: Legislative History and Commentary* (The Hague, Kluwer Law and Taxation 1989) at pp. 764–807; A. Redfern and M. Hunter *International Commercial Arbitration* (London, Sweet & Maxwell 1991) at p. 121. *See* also the *Explanatory Note* by the UNCITRAL Secretariat on the Model Law on International Commercial Arbitration at para. 35.

5 The change was intentional. It was felt at the time of drafting the Model Law that the arbitrators' power to determine the applicable law should not be as extensive as that of the parties under Article 28(1) without the parties' express agreement. See the comments by Holtzmann and Neuhaus *op. cit.* at p. 770. Dr Gerold Hermann has explained that 'UNCITRAL was evenly divided on this issue and one of the main reasons given in support of the more cautious or conservative approach embodied in the Model Law was that the liberal solution seemed unlikely to be accepted by many states'. Cf. G. Hermann, 'The British Columbia Enactment of the UNCITRAL Model Law', in *UNCITRAL Arbitration Model in Canada*, ed. R. Paterson and B. Thompson (Toronto, Carswell 1987), at p. 72.

will not be bound by English conflict of laws rules, they must still first conduct a conflict of laws analysis and, by implication, determine whose conflict rules apply. The Act has thus not opted for the 'direct method' which allows arbitrators to bypass national conflict of laws rules and apply either national law, anational rules of law or a combination of both. The arbitral tribunal has not, for example, been empowered to apply the law or the rules of law it considers 'appropriate'. The restrictive wording of section 46(3) is thus one indication that an arbitral tribunal sitting in London may not determine applicable law independently of national conflict rules.[6] Section 46 embodies a classic approach to conflict of laws, one designed to lead almost invariably to the choice of a national law.

While it might appear that the arbitral tribunal does not have the same freedom of choice as the parties under the Model Law, the practical result is somewhat attenuated since Article 28 specifically names another source of rules applicable to an international contractual relationship: 'trade usages' (Art. 28(4)). These must be applied by the arbitral tribunal 'in all cases', *i.e.* whether the applicable law is determined by the parties or the arbitrators. This requirement can operate, in effect, to free the arbitral tribunal from exclusive reference to a single domestic law. Different rules can be applied because 'trade usages' constitute a legal category that has been given an increasingly broad interpretation in international arbitral case law. It extends beyond technical standards and rules to include *lex mercatoria*, principles of law common to diverse legal systems and customary rules of international transactions.[7] Trade usages are all the more important a source of norms in international commercial relations where practices and expectations often differ from those encountered in a purely domestic context, but where the law is still fragmentary. Even from a secure

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[6] *See* the comments by Holtzmann and Neuhaus *op. cit.* at p. 770, footnote 36. V. V. Veeder has suggested that section 46(3) *'semble dire que l'arbitre anglais est libéré du devoir d'appliquer les règles de conflit anglaises auxquelles est soumis le juge étatique'*, although this observation is consistent with an obligation on the arbitrator to apply the national conflict rules of some other state in place of English rules. Cf. V. V. Veeder 'La nouvelle loi anglaise sur l'arbitrage de 1996: la naissance d'un magnifique éléphant', (1997) 1 *Rev. de l'Arb.* at p. 24. Veeder's views are confirmed by the editors of *Dicey & Morris The Conflict of Laws* (4th Cum. Supp. to the 12th ed.) (London, Sweet & Maxwell 1997) at p. 102.

[7] *See* P. Fouchard, E. Gaillard and B. Goldman *Traité de l'arbitrage commercial international* Paris, Editions Litec 1996) at pp. 856–858. It should be noted that these authors are critical of the broad extension of 'usages' on the grounds that the expression, as it is used in Article 1496 of the French Code of Civil Procedure and Article VII(1) of the Geneva Convention of 1961 on International Arbitration which inspired it, could not have been intended by the drafters to have had the extended meaning in view of the early date at which both of these texts first appeared. However, *see* as well their comments at p. 819 with respect to the acquired meaning of trade usages. *See* also L. Craig, W. Park and J. Paulsson *International Chamber of Commerce Arbitration* (Paris, ICC Publishing 1990) at pp. 293–300. Note that one well known opponent of *lex mercatoria*, F. A. Mann, appears, although perhaps unwittingly, to have subscribed to a broad definition of 'trade usages' acknowledging that they may contain 'rules of conduct of variable, yet for the time being definite content' (F.A. Mann, '"Delocalised" Contracts and Arbitration', in (1984) 33 ICLQ at p. 196). For a recent and thorough study of the question, *see* in particular R. Goode 'Usage and its Reception in Transnational Commercial Law', in (1997) 46 ICLQ at p. 1; and G. Aksen 'The Law Applicable in International Arbitration – Relevance of Reference to Trade Usages', in *Planning Efficient Arbitration Proceedings and the Law Applicable in International Arbitration* (ed. A. J. van den Berg) (ICCA Congress series no. 7) (The Hague, Kluwer Law International 1996) at p. 471.

statist perspective, Alan Redfern and Martin Hunter have ventured the view that such usages are, indeed, a form of customary international law which may be developed outside the state by arbitral practice:

> Such uniform rules only apply within the ambit of a national system of law; but if the same rules are uniformly applied by many different national courts, *or by arbitral tribunals*, the basis is laid for the establishment of a customary law which has been created by merchants and traders themselves (rather than by lawyers) and which has achieved international importance.[8] (emphasis added)

The persistence of the statist conception of law in the new English Arbitration Act is perhaps most evident in the reference to 'trade usages' in section 46. There is likewise no explicit reference in the English Act, as there is in the Model Law, to decisions made by arbitrators, acting as *amiables compositeurs*, or to decisions *ex aequo et bono*. Section 46 does not prohibit parties from resolving disputes in accordance with alternatives to a municipal law, however, these are relegated to an inferior status. Significantly, trade usages, *amiable composition* and *ex aequo et bono* decisions are referred to not by their proper names, or even under English equivalents, but collectively as 'other considerations'. Clearly, under the Arbitration Act 1996 there are two legal categories only: law, understood as a national law, and a residual category, non-law. The Act shuts out autonomist views of transnational commercial law as 'law'.

III. THE REJECTION OF TRANSNATIONAL RULES OF LAW

The valorization of state law is further apparent from its default application status under the 1996 Act. State-created law can apply, regardless of whether or not the parties ever really intended it to apply, because arbitrators are bound to choose a 'law' in accordance with applicable conflict rules where the parties fail to make the choice.[9] Anational rules may still be applied, but not on their own as law and only, it appears, if the parties expressly agree. This ensures that the application of transnational rules will not result from any inherent *vocation*, but only by way of party autonomy and state licence. In England, an express choice by the parties of *lex mercatoria* will be given effect, but will not be viewed under the new

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[8] Redfern and Hunter *op. cit.*, pp. 120–121. Professor Roy Goode has pointed out that Redfern and Hunter indicated at p. 90 of the first edition (1986) of their textbook that 'There *is* evidence of a unified international standard in the practice of many forms of commerce'. R. Goode 'The Adaptation of English Law to International Commercial Arbitration', in (1992) 8 *Arbitration International* 1 at p. 13.

[9] The presumption is exactly the opposite for international organisations who transact with private parties. In such cases, no national system of law will apply unless one has been specifically provided for by the parties and failure to choose an applicable law is construed as a deliberate exclusion of any particular system of national law in favour of general principles of law and international law. The Resolution on Transnational Rules adopted by the 1992 ILA Cairo Conference should be noted as well. It provides that where the parties remain silent concerning the applicable law, 'the fact that an international arbitrator has based an award on transnational rules (general principles of law, principles common to several jurisdictions, international law, usages of trade, etc.) rather than on the law of a particular State should not in itself affect the validity of or enforceability of an award'. The ILA Resolution is published in *Transnational Rules in International Commercial Arbitration* (ICC publication No. 480/4, 1993) p. 36.

Arbitration Act as choice of an applicable law and it would appear that any implied choice by the parties of *lex mercatoria* as the applicable law, either alone or in addition to a designated municipal law, cannot be given effect.

The idea that international transactions are distinct from domestic contracts and may be governed by specific substantive rules evolved at the international level is thus firmly rejected by the new Act which rests on a notion of the primacy of national law. The legislative history of section 46 confirms this view. The Departmental Advisory Committee (DAC) explained, for example, that it did not direct tribunals to take trade usages into account because the provision is not necessary where the applicable law already allows this, whereas 'if it does not, then it could be said that such a direction overrides that law, which to our minds would be incorrect'.[10] The DAC also noted that by agreeing that their dispute be resolved according to other considerations, *ex aequo et bono* or by arbitrators empowered to decide as *amiables compositeurs*, 'the parties are in effect excluding any right to appeal to the Court (there being no "question of law" to appeal)'.[11] Many other jurisdictions, when adopting the Model Law, also amended Article 28, not to restrict its broad conception of law, but to extend the expression 'rules of law' to the province of the arbitrators, as well as the parties, and to permit arbitrators to apply the law they consider 'appropriate' inde-pendently of national conflict rules where the parties have been silent on the question. This is in keeping with current international arbitral practice. The DAC Report explains its decision to retain the traditional expression 'law' rather than 'rules of law' - where there is no choice of law by the parties - as follows:

> In such circumstances the tribunal must decide what conflicts of law rules are applicable, and use those rules in order to determine the applicable law. It cannot simply make up rules for this purpose.[12]

The DAC's position represents an underlying current of English jurisprudence and case law which is hostile to legal pluralism and legal norms which arise outside of the state or state institutions. *Czarnikow* v. *Roth Schmidt and Co.* provides an excellent illustration of this unitary conception which has strongly influenced the development of English arbitration law.[13] The court in that well-known case struck

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[10] Departmental Advisory Committee on Arbitration Law, Report on the Arbitration Bill, February 1996 (hereinafter the DAC Report) p. 49 at para 222.

[11] *Ibid.*, p. 49 at para 223. The DAC's position overlooks the fact that arbitrators who have received authority to act as *amiables compositeurs* are not necessarily precluded from applying the letter of a national law or transnational rules (*See* Fouchard, Gaillard and Goldman *op. cit.* at pp. 958-959). Article 1482 of the French Code of Civil Procedure allows parties expressly to reserve the right to appeal from an award rendered by arbitrators empowered to act as *amiables compositeurs.*

[12] *Ibid.*, p. 50 at para 225.

[13] The 1978 Commercial Court Committee Report on Arbitration (hereinafter the Donaldson Report) considered the *Czarnikow* decision to be one of fundamental importance. The Committee Chairman, Mr Justice Donaldson, affirmed at para. 14 of the Report, that it was 'a decision of such importance that relevant extracts from the judgments are reproduced at Appendix 2. As will be seen, it was based upon the considerations of public policy that there should, in principle, be no sphere of national activity in which the King's writ did not run, that there should be but one system of law...'.

down a provision of the arbitration rules of the Refined Sugar Association which purported to exclude recourse to the courts on questions of law. In setting out the reasons for the court's decision, Lord Justice Bankes echoes the reasoning contained in the DAC Report:

> Among commercial men what are commonly called commercial arbitrations are undoubtedly and deservedly popular. That they will continue their present popularity I entertain no doubt, so long as the law retains sufficient hold over them to prevent and redress any injustice on the part of the arbitrator and to secure that *the law that is administered by an arbitrator is in substance the law of the land and not some home-made law of the particular arbitrator or the particular association.* To release real and effective control over commercial arbitrations is to allow the arbitrators, or the Arbitration Tribunal, to be a law unto himself, or themselves, to give him or them a free hand to decide according to law or not to law as he or they think fit, in other words to be outside the law. ... At present no individual or association is, so far as I am aware, outside the law except a trade union.[14] (emphasis added)

Lord Justice Scrutton explained that the case stated procedure was based on the court's opposition to legal pluralism:

> ... the courts may require [arbitrators], even if unwilling, to state cases for the opinion of the court on the application of a party to the arbitration if the courts think it proper. This is done in order that the courts may ensure the proper administration of the law by inferior tribunals. In my view to allow English citizens to agree to exclude this safeguard for the administration of the law is contrary to public policy. There must be no Alsatia in England where the King's writ does not run ...[15]

The clearest perhaps was Lord Justice Atkin who expressed the court's opposition to the autonomous formulation of legal norms by underlining the potential undesirable consequences in accordance with a logic which still operates today in section 69 of the 1996 Act:

> This appears to me to be a provision of paramount importance in the interests of the public. The jurisdiction that is ousted in this case is not the jurisdiction of the courts to give a remedy for breaches of contract, but the special statutory jurisdiction of the court to intervene to compel arbitrators to submit a point of law for determination by the courts. If it did not exist arbitration clauses making an award a condition precedent would leave lay arbitrators at liberty to adopt any principles of law they pleased ... the result might be that in time codes of law would come to be administered in various trades differing substantially from the English mercantile law.[16]

Autonomous sources of legal norms have been generally unwelcome in English arbitration law. They are naturally a challenge to the competence of state systems to control and resolve disputes.[17] An important jurisprudential postulate is also at issue. The theoretical origin of *lex mercatoria*, trade usages and general principles is not a familiar or accepted source. It runs contrary to positivist views which

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[14] [1922] 2 KB 478 at p. 484.
[15] *Ibid.*, at p. 488.
[16] *Ibid.*, at p. 491.
[17] A recurrent theme of the opposition to *lex mercatoria* is that the advent of modern and complex state systems means that it is now superfluous. See Mustill & Boyd *The Law and Practice of Commercial Arbitration in England* (London, Butterworths 1989) at p. 81.

closely associate law with the state and which dominate legal thinking in common law jurisdictions. Indeed, the essence of much criticism of *lex mercatoria* and other transnational normative structures as distinct bodies of law is the lack of resemblance to state legal systems invariably presented as having superseded other forms of law.[18] A further underlying assumption implicit in such thinking is that normative structures all share the same fundamental attributes. Positivism, moreover, is analytically inadequate to account for non-statist legal phenomena, and might even be said to be specifically constructed not to account for it. *Lex mercatoria*, theories of anational legal norms and the spontaneous development of international law from the parties' expectations in international practice and transactions are more closely connected to pre-positivist theories of natural law and civil law conceptions of subjective rights which have no directly corresponding category in common law.[19]

IV. INTERNATIONAL TRENDS

(a) Domestic Arbitration Laws

The question arises as to whether the English approach to applicable law is out of step with modern trends: a legitimate enquiry considering that the stated objective of the Act is to conform to accepted international views on arbitration.[20] Looking abroad, one finds that the expression 'rules of law' is used in several municipal legal systems, including common law jurisdictions, which have ventured beyond Article 28 of the Model Law by allowing both parties and arbitrators to determine applicable 'rules of law' and by freeing arbitrators to

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[18] The comparisons are invariably made with modern European or European-inspired state systems. *See* Mustill & Boyd (1989) *op. cit.* pp. 80–82. *See* Lord Mustill 'The New *Lex Mercatoria*: The First Twenty-five Years' in (1988) 4 *Arbitration International* 2 at p. 86.

[19] On the question of whether or not common law recognizes or contains a notion similar to *le droit subjectif* or *das Subjektives Recht*, see R. David, 'Les caractères originaux de la pensée juridique anglaise et américaine', (1970) 25 *Archives de philosophie du droit*, at p. 1; F. H. Lawson, '*"Das Subjektives Recht"* in the English law of Torts', Selected Essays (vol. 1, North-Holland 1977) at p. 76; G. Samuel '*"Le Droit Subjectif"* and English Law', in (1987) 46 *Cambridge Law Journal* 2 at p. 264; and S. Shackleton 'La pensée juridique de Michel Villey dans le monde anglophone', in *Michel Villey et le droit naturel en question* (eds. J-F. Niort and G. Vannier) (Paris, L'Harmattan 1994) at p. 105.

[20] Paragraph 109 of the Mustill Report recommended reforms to English arbitration law so that it would '[remain] in the vanguard of the various systems currently enjoying the preference of regular international users'. It should be noted that an initial draft of Article 28 of the Model Law which, like the 1996 English Act, contained no reference to 'trade usages' and limited the arbitrators' choice to a single national law was, as early as 1984, severely criticized for being 'a definite regression in relation to international arbitral practice', and for being 'objectionable in ... its exclusive reference to the 'conflictual' method, in contradistinction to the *pluralisme des méthodes* generally accepted by the modern science of private international law [and] ... by its rigid character, in sharp contrast to the variety of approaches and the flexibility displayed for many years by modern arbitration practice.' Cf. the summary of ICCA discussions by Pierre Lalive in *UNCITRAL's Project for A Model Law on International Commercial Arbitration* (ed. P. Sanders) (ICCA Congress Series No. 2) (The Hague, Kluwer 1984) at pp. 192–3.

apply the 'direct method' for choice of law. A recent example is section 28(b)(iii) of the Indian Arbitration and Conciliation Act 1996. It departs from the Model Law to allow arbitrators to apply 'rules of law it considers appropriate given all the circumstances surrounding the dispute' where the parties have made no choice of law. While England is certainly not alone in preferring reference to a single national law,[21] most other civil[22] and common law[23] jurisdictions which have recently modified their arbitration laws or adopted the Model Law, have done so without any change to the parties' liberty to choose 'rules of law'. Many others, as India, extend the arbitral tribunal's recourse to 'rules of law' the tribunal considers 'appropriate'. In addition to India, these jurisdictions now include Algeria,[24] California,[25] the ten Canadian provinces,[26] Djibouti,[27] Florida,[28] France,[29] Lebanon,[30] Ohio,[31] Oregon,[32] the Netherlands,[33] Switzerland[34] and Tunisia.[35] One of the more interesting of these formulations is from

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[21] The Bulgarian arbitration law (Article 38(1)), like the English Act, modified Article 28(1) of the Model Law to restrict the parties' choice to a single 'law'. A few other recent reforms have opted for a primary reference to 'the law'. Colombia (Article 6) requires arbitrators to decide 'in law' unless the parties agree otherwise. Egypt (Article 39.2) requires the arbitral tribunal to 'apply the substantive rules of the law it considers most closely connected to the dispute'. Finland (Article 31) states that the 'arbitrators shall base their award on the law'. Portugal (Article 22) requires arbitrators to decide in 'accordance with law' unless the parties authorize a decision in equity. *See* the very useful comparative survey conducted by P. Sanders 'Unity and Diversity in the Adoption of the Model Law' in (1995) 11 *Arbitration International* 1 at p. 1 and equally that by Marc Blessing 'Regulations in Arbitration Rules on Choice of Law' in *Planning Efficient Arbitration Proceedings and the Law Applicable in International Arbitration* (ed. A. J. van den Berg) (ICCA Congress series no. 7) (The Hague, Kluwer Law International 1996) at p. 391.

[22] Cf., for example, the recent changes in Algeria, Egypt, Lebanon, Mexico, Peru, Russia, Scotland and the Ukraine. Article 73(1) of the Tunisian arbitration law refers to 'the law'. However, according to an interpretative footnote by the editors of the (1993) *Rev. de l'Arb.* 4 at p. 742, footnote 7, this should be read as 'rules of law'. The recent Italian and the new Brazilian arbitration laws use the expression 'rules of law' with respect to the law chosen by the parties.

[23] Australia, Bermuda, California, the common law provinces of Canada, Connecticut, Cyprus, Florida, Hong Kong, Kenya, New Zealand, Nigeria, North Carolina, Ohio, Oregon, Singapore, Texas and Zimbabwe.

[24] Article 458 bis/14.

[25] Section 1297.283.

[26] For example, Article 32(1) of the Ontario Act: 'In deciding a dispute, an arbitral tribunal shall apply the rules of law designated by the parties or, if none are designated, the rules of law it considers appropriate in the circumstances.' Article 28(3) of the Arbitration Act of British Columbia authorizes arbitrators, in the absence of choice of law by the parties, to apply 'the rules of law it considers appropriate given all the circumstances surrounding the dispute'.

[27] Article 12 of the Djibouti Code of International Arbitration.

[28] Florida (s. 684.17) refers to 'the law, including equitable principles which [the arbitral tribunal] determines should control'.

[29] Article 1496 of the French NCPC introduced in 1981 states that: *'L'arbitre tranche le litige conformément aux règles de droit que les parties ont choisies; à défaut d'un tel choix, conformément à celles qu'il estime appropriées.'*

[30] Article 813.

[31] Section 2712.53.

[32] Section 36.508.

[33] Article 1054 of the Netherlands Arbitration Act 1986.

[34] Article 187 of the Swiss Private International Law Act 1987.

[35] Article 73(2) appears to refer to 'the law it considers appropriate', however, cf. the interpretative observations of the editors of the (1993) *Rev. de l'Arb.*, 4 at p. 742, footnote 7.

the province of Quebec where no reference at all is made to the parties.[36] A draft arbitration law presently being considered in Japan refers only to 'rules of law'.[37] A recent exception to this general trend is the current German Draft Arbitration Law which does not allow the arbitrators to apply 'rules of law' in the absence of choice of law by the parties, but does authorize them to apply a 'closest connection' test albeit with reference to state law.[38] Such developments surely belie the dire consequences predicted for the development of *lex mercatoria* as a result of the original timid wording of Article 28(2) of the Model Law.[39]

(b) International Rules

International arbitral practice has likewise sought to broaden traditional conceptions of law by providing a theoretical foundation and institutional support for anational approaches to resolving international commercial disputes. Use of the expression 'rules of law' is now accepted practice in the codification of international law and is found in an increasing number of arbitration rules where it refers to a source of law available to both parties and arbitrators.[40] It continues

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[36] Article 944.10 of the Quebec Code of Civil Procedure provides that: '*Les arbitres tranchent le différend conformément aux règles de droit qu'ils estiment appropriées et, s'il y a lieu, déterminent les dommages-intérêts.*'

[37] An unofficial draft for the adoption of the UNCITRAL Model Law in Japan has been issued by a group of Japanese academics. In a fashion comparable to the Quebec provisions, Article 30 of this draft, 'Rules Applicable to the Substance of the Dispute', makes only secondary reference to the parties: it provides simply that:

> '(1) An arbitral award shall be based upon the rules of law.
> (2) Notwithstanding subsection (1), different rules shall apply when the parties have agreed upon the application of such rules.'

[38] Section 1051(2) of the draft German law provides that *'Haben die Partien die anzuwendenden Rechtsvorschriften nicht bestimmt, so hat das Schiedsgericht das Recht des Staates anzuwendenden, mit dem der Gegenstand des Verfahrens die engsten Verbindungen aufweist'*. This is a solution consistent with Article 4 of the Rome Convention. *See* also Article 1445 of the new Mexican law: *Art. 1445. – 'Le tribunal arbitral tranche le différend conformément aux règles de droit choisies par les parties.... A défaut de désignation par les parties de la loi applicable au fond du différend, le tribunal arbitral détermine quel est le droit applicable, en prenant en compte les caractéristiques et les points de rattachement du cas considéré.'* ((1994) *Rev. de l'Arb.* at pp. 413–414).

[39] See Lord Mustill *op. cit.* at p. 117:

> 'The conscious decision of those who framed the UNCITRAL Model Law to adopt the expression "the law determined by the conflict of laws rules which [the arbitral tribunal] considers applicable" in Article 28(2), in preference to looser words such as "the rules of law", must have been a great disappointment to mercatorists, and, if the Model Law is reproduced on any scale in national legislation, it will be a serious obstacle to the growth of the *lex*. It may also be sensed that the tide of economic opinion is hardly running in its favour.'

[40] Apart from Article 28 of the UNCITRAL Model Law, the expression is found notably in Article 42 of the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention): 'The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the contracting State, party to the dispute (including its rules of conflict of laws) and such rules of international law as may be applicable.' *See* also UNCITRAL Rule 33, LCIA Rule 13(1)(a), the 1998 ICC Rule 17, SIAC Rule 24.1(a), WIPO Rule 59, NAI Rule 46, CACNIQ Rule 46(a), SAT Rule 45, Milan Chamber Rule 41, the Vancouver BCICAC Rule 30; the new AAA Rule 28 and CAMCA Rule 30(1) which follows the Model Law to require arbitrators to apply the 'law' or 'laws' it considers applicable where the parties are silent. For an exception to the general trend, see Rule 26 of the newly formed Franco-Belgian and Luxembourg Court of Arbitration.

to gain ground. LCIA Rule 13(1)(a) refers to 'rules of law'.[41] ICC Rule 13(3) was revised this year to include reference to 'rules of law' in place of the former expressions, 'the law' and 'the law designated as the proper law'. Under the new ICC Rule 17, both parties and arbitrators may choose 'rules of law'. Reference in the former ICC Rule 13(3) to a 'rule of conflict' which the arbitrator 'deems appropriate' has likewise been deleted in favour of the '*voie directe*' approach.[42] The issue was the subject of discussion between the ICC National Committees and the ICC Working Party on the Revision of the Rules. When the German National Committee objected to a draft of Rule 17, on the grounds that it would permit the application of *lex mercatoria*, and proposed the adoption of the Model Law solution under which arbitrators may only apply 'rules of law' with the parties' express agreement, the Chair of the Working Party, Yves Derains, explained that the German position was 'a digression from arbitral practice' and that 'the arbitral tribunal should always be able to apply "rules of law" without this being formulated in such a way as to distinguish between "the law" and "rules of law" '.[43] In similar manner, former AAA Rule 29 was also modified this year to include the expression 'rules of law'. The new AAA Rule 28 now refers to the 'substantive law(s) or rules of law' chosen by the parties and provides that failing such designation, 'the tribunal shall apply such law(s) or rules of law as it determines to be appropriate'. The previous AAA Rule 29 referred only to 'the substantive law or laws...'.

(c) Trade Usages

The removal of any reference to trade usages in section 46 of the Arbitration Act 1996 can also be seen as resistance to international trends. French[44] and Dutch[45] legislation expressly refer to trade usages. Chinese law instructs the application of 'international practice' where 'there is no regulation'.[46] The draft German law

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[41] This provision remains unchanged in the proposed Article 19 of the revised LCIA Rules published as a 'discussion draft'. Cf. (1996) *LCIA Worldwide Arbitration Newsletter* 1, 2, at p. 17.

[42] The new ICC Rules were approved by the ICC Council meeting in Shanghai on 8 April 1997. They are set to come into force on 1 January 1998. The new ICC Rule 17, which closely follows WIPO Rule 59 with respect to the law applicable by the arbitrators in the absence of choice by the parties, reads as follows:

> Applicable rules of law
>
> (1) The parties shall be free to determine the rules of law to be applied by the Arbitral Tribunal to the merits of the dispute. In the absence of any agreement, the Arbitral Tribunal shall apply the rules of law which it determines to be appropriate.
>
> (2) In all cases, the Arbitral Tribunal shall take account of the provisions of the contract and of the relevant trade usages.
>
> (3) The Arbitral Tribunal shall assume the powers of an amiable compositeur or decide ex aequo et bono only if the parties have agreed to give it such powers.

[43] Meeting of the ICC International Commission on Arbitration on 3 December 1996, ICC Document no. 420/355, p. 8.

[44] Article 1492 of the French Code of Civil Procedure.

[45] Article 1054 of the Netherlands Arbitration Act.

[46] Foreign Economic Contract Law of the People's Republic of China adopted by the 10th Session of the 6th National People's Congress, 21 March 1985, Art. 5.

refers to trade usages.[47] Both civil and common law jurisdictions have adopted the term 'trade usages' contained in the Model Law without much controversy.[48] It is an expression that is increasingly popular in instruments and conventions for the codification of international law[49] as well as international arbitral rules.[50]

V. CONSEQUENCES FOR PRACTICE IN ENGLAND

There has been much discussion about the new and extensive powers of arbitrators under the new English Act. However, with respect to applicable law, arbitrator autonomy has not followed party autonomy. What are the practical consequences of the statist character of the English provisions? Beyond the question of outdated terminology, are there any real disadvantages to the formulation of section 46? Will it disincline arbitrators in England to apply *lex mercatoria* or other internationally accepted norms or usages that are not state-recognized unless specifically authorized to do so by the parties? Lord Mustill has provided one answer to this question:

> If the transaction is governed by an international agreement or a standard form of rules which require the arbitrator to choose the 'law' which he deems applicable to the substance of the dispute, is he thereby enabled to apply the *lex mercatoria* to the exclusion of any national law? ... I suggest that the answer must surely be no.[51]

The editors of *Dicey & Morris* have recently affirmed that the situation has not changed under the 1996 Act where 'there is ... no scope for the arbitrators to apply (in the absence of the agreement of the parties) the *lex mercatoria* or general principles of law'.[52]

Parties are free to opt out of large sections of the Arbitration Act, including section 46, and the answers given by Lord Mustill and the editors of *Dicey & Morris*, read in the context of a choice by the parties of the LCIA or the 1998

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[47] Article 1051(4).

[48] Pursuant to Article 28(4) of the Model Law, 'in all cases the arbitral tribunal *shall* take trade usages into account'. Compare with Article 33 of the Ontario law: 'The arbitral tribunal... may also take into account any applicable usages of trade.'

[49] *See* Article VIII(1) of the European Convention of 1961 on International Commercial Arbitration, Article 9(2) of the Vienna Convention of 1980 on the Sale of Goods. *See* also Article 10 of the Organisation of American States Inter-American Convention of 1994 on the Law Applicable to International Contracts which provides that 'In addition to the provisions in the foregoing articles, the guidelines, customs and principles of international commercial law as well as commercial usage and practices generally accepted shall apply in order to discharge the requirements of justice and equity in the particular case'. Recently the UNIDROIT Principles for International Commercial Contracts have accorded an important role to 'usages and practices' either established between parties or 'widely known' and 'regularly observed in international trade' (Article 1.8). Usages are also referred to at Article 4.3(e) and (f) of the UNIDROIT principles as criteria governing the interpretation of international contracts.

[50] UNCITRAL Arbitration Rule 33(3), ICC Rule 13.5, WIPO Rule 59, AAA Rule 28.2, NAI Rule 47, Moscow Chamber of Commerce and Industry Arbitration Rule 13, BCICAC Rule 30(5), DIS Rule 21.4.

[51] Lord Mustill *op. cit.*, pp. 96–97.

[52] *Dicey & Morris The Conflict of Laws* (gen. ed. L. Collins) (4th Cum. Supp. to the 12th ed.) (London, Sweet & Maxwell 1997) at p. 102.

ICC Rules, neither of which require application of the 'law', but use the expression 'rules of law', would appear to support the view that arbitrators may, at least under these standard rules of procedure, be at greater liberty to apply general principles of the law of international contracts and *lex mercatoria*.

However, an award rendered in England may otherwise risk being set aside where an arbitral tribunal applies *lex mercatoria* either to the exclusion of, or as a supplement to, the domestic law chosen by the parties. This risk is potentially increased under the 1996 Act by the lumping together of notions such as general principles of law, *lex mercatoria* and trade usages, with *amiable composition* and *ex aequo et bono*, as 'other considerations'. Only with respect to the last two is there clear international consensus that arbitrators require the parties' express agreement. The implication under the English Act is that specific party authorization is required for all such categories. Some authors consider that the application of *lex mercatoria* and 'trade usages' by arbitrators in the absence of express authorization amount to an excess of jurisdiction[53] or a 'serious irregularity' such as to form the basis for a challenge of the award under section 68. Where English law is applicable, the award may likewise be liable to invalidation for an error of law under section 69. The public interest criterion set out in section 69 would certainly appear to be met if it can be established that the arbitrators departed from the applicable law chosen by the parties.[54] While there is no reason why parties to international contracts could not be presumed to have intended that their international contractual relationship accord with international law, standards and practices, the difficulty, of course, is that the 1996 Act is founded on a particular domestic definition of 'law' as a national law. The DAC Report distinguishes quite clearly between law defined as a 'recognised system of law' and everything else: 'what in this country may often be called "equity clauses" or arbitration "*ex aequo et bono*" or "*amiable composition*", *i.e.* general considerations of justice and fairness etc.'[55] The editors of *Dicey & Morris* have also explained that neither '...the *lex mercatoria* [nor] general

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[53] *See* Margaret Rutherford and John Simms *The Arbitration Act 1996: A Practical Guide* (London, FT Law and Tax 1996) at p. 202 where the authors affirm that under section 66(1) the court may refuse enforcement with respect to an award which did 'not decide a dispute in accordance with the law chosen by the parties or with such other considerations as they may have chosen under s. 46(1)'. See also the comments of Jonathan Hill 'Some Private International Law Aspects of the Arbitration Act 1996', in (1997) 46 ICLQ 2 at pp. 303–4: 'There is a strong argument for saying that if a party suffers substantial injustice as a result of the arbitral tribunal's failure to respect the parties' choice of law or because the tribunal – without having been authorised by the parties to do so – decides the dispute as *amiable compositeur* or by reference to the *lex mercatoria*, the award may be set aside by the court on the basis that the tribunal exceeded its powers.'

[54] The question of whether arbitral tribunals could apply 'home-made law' was held in *Czarnikow, op. cit.* to be one of 'public interest' and public policy. *See* also the Donaldson Report on Arbitration (para. 14) where the maintenance of a single system of law was viewed as a matter of public policy. It should be noted, however, that at the time of the Donaldson Report, it was accepted law that parties could not contract out of their rights to the special case procedure. Under the 1996 Act, the parties can now contract out of any appeal to the courts on questions of law.

[55] DAC Report, p. 49, at para. 223.

principles of law... constitutes "law" which can only mean a specific system of law'.[56]

This narrow view of what qualifies as 'law' and the abusive amalgamation, under the 1996 Act, of general principles, trade usages and *lex mercatoria* with *amiable composition* are at odds with two fundamental objectives of the Act. First, they are incompatible with the internationalization of English arbitration law and will hinder its universal adaptability across legal cultures. What constitutes 'law' or even a 'recognized system of law' differs greatly from country to country, and even between legal cultures within a single country, and there is little justification for imposing such anglo-centric legal conceptions on foreign parties arbitrating in England. Secondly, the limitations placed on the arbitrators' choice of law in section 46 put the state's interests first and will, in some circumstances, result in a violation of the will of the parties.[57] This was pointed out in 1984 by Yves Derains in a report on the provisions of a draft of the Model Law which, like the present English Act, lacked a reference to 'trade usages':

> On the other hand the arbitrator's obligation to apply a national law is worrying because it goes against the recent trends in arbitral practice which largely uses a-national rules.... What should the arbitrator do if, after consideration of the will of the parties, he realises that they wish the application of international trade usages? Should he set aside the implicit will of the parties, thwart their legitimate expectations, on the basis that the conflict rule which he judges applicable points to a 'rule of law' rather than to a 'law'? The fact that, contrary to the 1961 Geneva Convention, the ICC rules and the UNCITRAL Rules, the Model Law does not even refer in Article 28 to trade usages makes such a consequence quite unacceptable.[58]

At the heart of the positivist refusal to admit *lex mercatoria* or general principles of international commercial law to the full status of law is a belief in the completeness of national systems of law. In reality, however, all legal systems are incomplete and domestic laws do not always contain solutions to new and unexpected developments in the rapidly-evolving world of international business. Will the parties' designation of a national governing law, in an arbitration in England, mean that their international transaction will be governed solely by a domestic law the authority of which cannot be displaced by rules that are not state-acknowledged? Will parties arbitrating disputes in England be disadvantaged if, having designated a national law, they are prevented from invoking or relying on a principle of *lex mercatoria* perfectly suited to the circumstances of their dispute and well within their expectations, but unavailable or unknown in the applicable domestic law?

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[56] *Dicey & Morris*, *op. cit.* at p. 102.

[57] Rule 11.3 of the European Court of Arbitration provides an example of the importance that can be attached to the parties' intentions: '*Les parties sont libres de décider du droit matériel applicable à leur litige. Si les parties n'ont pris aucun accord en ce domaine, le Tribunal arbitral appliquera le droit matériel déterminé par les règles de conflit communes aux systèmes juridiques dont relèvent les litigants, en veillant à écarter l'application d'un droit qui heurterait les prévisions raisonnables des parties à cet égard.*'

[58] Y. Derains 'Report IV', Possible Conflict of Laws Rules and the Rules Applicable to the Substance of the Dispute' in *UNCITRAL's Project for A Model Law on International Commercial Arbitration*, (gen. ed. P. Sanders) (ICCA Congress Series No. 2) (The Hague, Kluwer 1984), *op. cit.*, pp. 192–3.

The wording of section 46 does not mean that arbitral tribunals will not be able to take into account trade usages where the applicable law allows it or the parties expressly authorize it. It has also recently been suggested that as regards English law, principles or usages may yet be applied contractually by way of the mechanism of implied terms.[59] Whether this would also be adequate for the inclusion of the extended meaning of trade usages - principles of *lex mercatoria*, legal categories or international practices unknown in the applicable law - or whether standard form international contracts, general conditions or uniform customs or rules will have to be specifically incorporated into a contract before they can produce any normative effect in an arbitration in England, remains to be seen.

To the extent that parties have settled on arbitration in accordance with institutional rules that explicitly import such a reference (such as, for example, the new ICC Rule 17 or AAA Rule 28.2) and require the arbitrators to take trade usages into account, party autonomy should mean that there will be no difficulty, even if the usage in question produces results contrary to the applicable substantive law. In accordance with what can be presumed to be the parties' intentions in choosing ICC arbitration together with established ICC arbitral practice, usages may include general principles of law and *lex mercatoria*. However, the same flexibility may perhaps not always be available in *ad hoc* proceedings under the 1996 Act or where, for example, international arbitration is conducted in England under LCIA Rules which do not contain a reference to trade usages.

Section 46 of the new Act reflects an unresolved tension that may be to some extent inevitable in any attempt by the state to regulate a process which occurs by definition outside the state. The 1996 Arbitration Act encourages the resolution of international commercial disputes through arbitration rather than state courts, but at the same time refuses to recognize in that practice any form of competing normative or 'law-making' activity akin to the decisions of state courts. This may be a source of potential legal impoverishment. If fewer such disputes are to be decided by municipal courts, the latter are bound to be less important as a source of law for the regulation of international commercial relations. Section 46 reduces the extent to which parties and arbitral tribunals might refer to the latest legal developments and solutions to disputes evolved by international arbitral tribunals, whose decisions might otherwise serve as an important alternative source of law. How is international commercial law to evolve in England in isolation from such essential and formative points of application?[60]

This same tension is evident also in section 69. Having excluded reference by arbitrators to principles of *lex mercatoria*, developed and refined by other

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[59] Goode (1997), *op. cit.* at p. 8.

[60] The importance of the continued production of English law was acknowledged by the Donaldson Report (para. 15) which considered one advantage of judicial review of arbitral awards to be the 'opportunity which it has afforded to the Courts of developing English commercial law in line with the changing needs of the times'.

arbitral tribunals dealing with similar international disputes as applicable law, together with domestic law and notwithstanding the parties' decision to arbitrate private disputes privately and away from state courts, the 1996 Act retains limited authority for English courts to decide questions of English law that have been decided by an arbitral tribunal where the court is satisfied that the question is one of 'general public importance'. This provision can only be understood from the perspective of the logic operating in *Czarnikow*: the state reasserts its role as the sole legitimate normative authority for English law.

VI. CONCLUSION

In time the harmonization of international arbitral practice may overtake the subtle distinctions between the terms 'law' and 'rules of law', 'applicable' and 'appropriate', such that the wording of section 46 will have little practical effect. There is 'international' precedent for such a development. Liberal evolutions in ICC arbitral practice do not appear to have been hampered by the restrictive wording of former ICC Rule 13(3). Indeed, section 46 is arguably broad enough to allow arbitrators to overlook the implications of the conservative jurisprudential statements it contains and refer to international arbitral practice in order to identify 'international' conflict rules as the applicable choice of law rules leading more easily to the application of anational norms.[61]

Given the restrictions on Court intervention where a law other than English law is applied, arbitrators may yet enjoy some freedom from sanction for the application of forms of law unrecognized in England, including *lex mercatoria* or general principles of law. However, where English law is chosen by the parties and the place of arbitration is in England, much will depend on the willingness of English courts to tolerate any latitude exercised boldly by arbitrators in their appreciation of the rules which govern international contractual relations. Paradoxically, arbitral tribunals applying English law outside of England will have the broadest discretion to produce English-inspired international commercial law even where the award is finally to be enforced in England.

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[61] With respect to guidance on the question of choice of law, the DAC itself declined to 'lay down principles in this highly complex area' in the interest of 'flexibility', DAC Report, p. 50 at para. 225.