Rue Britannia: why English law is a poor choice for international arbitration

Tuesday, 1 April 2014 *(1 week ago)*

English law is frequently chosen to govern cross-border contracts but is singularly ill-suited to international arbitration, argue **Paul Cohen** of Perkins Coie and **Gabrielle Farina** of Thompson & Knight in New York.

Quick, pick a neutral law for an international arbitration.

What was the first law that came into your head? If it was that of England and Wales, you would not be alone. Fully 40 per cent of respondents to the 2012 Queen Mary/White & Case international arbitration survey said that English law was their most frequent choice for “neutral” law. The same survey noted that 25 per cent of respondents choose English law in international contracts – the second most popular choice after the law of a party’s home jurisdiction, and nearly three times more popular than the third choice (Swiss law).

It is not too difficult to determine how we came to this state of affairs. English is the language of international business. It has been for some time, and it shows no sign of ceding its place to any rival. Lawyers naturally prefer to choose a law that will be susceptible to ready application to the contract. In the absence of widespread translation of civil law codes, lawyers drafting contracts in English will usually select an applicable law

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whose authorities are in English.

So, with the in-built bias of a contract in English, the drafting lawyer has a limited number of choices. Rightly or wrongly, the lawyer will almost certainly reflexively exclude the law of developing, English-speaking countries. The law of smaller jurisdictions, such as Scotland or New Zealand, similarly escapes most lawyers' minds (few people outside the UK realise that Scotland has its own law) or is dismissed as too obscure (sorry, Kiwis). That effectively leaves only a handful of places: England, the US, Canada and Australia.

Both Canada and the US are federal systems; one cannot choose "American" or "Canadian" law to apply to a contract. The drafting lawyer therefore needs to consider whether there is a particular province or state whose law might apply. In practice, only a handful of the state and provincial jurisdictions are considered – Ontario, British Columbia, Alberta or Texas (where oil and gas are concerned), New York, Illinois, Florida, California and Delaware.

But why resort to the derivative Canadian regimes when one can as easily select the English original? As for the US alternatives, they come (at least in the popular imagination) with a whiff of the extremes of US legal procedure: intrusive discovery, jury trials for virtually all matters, aggressive hearing theatrics, and punitive damages. None of these, of course, would have the slightest application in an international arbitration over a contract governed by a US state law. But why take the risk? asks the cautious draftsperson.

Then there is Australia. For most people, it's literally the other side of the world. Unless we're dealing with a contract involving interests in East Asia or Oceania, Australian law is simply not a relevant consideration (sorry, Aussies).

Thus, English law wins – almost by default. This state of affairs has quickly become self-perpetuating. As English law came to dominate international arbitrations, English lawyers became increasingly familiar with, and central to, proceedings. The first dedicated international arbitration groups in law firms developed in the magic circle firms and their competitors; barristers' chambers collected stables of full-time arbitrators, alongside counsel who honed their skills in hearing rooms as well as courtrooms. As English lawyers have become more tried and tested than their counterparts, they become safer and more reliable choices as arbitrators and counsel.

Even arbitration's mechanics have taken on the appurtenances of English

procedural law: discovery that is more expansive than civil law traditions but less than the US norm; cross-examination, but without US pre-hearing procedures such as depositions; and awards of costs to prevailing parties.

So Britannia (or at least England) rules the arbitral world, punching well above its weight in this discrete field of the law. That much is relatively beyond doubt. For empirical evidence to bolster the anecdotal impression, look at *The International Who's Who of Commercial Arbitration 2014*: ten of the top 25 are based in London – more than twice the next most frequently occurring place on the list (Paris).

Wrong law, right reasons

The purpose of our article is to ask: is English law really a good fit for international arbitration? Our answer is a resounding "no."

Don't get us wrong: English law has many virtues (okay, we don't really think so, but we wanted to be polite). It's just that the premises of English law are so at odds with those of its counterparts (civil and common law alike) that it's liable to surprise a great many parties who selected it in the hope that it would provide a reliable, neutral and predictable alternative to one of the parties' laws.

And make no mistake: that is precisely why most drafters select English law in contracts with arbitration clauses. The same arbitration survey noted the following:

> *We also asked respondents to explain why they choose their most frequently chosen law. Most respondents referred to 'familiarity' and 'predictability,' 'foreseeability' or 'certainty.' They also referred to the existence of a 'well developed jurisprudence' and 'international acceptance.' Some also referred to the appropriateness of the law for particular types of contracts (eg, maritime, oil and gas, finance and reinsurance) and more general principles that are seen to be desirable (eg, respect for freedom of contract). A number of interviewees referred to these factors when discussing why they select English law in particular, so the predominance of English law appears to derive from the fact that many consider it to be one of the national laws that best fulfils these criteria.*

That is precisely the problem. English law, perceived to be neutral, predictable, and foreseeable, is so only to English lawyers. To everyone else, it looks like an outlier. Indeed, no lesser a figure than Lord Hope, at the time the deputy president of the UK Supreme Court (albeit a Scot),

cautioned the Bailiwick of Jersey against adopting English law as part of planned contract reforms:

> *It would seem unwise, if I may say so, for you to adopt wholesale the entirety of English contract law. In so many respects it is out of keeping with that of most, if not all, of the other jurisdictions who wish to be a part of the European project: as to its requirement for consideration, its rejection of the broad notions of good faith and reasonableness and its exclusion of evidence of pre-contractual negotiations, for example. It may look attractive today. That may not be so fifty years on from now, when so much more will have been done to encourage harmonisation along the lines favoured by the current generation of code-makers.*

Yet English lawyers have persisted in making a virtue of what, from the perspective of other legal systems, can only be termed its idiosyncrasies. Here is Lucy Scott-Moncrieff, then-president of the Law Society of England and Wales, lauding English law's suitability for international arbitration:

> *English law attracts many parties to contracts because it is based on the principle of freedom of contract – it is there to give effect to their intentions. There is nothing hidden in English law that will defeat their intentions – a principle that has always been attractive to commercial parties. So I am proud to promote English law to our partners abroad as the law for business because of the clarity it provides and because it is used right across the world. It is a tried and trusted friend in so many countries. Parties to contracts, or those seeking litigation, mediation or arbitration know that they can place their trust in a legal system which is clear, and built upon well founded principles such as the ability to require exact performance and the absence of any general duty of good faith*.

Even upon cursory review, it seems clear that there is less here than meets the eye: all contract laws, for starters, are designed, absent a strong public policy objection, to give effect to the parties' intentions. The question is how to determine what exactly those intentions are. And it is here, as Scott-Moncrieff hints at, that the English begin to diverge from pretty much everyone else on matters such as "exact performance" and "the absence of any general duty of good faith." And that is only the beginning.

The best law the 20th century can offer

English contract law, to put it bluntly, is backward: in an age where virtually every jurisdiction, common and civil law alike, has embraced a flexible and nuanced understanding of contractual interpretation, English law has

remained unfailingly literalist. Like a clever child bent on misconstruing the sense of his parents' instructions, English law refuses to acknowledge the forest of a contract's meaning because it can count the trees of its words.

Again, that may be no problem – and even a benefit – for lawyers and businessmen familiar with the ins and outs of English law. But it comes as an unpleasant surprise to those who choose English law in the expectation that it provides an anodyne, harmless set of principles to govern an international dispute.

Begin with how to interpret a contract. The words of an agreement are, of course, the first recourse for anyone looking to establish the parties' intent. So far, so obvious. But it is at this point that English law makes a fetish of the contractual language, determining to consider it to the virtual exclusion of all else.

It has taken a shockingly long time for English law to begin to catch up to the rest of the world in realizing that the plain terms of an agreement may not be the only factor worth evaluating when interpreting it. Consider these two quotations about the law of contracts:

> *The law has outgrown its primitive stage of formalism where the precise word was the sovereign talisman, and every slip was fatal. It takes a broader view today. A promise may be lacking, and yet the whole writing may be 'instinct with an obligation,' imperfectly expressed.*
>
> *The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meaning of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax.*

The first quotation is from Judge Cardozo of the New York Court of Appeals in *Wood v Duff-Gordon* in 1917. The second is from Lord Hoffmann in the House of Lords case *Investor Compensation Scheme v West Bromwich Building Society* in 1997 – 80 years later. It took Lord Hoffmann's recitation of a preferred approach to contractual interpretation to crystallise the understanding that words may not be everything. Even then, his dictum is often honoured in the breach by a cadre of judges and lawyers who

consider 1997 to be the cusp of the avant-garde in a 1,000-year-old legal system premised on reverence for precedent.

But even this late rationalisation of English contract law does not rescue it from its defects. Even Lord Hoffmann was unwilling to reconsider the position that judges could not review parties' pre-contractual negotiations to determine their ultimate intent. Lord Wilberforce had reiterated the long-standing tradition that pre-contractual negotiations were inadmissible in *Prenn v Simmonds* in 1971:

> *The reason for not admitting evidence of these exchanges is not a technical one or even mainly one of convenience (though the attempt to admit it did greatly prolong the case and add to its expense). It is simply that such evidence is unhelpful. By the nature of things, where negotiations are difficult, the parties' positions with each passing letter, are changing and until the final agreement, though converging, still divergent. It is only the final document which records a consensus. If the previous documents use different expressions, how does construction of those expressions, itself a doubtful process, help on the construction of the contractual words?*

Lord Wilberforce's argument reflects English law's assumption about the perfectibility of contractual language. This is a Platonic ideal; virtually no disputed contract is entirely free of doubt as to its meaning (and even when it is, a clever lawyer can inject such doubt.) But English law has doggedly refused to do what every other law does in the case of contractual ambiguity: look at pre-contractual negotiations to see whether they shed light on what the parties' intentions were.

What's it all about?

Speaking of parties' intentions, here is yet another English idiosyncrasy flowing from the refusal to examine pre-contractual documents: the language of the contract will be the sole guide to the parties' intentions. Here again is Lord Hoffmann, this time in *Chartbrook v Persimmon* in 2009:

> *I do not think that these opinions [that a document should speak for itself] can be dismissed as merely based upon the fallacy that words have inherent or 'available' meanings, rather than being used by people to express meanings, although some of the arguments advanced in support might suggest this. It reflects what may be a sound practical intuition that the law of contract is an institution designed to enforce promises with a high degree of predictability and that the more one allows conventional meanings or syntax to be displaced by inferences*

> *drawn from background, the less predictable the outcome is likely to be.*

Perhaps so in the context of an English contract law dispute among Englishmen. The problem, however, is that English law's insistence on this "objective" approach surprises the non-English practitioners who unwittingly adopt it.

As might be expected, English law's upstart cousin across the Atlantic has occasionally pronounced on contract law in similar terms. But again, such statements tend to come from a much older vintage of American justice, and would be unlikely to cross the lips of modern lawyers. Thus, Oliver Wendell Holmes, in *The Common Law* (1881):

> *The law has nothing to do with the actual state of the parties' minds. In contract, as elsewhere, it must go by externals, and judge parties by their conduct.*

We would venture to suggest that 21st century US lawyers take a different view; the tide had probably changed by the mid-20th century. In any event, the vast corpus of civil law takes the subjective intention of parties much more seriously. Article 1156 of the French Civil Code instructs the fact-finder that "in agreements, we must search for the common intention of the contracting parties, rather than stopping at the literal meaning of their words."

The German Civil Code makes exactly the same caution, as do the Swiss Code of Obligations and the Italian Civil Code. Since most civil law jurisdictions are modelled on one or more of these legal systems, it seems fair to conclude that much of the world adheres to a liberal, rather than literal, interpretation of contractual language.

Back to arbitration. All these lawyers and businesspeople drafting international contracts do so expecting that these underlying assumptions about their intentions, inherent in their legal systems, will come across in any dispute. The language of an agreement between two non-native English speakers is often, and unsurprisingly, less than entirely clear and cogent. (Who among us does not have a war story about an arbitration in which a critical contractual clause, drafted in English by non-native speakers, was incoherent?)

These parties can hardly have known that English law takes a view of contract interpretation completely at odds with that of their home jurisdictions. Had they done so, they surely would have thought twice before selecting English law to govern their agreement. If they felt that the

English language of the contract compelled a law with English-language precedents, they would have the options of the more evolved Canadian or US jurisdictions.

“Observe good faith and justice” (George Washington)

English law’s obsession with the four corners of a contract likewise excludes principles that have long been staples of the laws of other countries. The prime example is the duty of good faith and fair dealing.

Civil law codes enshrine good faith in the operation of all contracts. Article 1134 of the French Civil Code states that contracts “must be executed in good faith.” The German Civil Code observes that contracts “are to be interpreted as required by good faith, taking customary practice into consideration.” The same is true of Italian law. The Swiss Code of Obligations makes multiple references to the requirement of good faith in contractual dealings. And the Unidroit Principles not only refer to good faith in contractual dealings, but also prohibit parties from contracting out of that duty.

As with other elements of contractual interpretation, US law long ago developed flexibility on good faith, despite the absence of code-driven obligations. Thus, the New York Court of Appeals held in *Kirk La Shelle v Paul Armstrong* in 1933 that:

> *in every contract there is an implied covenant that neither party shall do anything which will have the effect of injuring or destroying the right of the other party to receive the fruits of the contract, which means that in every contract there exists an implied covenant of good faith and fair dealing.”*

The Uniform Commercial Code, promulgated in the 1950s and now adopted in all 50 states, enshrines good faith as a basic principle of all contractual arrangements for security, letters of credit, and the sale of goods.

Does English law recognise a generalised duty of good faith, if not specifically articulated in a contract? Take two guesses. Indeed, recall the quotation above from Scott-Moncrieff, in which she invoked the absence of a duty of good faith as one of English law’s virtues for the purpose of applying it in international arbitration.

A few brave souls on the bench have begun to suggest that English law ought to consider implying a term of good faith in contracts. It remains to be seen whether anyone will heed their call. And in any event, we are (once again) seeing a time lag of exactly 80 years between a change in the

common law in New York and the suggestion of a forward development in England. What's next – skyscrapers in London?

A frustrating exercise

It should come as no surprise that English law is similarly queasy about the doctrines variously known as frustration, impossibility and force majeure. The classic English approach was to supply an implied term that the circumstances of the contract would make performance possible. That was the reasoning behind the famous case of *Taylor v Caldwell* in 1863 (where the plaintiff contracted to rent out a concert hall that burned down before he could use it). In the first half of the 20th century, the notion of an implied term to address frustration of purpose came under (hyperbolic) criticism by commentators as "a grave threat to the sanctity of contract."

The test to which English law largely hews has become that of "radical" change in the circumstances of a contract. According to Lord Radcliffe in *Davis Contractors v Fareham Urban District Council* in 1956:

> [*F]rustration occurs whenever the law recognises that, without the default of either party, a contractual obligation has become incapable of being performed because the circumstance in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do.*

English law thus set a high bar for finding frustration, impossibility, force majeure, and similar notions of extra-contractual changed circumstances. Once again, there's nothing wrong with that in and of itself. The problem occurs with the application of English law to international contracts. Often – especially in the case of natural resource concessions or energy supply agreements – these contracts are measured in decades. Given the lifespan of these arrangements, it would be surprising if relevant circumstances were *not* somehow substantially different at their end than at their beginning.

Go west (or south, or north, or east…)

English law's preference for the certainty of explicit contractual obligations is mismatched with the nuanced, ever-evolving world of international investment and commerce. Predictability is a prized legal virtue; but predictability itself is a variable quality. Most parties contract to international agreements with the implicit understanding that a host of obligations and canons of interpretation – ones that are deeply imbued in their own legal systems – will accompany their written words.

They pick English law as a neutral compromise, assuming that its impressive mass of precedent carries the same assumptions. Why should they think otherwise?

When they find that they will be judged on the basis of their (often hastily written, sometimes ill-chosen) words alone, that is the very opposite of predictability: when their solicitors and barristers inform them that their draft agreements are irrelevant; that the other side's bad faith is unimportant; that a few words drafted in a language not their own are paramount; and that extenuating or altered circumstances are unlikely to carry the argument, it is a recipe for befuddlement and consternation.

So, by all means, pick English law for a contract to be resolved by international arbitration. But know what you are getting into: *caveat tabellanio* (let the drafter beware).

No English people were harmed in the making of this article.

EDITOR'S NOTE: Paul Cohen will take part in a debate at GAR Live London on 7 May on the motion, "This house believes that arbitrating in London is full of nasty surprises (more so if the contract is governed by English law)." Click here for more details.

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Beautifully written. Nonsense of course. But nicely done.

CHARLES ALLEN, SIDLEY AUSTIN HONG KONG - 02/04/14 AT 02:24

All very interesting, but I note the authors do not suggest a choice of law they believe would be preferable.

Do they believe, for example, that incorporating a good faith requirement would make things fairer? Where there is a good faith requirement in English Law (such as in insurance law) can anyone say that the outcome is any better, or just that it is tilted against the insured, because they have an opaque duty of disclosure based upon the doctrine of good faith?

As for pre-contractual negotiations, does that fact that other systems allow such evidence make for a better outcome? If it did, the parties could of course provide in their contract that such evidence would be admissible, by referring to it in the agreement to arbitrate.

ANONYMOUS - 02/04/14 AT 04:50

A good article that sums up many parties' reactions - and disappointments - in international arbitrations.

In the area of sale of goods, we have the 1980 UN Convention (the CISG), acceptable and understandable, it seems, to merchants all over the globe, accessible in various languages, laying down modern principles meeting most businessmen's (and -women's) expectations. More than 3000 national court judgments and international arbitral awards have been reported, interpreting the

Convention in an essentially harmonious fashion.

My hope is that the UN would expand its work to other aspects of international commerce beyond the sale of goods, lifting up, if you like, the present soft law UNIDROIT Principles to a convention status.

Sigvard Jarvin, arbitrator, Paris

SIGVARD JARVIN - 02/04/14 AT 09:58

Argentine civil code:

Art. 1.197. Las convenciones hechas en los contratos forman para las partes una regla a la cual deben someterse como a la ley misma.

Art. 1.198. Los contratos deben celebrarse, interpretarse y ejecutarse de buena fe y de acuerdo con lo que verosimilmente las partes entendieron o pudieron entender, obrando con cuidado y prevision. [...] (as modified in 1968)

ANONYMOUS - 02/04/14 AT 10:17

It has been suggested that the date of the article may have some significance.

ANONYMOUS - 02/04/14 AT 10:21

As in sport, business and many other endeavours the numbers do not lie. If English law is really the unwieldy, outdated and ineffective beast that this piece suggests it would, like the dinosaurs, have been replaced. The fact is that like many things that the English have invented it is not perfect but has a number of strong attributes which make it a popular choice. So, while a minority complain about the flaws of football, rugby, cricket and the worldwide web among other English creations, they endure and remain immensely popular with the majority. The conclusion? Take the Antipodean approach – don't complain about the rules, just beat them at their own game….

ANTIPODEAN LAWYER HAPPILY PRACTISING ENGLISH LAW - 05/04/14 AT 11:30

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