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Loosening the Grip of the Contracts (Rights of Third Parties) Act 1999 on Arbitration Agreements

Masood AHMED*

Section 8 of the Contracts (Rights of Third Parties) Act 1999 extends its controls to cover arbitration agreements and, in essence, makes a third party wishing to enforce his rights under a contract which contains an arbitration agreement a party to that arbitration agreement. This article critically evaluates section 8 and investigates the potential adverse impact which it may have upon the institution of international commercial arbitration. This article also considers how this area of law may be reformed so as to bring it in line with internationally accepted arbitral principles and practices.

1 INTRODUCTION

Arbitration has a long and established reputation as being an effective and attractive form of dispute resolution, especially amongst the international commercial community.[1] One of the defining features of arbitration which presents it as an attractive dispute resolution mechanism is the principle of party autonomy which underpins the institution of arbitration and which derives its legitimacy from the agreement of the parties. The principle of party autonomy dictates that parties who have agreed to refer their dispute to an arbitral tribunal should be free to do so and should be at liberty to construct the arbitral process as they see appropriate, to choose the laws which will govern the arbitral process, and to choose the substantive law which will apply to the issues in dispute.[2] However,

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1 There are two main reasons why international commercial parties may decide to refer their dispute to international arbitration. The first reason relates to the issue of neutrality, which means that the parties are free to choose a neutral jurisdiction and a neutral tribunal for the resolution of their dispute. The second reason relates to the enforcement of arbitral awards domestically and also internationally under the provisions of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 ('New York Convention').

2 For example, Art. 19(1) of the UNCITRAL Model Law embodies the principle of party autonomy which provides: 'Subject to the provisions of this Law, the parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting the proceedings'. Also, s. 1(b) of the English Arbitration Act 1996 states 'the parties should be free to agree how their disputes are resolved, subject only to such safeguards as are necessary in the public interest'.

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the principle of party autonomy is not without limitations. The free will of the parties in arbitration is subordinate to the laws of the state within which the seat of arbitration is situated and the place where the arbitral award is ultimately enforced.[3] Therefore, the principle of party autonomy is given effect by states. The extent to which the principle of party autonomy is upheld in its purest form will inevitably depend upon the influence of theoretical models of arbitration upon a state.[4]

States have enacted domestic legislation in order to achieve an appropriate balance between two competing factors in arbitration: the need to preserve the institution of arbitration as a consensual and private form of dispute resolution and which is characterized by the principle of party autonomy with the need for appropriate controls and supervision of arbitration. Trying to achieve this balance has, at times, resulted in the enactment of domestic legislation which has had the adverse effect of undermining arbitration. One such example is, in the opinion of the author, the Contracts (Rights of Third Parties) Act 1999 (the '1999 Act'); the legislation which reformed the privity rule in English contract law by allowing a party who is not a party to a contract (i.e., a third party) to enforce rights under that contract. Section 8 of the 1999 Act extends its controls to cover arbitration agreements and, in essence, makes a third party wishing to enforce his rights under a contract which contains an arbitration agreement a party to that agreement.

When the Law Commission was required to put forward proposals for reforming the privity rule, it considered whether to bring arbitration agreements within the jurisdictional scope of the 1999 Act but later rejected this idea on contractual grounds.[5] The Law Commission was of the opinion that parties should be permitted to confer rights upon a third party and that party should be entitled to enforce those rights under the contract rather than be subjected to the burden of having to refer a dispute in respect of that contractual right to arbitration.[6]

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[3] One of the main limitations is a state's public policy. If the arbitral award conflicts with the public policy of the state where the award is rendered or is being enforced, then the award will be deemed to be null and void. For a discussion of some of the procedural limits on the principle of party autonomy *see* M. Pryles, *Limits to Party Autonomy in Arbitral Procedure*, *available at* http://www.arbitration-icca.org/media/0/12223895489410/limits_to_party_autonomy_in_international_commercial_arbitration.pdf (accessed 12 Jul. 2014).

[4] For a critical discussion of the two main theories of international commercial arbitration, *see* M. Ahmed, *The Influence of the Delocalisation and Seat Theories upon Judicial Attitudes towards International Commercial Arbitration*, 77(4) Arb. 406–422 (2011). For a discussion of other theoretical models of international commercial arbitration, including the hybrid theory, the contractual theory and the concession theory, *see* H. Yu, *Explore the Void: An Evaluation of Arbitration Theories: Part 1*, Int'l A.L.R. 180 (2004); and H. Yu, *Explore the Void: An Evaluation of Arbitration Theories: Part 2,* Int'l A.L.R. 14 (2005).

[5] Privity of Contract: Contract for the Benefit of Third Parties LC242 (1996) ('Law Commission Report').

[6] *See ibid*., paras 14.14–14.19.

Despite the Law Commission's reservations, section 8 was introduced into the 1999 Act by government amendment.

Attempts have been made to reveal some of the practical difficulties which section 8 may present in arbitration.[7] However, the existing (limited) literature has not explored the potential wider impact which section 8 may have upon the institution of arbitration, in particular international commercial arbitration. Further, the existing literature does not explore the limited but significant jurisprudence which has developed since the enactment of the 1999 Act. Although the case of *Nisshin Shipping Co. Ltd. v. Cleaves & Company Ltd.*,[8] the first case which was directly related to section 8(1), has been dealt with by some,[9] it has not been analysed within the context of the recent Court of Appeal authority of *Fortress Value Recovery Fund LLC v. Blue Skye Special Opportunities Fund LP*,[10] a case which concerns section 8(1) and, for the first time, section 8(2). Therefore, this article investigates the potential wider adverse impact which section 8 may have upon the institution of international commercial arbitration and considers how this area of law may be reformed in order to bring it in line with internationally accepted principles and practices.

It should be noted from the outset that, although the parties to the main contract may choose to exclude the 1999 Act from applying to their contractual relationship, this article considers the effects of section 8 in circumstances where the main parties to the contract have not excluded the 1999 Act and, as a consequence, wish to confer benefits on a third party.[11]

Part 2 of this article will briefly consider the nature and types of arbitration agreements. Part 3 will discuss the main provisions of the 1999 Act and section 8. In Part 4, a critical analysis will be given of the potential impact which section 8 may have upon international commercial arbitration. Part 5 will analyse judicial approaches to the interpretation and application of section 8. Drawing upon the previous sections, in Part 6 the author will present options for reform.

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7 *See* C. Ambrose, *When Can a Third Party Enforce an Arbitration Clause?* J. B. L. 415–432 (2001) in which the author discusses the following three practical difficulties which may arise when applying s. 8: the scope of the jurisdiction of the arbitrator; the appointment procedure; and the relationship between disputes as to third party rights and disputes between the original parties. *See* also Anthony Diamond, *The Third Man: The 1999 Act Sets Back Separability?* 17(2) Arb. Intl. 211–224A (2001); and A. Tweeddale, *Arbitration under the Contracts (Rights of Third Parties) Act 1999 and Enforcement of an Award*, 27(4) Arb. Intl. 653–661 (2011).

8 [2003] EWHC 2602 (Comm); [2003] 2 C.L.C. 1097.

9 *See*, *e.g.*, J. Hayton, *Hijackers and Hostages: Arbitral Piracy after Nisshin v. Cleaves*, L.M.C.L.Q. 565-580 (2011).

10 [2013] EWCA Civ 367.

11 The 1999 Act does not explicitly state that the parties may exclude it from applying but the power is implicit and the Law Commission discussed this - *see* the Law Commission Report *supra* n 5, para. 7.18(iii).

2 NATURE AND TYPES OF ARBITRATION AGREEMENTS

The agreement of commercial parties to refer their dispute to an arbitral tribunal for adjudication is the cornerstone of domestic and international arbitration. The arbitration agreement records and is evidence of the parties' consent and intentions to submit to arbitration. Consequently, the arbitration agreement represents the voluntary nature of arbitration.

Arbitration agreements usually take two forms. The first is the arbitration clause which is inserted into a wider commercial contract and traditionally features at the back-end of the contract. An arbitration clause is an agreement to submit future disputes between the parties to arbitration and is the most common type of arbitration agreement. The second type of arbitration agreement is the submission agreement, which is an agreement which arises after a dispute arises and therefore is an agreement to submit existing disputes to arbitration.

The unique status and nature of the arbitration agreement is underlined by the internationally accepted doctrine of separability.[12] By the doctrine of separability, an arbitration agreement contained in a written contract may survive the termination of the contract, as the arbitration clause constitutes a *separate* and *distinct* agreement and must be considered independently from the main contract. Accordingly, an attack on the validity of the contract, even if successful, will not by itself bring the arbitration agreement to an end. The rationale for this is to avoid a paradox whereby the parties' own agreement to refer a dispute to an arbitral tribunal may be defeated if the main contract is terminated. This would have the undesirable effect of frustrating the agreement of the parties who obviously intended that disputes under the main contract ought to be resolved by arbitration. Thus, the doctrine allows arbitrators to consider questions of legality and may find the underlying contract void for illegality without thereby removing their own jurisdiction to arrive at this conclusion.[13]

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[12] Model Law, Art. 16(1) 'an arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract.' Also, UNCITRAL Arbitration Rules, Art. 21.2 states: 'an arbitration clause which forms part of a contract and which provides for arbitration under the Rules shall be treated as an agreement independent of the other terms of the contract.'

[13] In his authoritative work on the doctrine of separability Judge Schwebel sets out the following four justifications for the doctrine: (i) the principle of party autonomy should prevail so that any disputes should be referred to an arbitral tribunal and not domestic courts; (ii) if the doctrine did not apply then it would be easy for a party to delay the arbitration process by claiming that the main contract was void; (iii) there is no reason for treating an agreement in the main contract differently than an 'ad hoc' agreement. In this regard an arbitration agreement is not affected by the frustration or termination of the main contract; (iv) without separability the courts may have to consider the whole dispute in order to determine whether there was a valid arbitration agreement and this would undermine the very purpose of arbitration. *See* S. Schwebel, International Arbitration: Three Salient Problems (Grotius Publications Ltd 1987).

The doctrine is also reflected in domestic arbitral legislation.[14] In England, the doctrine was established in *Heyman v. Darwins*[15] and is enacted by section 7 of the Arbitration Act 1996.[16] In *Darwins*, Lord MacMillan explained the rationale behind the survival of the arbitration agreement thus: 'It survives for the purpose of measuring the claim arising out of the breach, and the arbitration clause survives for determining the mode of their settlement. The purposes of the contract have failed, but the arbitration clause is not one of the purposes of the contract.' In the French case of *Gosset Cass. Civ. Lere*,[17] the Court of Cassation recognized the doctrine of separability in very broad terms when it held:

In international arbitration, the agreement to arbitrate . . . is always save in exceptional circumstances . . . completely autonomous in law, which excludes the possibility of it being affected by the possible invalidity of the main contract.

Despite such diverging approaches, the doctrine of separability reinforces the fundamental significance of the arbitration agreement.

3 THE 1999 ACT AND SECTION 8

The fundamental change which the 1999 Act introduced in the area of privity of contract was succinctly expressed by Trietal when he remarked that 'the most significant doctrinal development in English contract law in the twentieth century was no doubt the outcome of what I shall call the battle over privity'.[18] This battle was won through the enactment of the 1999 Act which marked a necessary revolution in English contract law. It marked a necessary revolution because it fundamentally reformed the common law doctrine of privity of contract which dictates that a third party cannot acquire rights under a contact to which he was not a party.[19] The 1999 Act introduced a new legislative framework which allows parties to a contract, X and Y, to freely confer a right upon a third party, Z, who is

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14 *See*, *e.g.*, Art. 1447 of the French Civil Procedure Code, which provides: 'An arbitration agreement is independent of the contract to which it relates. It shall not be affected if such contract is void.'

15 [1942] 1 All E.R. 337.

16 Arbitration Act 1996, s. 7 provides: 'Unless otherwise agreed by the parties, an arbitration agreement which forms or was intended to form part of another agreement (whether or not in writing) shall not be regarded as invalid, non-existent or ineffective because that other agreement is invalid, or did not come into existence or has become ineffective, and it shall for that purpose be treated as a distinct agreement.'

17 7 May 1963.

18 G. Treital, Some Landmarks of Twentieth Century Contract Law (Oxford U. Press 2002).

19 For cases which illustrate the application of the doctrine of privity, *see Tweeddle v. Atkinson*, (1861) 1 B. & S. 393; 121 E.R. 762 (QB) and *Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge & Co. Ltd.*, [1915] A.C. 847, in which Viscount Haldane, LC opened his judgment by stating: 'My Lords, in the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it.'

not a party to the contract, to enforce a term of that contract.[20] The unfairness of the doctrine was obvious. It restricted a third party from claiming rights under a contract even though the main parties to the contract intended to confer rights to the third party.[21] The 1999 Act attempted to remove this unfairness by section 1 which permits, subject to certain conditions, a third party to enforce a term of a contract to which he is not a party.[22]

It is sensible to reflect upon some of the key elements of section 1 before proceeding in more detail to section 8 of the 1999 Act. This is necessary because it will provide the reader with a clearer understanding of how section 1 operates and its interrelationship with section 8, as well as appreciating the jurisprudence which surrounds this provision of the 1999 Act.

Section 1 sets out the test for enforceability by a third party of his rights, the simplest being section 1(1)(a). According to section 1(1)(a), if parties X and Y wish to confer rights on party Z then the contract must expressly provide for this. Section 1(3) provides an alternative test which allows greater flexibility and freedom to the main parties to the contract to confer rights on a third party who may not necessarily be expressly referred to by name in the contract but may form part of a wider group, or be described in a particular manner, or may not be in existence at the time the contract is made.[23] Although section 1(3) appears to provide flexibility to the parties, it can also cause a degree of uncertainty. It is unclear as to what is meant by the words 'answering a particular description'. These terms are also far too wide and may produce an unfair outcome for one of the parties to the contract. One could conclude that as long as X describes Z in a

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[20] It should be noted that the 1999 Act does not abolish the doctrine of privity with the consequence that if a contract falls outside its scope then the doctrine will still apply.

[21] Not all have been critical of the doctrine: *see* R. Stevens, *The Contract (Rights of Third Parties) Act 1999*, 120 L.Q.R. 292 (2004), for a critical analysis of the Law Commission's justifications for reforming the doctrine of privity of contract. *See also* the arguments of S.A. Smith, *Contracts for the Benefit of Third Parties: In Defence of the Third Party Rule*, 7 O.J.L.S. 643 (1997).

[22] 1999 Act, s. 1 provides: 'Subject to the provisions of this Act, a person who is not a party to a contract (a 'third party') may in his own right enforce a term of the contract if – (a) the contract expressly provides that he may, or (b) subject to subsection (2), the term purports to confer a benefit on him. (2) Subsection (1)(b) does not apply if on a proper construction of the contract it appears that the parties did not intend the term to be enforceable by the third party. (3) The third party must be expressly identified in the contract by name, as a member of a class or as answering a particular description but need not be in existence when the contract is entered into. (4) This section does not confer a right on a third party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract. (5) For the purpose of exercising his right to enforce a term of the contract, there shall be available to the third party any remedy that would have been available to him in an action for breach of contract if he had been a party to the contract (and the rules relating to damages, injunctions, specific performance and other relief shall apply accordingly). (6) Where a term of a contract excludes or limits liability in relation to any matter, references in this Act to the third party enforcing the term shall be construed as references to his availing himself of the exclusion or limitation.'

[23] Andrew Burrows has provided a useful commentary on the 1999 Act: *see* A. Burrows, *The Contracts (Rights of Third Parties) Act and its Implications for Commercial Contracts*, L.M.C.L.Q. 540, 542–546 (2000).

generic manner, then Y, at a later stage, will be bound by any party which comes forward and complies with that generic description, regardless of whether Y now wants to have any dealings with Z. Also, Y may be bound by rights conferred upon a group of third parties even though that group may not be the most appropriate for the purposes of performing the contract. For example, X and Y agree that engineering equipment will be purchased by a group or class of engineering equipment manufacturers. Y later realizes that Z has a poor reputation for supplying equipment. Y would be bound by the term of the contract as agreed with X, and Z will be entitled to enforce his rights under the contract if Y attempts to vary the contractual terms so as to exclude Z from having any rights under the contract.

Section 1 also makes clear that the main parties to a contract cannot confer a right on a third party which allows that party to enforce a term of a contract otherwise than subject to and in accordance with any other relevant terms of the contract.[24] Finally, where a term excludes or limits the third party's liability under the contract, enforcing that term is considered as availing the third party of the exclusion or limitation.[25]

Section 8 of the 1999 Act concerns the circumstances in which the enforceability of a term of the contract conferring benefits upon a third party may be subject to an arbitration agreement. Thus, in circumstances where the third party wishes to enforce such a term, then section 8(1) treats the third party as a party to the arbitration agreement.[26] The language of section 8(1) is such that it places a positive obligation upon the third party to engage in arbitration if he wishes to enforce his rights under the contract. It follows that if the third party subsequently attempts to issue court proceedings against the other party to the arbitration agreement, then the other party will be at liberty to apply to the courts to have the matter stayed in favour of arbitration under section 9 of the Arbitration Act 1996.[27]

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[24] 1999 Act, s. 1(4).

[25] *Ibid*. s. 1(6).

[26] 1999 Act, s. 8(1) provides: '1. Where—(a) a right under section 1 to enforce a term ("the substantive term") is subject to a term providing for the submission of disputes to arbitration ("the arbitration agreement"), and (b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996, the third party shall be treated for the purposes of that Act as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party.'

[27] Arbitration Act 1996, s. 9(1) provides: 'A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter.'

Section 8(1) provides:

> (1) Where:
>
> (a) a right under section 1 to enforce a term ('the substantive term') is subject to a term providing for the submission of disputes to arbitration ('the arbitration agreement'), and
>
> (b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996,
>
> the third party shall be treated for the purposes of that Act as a party to the arbitration agreement as regards disputes between himself and the promisor relating to the enforcement of the substantive term by the third party.[28]

In contrast to the obligation on a third party to refer a dispute to arbitration under section 8(1), section 8(2) provides a third party with an enforceable procedural right (i.e., arbitration) which the third party *may* but need not exercise. In other words, it provides the third party with an option to refer a dispute to arbitration. The optional nature of section 8(2) is clear from the wording of the provision which provides:

> (2) Where—
>
> (a) a third party has a right under section 1 to enforce a term providing for one or more descriptions of dispute between the third party and the promisor to be submitted to arbitration ('the arbitration agreement'),
>
> (b) the arbitration agreement is an agreement in writing for the purposes of Part I of the Arbitration Act 1996, and
>
> (c) the third party does not fall to be treated under subsection (1) as a party to the arbitration agreement,
>
> the third party shall, if he exercises the right, be treated for the purposes of that Act as a party to the arbitration agreement in relation to the matter with respect to which the right is exercised, and be treated as having been so immediately before the exercise of the right.

The words 'the third party shall, if he exercises the right, be treated for the purposes of that Act as a party to the arbitration agreement…' make clear that the third party will be treated as a party to the arbitration agreement only in respect of the matter which he is choosing to resolve by arbitration. Section 8(2) also makes clear that the third party will also be treated as having been a party to the arbitration immediately before exercising the right to arbitrate.

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[28] 1996 Act, s. 5(2) sets the requirement for the arbitration agreement to be in writing and provides: 'There is an agreement in writing—(a) if the agreement is made in writing (whether or not it is signed by the parties), (b) if the agreement is made by exchange of communications in writing, or (c) if the agreement is evidenced in writing.'

4 SECTION 8 AND IMPACT ON ARBITRATION

Bearing in mind that the main purpose of the 1999 Act is to allow third parties to enforce rights under a contract, the nature and legal effect of section 8 makes it an anomaly. This is so because section 8 fails to conform to the main legislative purpose of the 1999 Act which is to confer only *rights* on a third party. This does not conform to the nature of arbitration agreements. The nature of arbitration agreements is to confer a right on a third party, a right to refer disputes to an arbitral tribunal rather than to revert to the state court process. The nature of arbitration agreements also imposes a positive *obligation* upon a third party to refer any disputes to an arbitral tribunal. If a party to an arbitration agreement issues court proceedings, it will, prima facie, do so in breach of his agreement to arbitrate. Further, the existence of an arbitration agreement is such that it binds both parties to arbitration; it reflects the principle of party autonomy and is perceived by national courts as clear evidence of the parties' intentions to deliberately oust the jurisdiction of the courts in favour of a purely private form of dispute resolution.

Given the nature and legal effects of arbitration agreements, it was not surprising that the Law Commission found the issue of whether to include arbitration agreements (and jurisdiction clauses) the most difficult to deal with.[29] The Law Commission's main reasons for not including arbitration agreements within the scope of the 1999 Act were contractual. The Law Commission argued that its reforms were concerned only with the conferring of *rights* and *benefits* on third parties and not with the imposition of duties and burdens. The Law Commission had, at one point, been attracted by the idea that an arbitration agreement could operate as a procedural benefit to the third party and could also constitute a procedural condition on the third party's right to enforce the substantive promise. This would mean that if the third party wished to enforce its substantive rights, it would be bound by the procedural condition to proceed via arbitration. But this idea was subsequently rejected. However, despite the Law Commission's reservations, section 8 was later introduced by way of Government amendment at the Report Stage in the House of Commons and formed part of the 1999 Act.[30]

Aside from the contractual arguments advanced by the Law Commission, are there other reasons against extending the scope of the 1999 Act to arbitration agreements? And what is the potential impact of section 8 upon international commercial arbitration law and practice?

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[29] *See* the Law Commission Report, *supra* n. 5, para. 14.14.

[30] The Law Commission's recommendation was: '(52) a third party shall have no rights of enforceability under our proposed reform in respect of an arbitration agreement or a jurisdiction agreement.'

The first elementary argument against section 8 is that it undermines the principle of party autonomy which underpins domestic and international commercial arbitration.[31] Take the following example by way of illustration. A third-party corporation, Z Co., comes into existence after a contract is concluded between X Co. and Y Co. under which X Co. and Y Co. purport to confer rights on Z Co; or, X Co. and Y Co. provide Z Co. with certain rights and Z Co. forms part of a certain group or class for the purposes of section 1(3) of the 1999 Act. Where this happens, Z Co. (whether it comes into existence at a later date or emerges from a class or group) will come to realize that, although it possesses certain rights in respect of the contract, it is now bound to arbitration if a dispute arises when seeking to enforce those rights. Z Co. may also come to realize that it does not wish to refer disputes to arbitration for a number of commercial, practical and legal reasons. For example, Z Co. may not be comfortable with the seat of arbitration being situated in the jurisdiction of the party against whom it is enforcing his rights. Thus, it is easy to see how section 8, by placing a procedural burden on a third party to engage in arbitration before it can enforce its rights under the contract, may undermine the principle of party autonomy – put simply, there is no autonomy. Only those parties which have agreed to arbitrate (i.e., X Co. and Y Co.) should be bound to arbitrate because they have had the opportunity to negotiate the specific procedural and substantive elements of the arbitration agreement, including the crucial issue of the jurisdiction within which the seat of arbitration will be situated and the substantive laws which will govern the dispute. Z Co., entering the contract at a later stage, is bound by an arbitration agreement which it has not had the opportunity to negotiate.

The principle of party autonomy also dictates that the parties are at liberty to choose the substantive laws which will apply to the issues in dispute as well as the procedures which will govern the arbitral process. Article 28 of the UNCITRAL Model Law recognizes the significance of a party's freedom to contract according to the terms on which they have agreed. Article 28 provides:

> The arbitral tribunal shall decide the dispute in accordance with such rules of Law as are chosen by the parties as applicable to the substance of the dispute.[32]

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[31] For a detailed discussion of the principle of party autonomy in arbitration *see* Pryles, *supra* n. 3.

[32] ICC Rules, Art. 21(1) provides: 'The parties shall be free to agree upon the rules of law to be applied by the arbitral tribunal to the merits of the dispute. In the absence of any such agreement, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.' There are some restrictions to the choice of law, for example, the Rome Convention does not allow the choice of a foreign law to override the mandatory rules of law of a country to which all the factual elements of the contract point; so that, for example, the choice of a foreign law for the purposes of tax evasion or avoiding completion regulation would not be permissible. In *Soleimany v. Soleimany*, [1999] QB 785, the English Court of Appeal refused to enforce an award where the transaction was not illegal under the applicable law (Jewish law) but was illegal under English law. In contrast, the U.S. Supreme Court in

The significance of the freedom of the parties to choose the substantive law and procedure of the arbitral process is well illustrated by the recent Australian case of *Castel Electronics Pty. Ltd. v. TCL Air Conditioner (Zhongshan) Co. Ltd.*[33] Castel, an electrical goods distribution company registered in Australia, entered into a general distributorship agreement with TCL, a Chinese air conditioner manufacturer. Under the agreement, TCL granted Castel exclusive rights to sell TCL air conditioners in Australia. The agreement contained an arbitration clause which provided for the submission of disputes under the agreement to arbitration in Australia. Castel claimed that TCL had breached the agreement by manufacturing and supplying non-TCL branded air conditioners to other Australian distributors to be sold in competition to those distributed by Castel. The arbitral tribunal found in favour of Castel. TCL, however, defaulted in paying Castel damages under the arbitral award and Castel applied to the Australian Federal Court to enforce the award against TCL. TCL argued, *inter alia*, that the recognition and enforcement of the award was unconstitutional because it interfered with the judicial power of Australian courts and it impermissibly conferred judicial power on the arbitral tribunal that made the award by giving the arbitral tribunal the last word on the law when deciding the dispute. In the alternative, TCL submitted that it was an implied term of every arbitration agreement that the authority of the arbitrator is limited to the correct application of the law. The court drew an important difference between judicial power and arbitral power. Judicial power is conferred by law and coercively made against the will of at least one side. It is not, the court explained, invoked by mutual agreement, but is enforced upon the other side. It exists to be resorted to by any party considering themselves aggrieved. The court held:

> the essential distinction between the judicial power of the Commonwealth and arbitral authority, of the kind governed by the Model Law, [is] based on the voluntary agreement of the parties.

Thus, the problem with section 8(1) arises where the main parties to the contract have chosen a particular law to apply to the legal issues in any future contractual disputes. The third party seeking to enforce its rights which is subject to an arbitration agreement may find that it is bound by a choice of law which favours the other party's position. Again, this undermines the principle of party autonomy.

The second argument against section 8(1) rests upon the effects of an arbitration agreement in ousting the jurisdiction of national courts. The nature of

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Mitsubishi Motor Corp. v. Soler Chrysler-Plymouth, (1986) XI Y.B. Commercial Arbitration 555 has confirmed that competition law issues can be subject to arbitration.

[33] [2012] F.C.A. 21.

arbitration agreements is such that, apart from evidencing the principle of party autonomy, it reflects the intentions of the parties to exclude the jurisdiction of national courts in favour of engaging in a private dispute resolution process. Excluding the jurisdiction of the national courts is a serious matter because it requires the parties to surrender their fundamental rights to have their dispute adjudicated by a state-appointed judge in favour of an adjudicative process which, when agreed, restricts the rights of those parties to invoke the jurisdictions of the courts at a later stage. Therefore, it is not surprising that international conventions and the vast majority of domestic arbitral legislation require the arbitration agreement to be in writing.[34] The requirement that the arbitration agreement be in writing is regarded as clear evidence that the parties expressly agreed to refer their dispute to an arbitral tribunal and, as a consequence, intended to oust the jurisdiction of the courts. By requiring a third party to be automatically bound to arbitrate in respect of any potential future disputes undermines the policy and rationale which underpins the need for the existence of arbitration agreements. A third party who may otherwise wish to revert to the national courts will find himself being bound to go to arbitration.

Problems may also arise when considering the jurisdiction in which the seat of arbitration should be situated. The principal difficulty lies with the main parties' choice of the jurisdiction in which the seat of arbitration should be situated. The jurisdiction of the seat of arbitration is significant because, as a general principle, the procedural laws of the jurisdiction within which the seat of arbitration is situated, also referred to as the *lex arbitri*, will be taken to govern the arbitral process. It is these procedural laws or the *lex arbitri* of the country within which the seat of arbitration is situated that will govern the arbitral process whether the parties intend those laws to apply or not – it will suffice that the jurisdiction has been mentioned in the arbitration agreement. Steyn, J. (as he then was) helpfully explained the characteristics of the *lex arbitri* in the English case of *Paul Smith Ltd. v. H&S International Holding Inc.*:[35]

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[34] For example, Art. 7(2) of the UNCITRAL Model Law on International Commercial Arbitration 1985 (with amendments 2006); Art. II of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 ('New York Convention'); s. 5 of the English Arbitration Act 1996 and s. 2A(3) of the Singapore Arbitration Act (ch. 143A). An exception to the writing requirement is French Decree of 13 Jan. 2011, ch. I Art. 1507 nn 2011–48, which does not require agreements in international commercial arbitration to be in any form. The elimination of the writing requirement under the Decree is said to accommodate the frequent lack of formal written consent to arbitration on the part of the investor in investment arbitrations (*see* Ministry of Justice and Civil Liberties, Report to the Prime Minister concerning Decree No. 2011-48 of January 2011 Reforming Arbitration, *available at* http://www.legifrance.gouv.fr/jopdf/common/jo_pdf.jsp?numJO=0&dateJO=20110114&numTexte=9&pageDebut=00777&pageFin=00781(French) and http://www.parisarbitration.com/uploads/FRENCHLAWÖNÄRBITRATION.pdf(English) (accessed 12 Jul. 2014).

[35] *Paul Smith Ltd. v. H&S International Holding Inc.,* [1991] 2 Lloyd's Rep. 127 (Comm).

> What then is the law governing the arbitration? It is . . . a body of rules which sets a standard external to the arbitration agreement, and the wishes of the parties, for the conduct of the arbitration. The law governing the arbitration comprises the rules governing interim measures . . . the rules empowering the exercise by the Court of supportive measures to assist an arbitration which has run into difficulties . . . and the rules providing for the exercise by the Court of its supervisory jurisdiction over arbitration.[36]

The parties to the main contract may have agreed upon the seat of arbitration being situated within an 'arbitration friendly' jurisdiction such as France where the courts are influenced by the delocalization theory of international commercial arbitration and so adopt a *laissez faire* approach in supervising international commercial arbitrations. The delocalization theory maintains that international commercial arbitration should remain free from the constraints of national laws and therefore the *lex arbitri*. International commercial arbitration does not and should not have any connection to the legal mechanisms and controls of the seat of arbitration – it should remain detached from the *lex arbitri*. Only the judicial seat of arbitration should form part of international commercial arbitration, and any territorial links to municipal laws should be disregarded. International commercial arbitration should not, it has been argued by Jan Paulsson, a leading advocate of the theory, be 'anchored' in the national legal system where the award was rendered, and only the country where the award is being enforced or recognized should maintain control.[37] Paulsson has explained the concept of delocalized arbitration thus:

> The sometimes-used expression 'floating arbitration' is not entirely satisfactory, because all arbitral awards may, and frequently do, 'float' . . . the question is not so much whether an award may float—this seems beyond dispute—but whether it may also drift, that is to say enjoy a potential for recognition in one or more enforcement jurisdictions without being ultimately anchored in the national legal system of the country where it was rendered.[38]

However, a third party may wish the seat of arbitration to be situated within a jurisdiction in which the courts, who are influenced by the seat theory, adopt a closer, more 'hands-on' supervisory approach to arbitration. The seat theory places

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[36] *Ibid*. at 130. Redfern and Hunter have provided a non-exhaustive list of the matters which would be covered by the *lex arbitri*. According to them, the *lex arbitri* would include the following matters in international commercial arbitration: whether a dispute is capable of being referred to arbitration (i.e., whether it is 'arbitrable' under the local law); time limits for commencing arbitration; interim measures of protection; the conduct of the arbitration; the powers of the arbitrators, including any powers to decide as 'amiable compositeurs'; the form and validity of the arbitration award; and the finality of the award, including any right to challenge it in the courts of the place of arbitration (A. Redfern & M. Hunter, Law and Practice of International Commercial Arbitration, para. 2-06 (4th ed., Sweet & Maxwell 2004)).

[37] J. Paulsson, *Arbitration Unbound: Award Detached from the Law of its Country of Origin*, 30 I.C.L.Q. 358 (1981).

[38] *Ibid*. at 358.

importance upon the territory or state within which arbitration is to take place in regulating the arbitral process. Those who support the jurisdictional theory argue that the national laws of the seat of an international commercial arbitration will have an automatic and legitimate right to supervise the arbitral proceedings or, to put it another way, the *lex arbitri* will govern the arbitral proceedings. These ideas form the very foundations of the seat theory. F.A. Mann, an ardent supporter of the seat theory, has strongly argued in favour of the role of the *lex arbitri* in international commercial arbitration and has contended that the rights of the parties to arbitration are actually derived from municipal laws and this in itself highlights, in his opinion, the importance of the *lex arbitri*:

> Every right or power a private person enjoys is inexorably conferred by or derived from a system of municipal law which may conveniently and in accordance with tradition be called *lex fori*, though it would be more exact (but also less familiar) to speak of the *lex arbitri*.[39]

This is not to say that Z cannot renegotiate the seat of arbitration when a dispute arises. But equally, it would be perfectly legitimate for X, against whom Z is seeking to enforce a term, to contend that Z is bound by the originally negotiated arbitration agreement and therefore obliged to submit to the *lex arbitri* of the seat of arbitration which X negotiated with Y.

Important commercial and practical considerations must also be taken into account when analysing the adverse effects of section 8(1). One of these considerations is cost. Arbitration can be an extremely expensive dispute resolution process. The parties will usually engage specialist commercial lawyers who will carry out work on an hourly basis. Arbitral disputes, such as construction disputes, will involve detailed, lengthy and complex facts and legal issues which will contribute to the huge costs which will be incurred by the parties. As well as the costs of the lawyers, the parties will be required to pay the arbitrator's fee as well as the cost of the venue and other related costs such as expert's fees. These costs will increase substantially if the arbitration agreement provides for institutional arbitration, that the dispute will be heard by three arbitrators and if the parties decide to call a number of experts. Thus, Z will find itself bound by a dispute resolution process which it may not be able or willing to finance and which may, in fact, be more expensive than the court process.

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[39] F.A. Mann, *Lex Facit Arbitrum*, International Arbitration 160 (1967). *See also* F.A. Mann, *Lex arbitri and locus arbitri,* 104 L.Q.R. 348 (1988); and *Naviera Amazonica Peruana S.A. v. Compania Internacional de Seguros de Peru*, [1988] 1 Lloyd's Rep. 116 (CA).

5 SECTION 8 JURISPRUDENCE

There has been very limited case law which has considered the scope and application of section 8. In fact, there have only been two cases. The first is the High Court case of *Nisshin* which was the first case to consider the 1999 Act since its enactment and it was the first and only case to deal with the application of section 8(1).[40] The second is the Court of Appeal authority of *Fortress*, which, for the first time, analysed both sections 8(1) and (2). Although the jurisprudence surrounding section 8 is limited to two authorities, those authorities reveal diverging and inconsistent judicial approaches which have been adopted when interpreting and applying section 8.

In *Nisshin*, Cleaves were engaged as Nisshin's chartering brokers. Each charterparty provided for the payment of commission to Cleaves and each arbitration clause contained wording referring to disputes between the 'parties' to the charterparty or between Owners and Charterers. A dispute arose between Nisshin and Cleaves as to Cleaves' entitlement to commission under the charterparties. Cleaves commenced arbitration proceedings against Nisshin notwithstanding that it was not party to any of the charterparties which contained the arbitration agreements. On the issue of jurisdiction, the arbitrators issued an interim final award in which they concluded that they did have jurisdiction to entertain the claim on the basis of sections 1 and 8 of the 1999 Act. Nisshin appealed the award to the Commercial Court and Colman, J. upheld the award.

Coleman, J. held that the effect of the commission clause in the contract was to confer a benefit of 1% commission on Cleaves and therefore section 1(1)(b) of the 1999 Act had been satisfied. The next question for Coleman, J. was whether the enforcement of these rights were subject to the arbitration agreement in the charterparties. Nisshin contended, *inter alia*, that the question whether under section 8 a third party's right is subject to an arbitration agreement was to be determined by the proper construction of the contract as to whether the parties intended an arbitration agreement contained in it to apply to any dispute relating to the third party's right. This was not the case, as the terms of the arbitration agreement could not be interpreted as including Cleaves. In determining how to interpret section 8, Coleman, J. noted that section 1(4) was based on a 'conditional benefit' approach. It ensured that a third party who wishes to take action to enforce his substantive right is not only able to enforce effectively his right to

[40] *See* the comments of Coleman, J. in *Nisshin* when he said: 'This case is, I understand, the first time that the 1999 Act has been before the courts' (para. 2).

arbitrate, but is also 'bound' to enforce his right by arbitration. Coleman, J. referred to the Explanatory Notes which accompany the 1999 Act and which provide:[41]

> This approach is analogous to that applied to assignees who may be prevented from unconscionably taking a substantive benefit free of its procedural burden (see, for example, *DVA v. Voest Alpine, The Jaybola* [1997] 2 Lloyd's Rep. 279).[42]

Coleman, J. relied upon the assignment analogy to find that Cleaves was a party to the arbitration agreement and therefore could seek to resolve its disputes in enforcing the commission term through arbitration. As Coleman, J. explained:

> The introduction into these [Explanatory] Notes of the assignment analogy directs attention to the concept that under the contract the promisee could not enforce the substantive term unless he had resort to arbitration if the scope of the agreement to arbitrate were wide enough to cover the dispute about such enforcement. Once the latter condition is satisfied an assignee from the promisee stands in the shoes of the promisee as regards enforcement of that term. …
>
> The promise under these charterparties to pay commission to the brokers was clearly a promise made to and enforceable by the charterers. Failure to perform that obligation would clearly fall within the scope of all the arbitration clauses. If the charterers had assigned their cause of action for failure to pay commission to the brokers by a statutory assignment the latter could only have enforced that promise if they resorted to arbitration against the owners. Had they done so, it would not have been open to the owners to challenge the arbitrators' jurisdiction on the grounds that the only parties to the arbitration agreement who were identified by it were the owners and the charterers. That would be because such identification would be completely irrelevant to the entitlement of the brokers to utilize the arbitration agreement. The transference by assignment of the substantive chose in action necessarily involved the transference of the procedural means of enforcement of it.[43]

Upon first reading of the judgment in *Nisshin*, Colman, J.'s reasoning appears to be convincing. It was a case in which the court had to grapple, for the first time, with arbitration agreements under the 1999 Act without the assistance of past authorities. Therefore, Coleman, J.'s reliance upon the assignment analogy in the Explanatory Notes appears to be sensible. A party should not be able to take advantage of a term under a contract without being bound by the procedural obligation of arbitration. A closer reading, however, reveals a number of weaknesses which undermine Coleman, J.'s judgment. Coleman, J. appears to have relied too heavily upon the Explanatory Notes as a means of interpreting section 8 and, as a result, upon the assignment analogy. The commission clauses did not state that Cleaves, as the third party beneficiary under the contract, would be subject to the

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41 The Lord Chancellor's Department issued Explanatory Notes which were made available to Members of Parliament and peers before the enactment of the 1999 Act.

42 Explanatory Notes, para. 34.

43 *Ibid.* paras 39 and 40, respectively.

arbitration agreement if a dispute arose in the future. There was no clear language within the contract to bind Cleaves to the arbitration agreement and therefore there was no substantial evidence to support Coleman, J.'s reasoning aside from relying upon the assignment analogy.

Coleman, J.'s judgment also introduces uncertainty in arbitral practice which we have considered above but which also deserves mention here. X and Y may be content in negotiating to take future disputes to arbitration. They will negotiate the seat of arbitration as well as the applicable laws and rules of procedure. These will be discussions between X and Y and will reflect their personal preferences, which will usually be based on commercial and practical considerations. The arbitration agreement which is finally incorporated into the contract, which would also bind a third party, may not be fair to that third party. The seat of arbitration, rules of procedure or applicable laws are issues which the third party will not have been privy to and may put the third party at substantial disadvantage when going to arbitration.

In contrast to *Nisshin*, the Court of Appeal in *Fortress* adopted a more pragmatic approach in construing the contract between the parties when seeking to apply section 8. In that case, the Court of Appeal revisited section 8(1) but also, for the first time, provided guidance on section 8(2). The main issue in *Fortress* was whether a third party was bound to enforce its rights under an exclusion clause by arbitration.

The case concerned claims brought by three claimants against eighteen defendants, although the appeal concerned one claimant, Fortress Value Recovery Fund I LLC ('Fortress') and two defendants, Mr C and Mr D, the appellants.

The appellants were managers of an investment structure which was based around an English Deed of Partnership Agreement. The partnership was called the Blue Skye Fund which had one general manager and three limited partners, the principal limited partner being Steptone Acquisition SARL ('Stepstone'). Stepstone assigned its interests in the fund to Fortress. Following the assignment, Fortress brought a claim against the appellants arguing, *inter alia*, that they had acted in collusion with others and designed and implemented a dishonest scheme to reorganize the fund and its assets in order to diminish the rights of Stepstone and others to those assets. The Deed was governed by English law and provided for arbitration in accordance with ICC Rules with a seat in London. One of the applications which came before Blair, J. in the High Court was an application by the appellants and others to stay the claims in reliance upon the arbitration clause.[44] The Deed also provided substantial indemnities and exclusions in respect

[44] Arbitration Act 1999, s. 9 provides: 'Stay of legal proceedings (1) A party to an arbitration agreement against whom legal proceedings are brought (whether by way of claim or counterclaim) in respect of a

of liability to the Partnership or Partners, including Stepstone. Finally, the Deed made express reference to the 1999 Act and allowed third parties to take and enforce rights under the Deed.

At first instance, Fortress opposed the application to stay in favour of arbitration on the grounds that the claims did not relate to the Fund and the participation of the limited partners in it but rather that the claims against the limited partners related to their roles as shareholders in Stepstone.[45] Thus, Fortress contended that the claims against the limited partners did not arise out of the Deed. Blair, J. dismissed this contention and applied a wide interpretation of an arbitration agreement as required by *Fiona Trust & Holdings Corp. v. Privalov*.[46]

The appellants further argued that, although they were not parties to the Deed, they too were entitled to rely upon the arbitration clause. This was so, it was argued, because the Deed allowed the appellants to benefit from the arbitration clause and this was supported by section 8 of the 1999 Act. The appellants also contended that they were entitled to avail themselves of the indemnities and exclusions under the Deed because the appellants were third parties in whose favour rights has been provided and therefore they could enforce those rights and any dispute in this respect should be referred to arbitration. The appellants concluded that, by parity of reasoning with that in *Nisshin*, their entitlement to rely upon the exclusion from liability should be regarded as subject to the condition to refer any disputes to arbitration. The appellants pointed to section 1(6) of the 1999 Act which provides that the third party availing himself of the exclusion was to be equiparated with his enforcing the exclusion.

The appellant's arguments were rejected by Blair, J. who accepted Fortress' contention that the appellants' right to avail themselves of the exclusion clause fell outside the arbitration clause. Blair, J. drew a distinction between a right of action and a contractual defence. He held that only a contractual right of action would be subjected to arbitration. Blair stated that the exclusion clause was a contractual right and as such:

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matter which under the agreement is to be referred to arbitration may (upon notice to the other parties to the proceedings) apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter. (2) An application may be made notwithstanding that the matter is to be referred to arbitration only after the exhaustion of other dispute resolution procedures. (3) An application may not be made by a person before taking the appropriate procedural step (if any) to acknowledge the legal proceedings against him or after he has taken any step in those proceedings to answer the substantive claim. (4) On an application under this section the court shall grant a stay unless satisfied that the arbitration agreement is null and void, inoperative, or incapable of being performed. (5) If the court refuses to stay the legal proceedings, any provision that an award is a condition precedent to the bringing of legal proceedings in respect of any matter is of no effect in relation to those proceedings.'

45 [2012] EWHC 1486 (Comm).

46 [2007] UKHL 40, paras 12 and 13.

> it is a contractual defence, as opposed to a contractual right of action which is subject to arbitration. In my view, that is correct.[47]

In the Court of Appeal, the appellants put forward three steps to their argument that the claims must be brought in arbitration. First, the appellants contended that they could potentially rely upon the exclusion clause which was a right or benefit which they were given under the contract and of which they could take advantage because that was the effect of section 1(1) of the 1999 Act. Second, the exclusion clause was, like all the other terms in the Deed, itself subject to the agreement of the parties to refer their disputes to arbitration. Third, the appellants were by reason of section 8(1) of the 1999 Act accordingly to be treated as parties to the arbitration agreement as regards the dispute between themselves and Stepstone/Fortress which potentially engaged the availability of the defence under the exclusion clause in the Deed. Alternatively, if that last step in the argument was unavailable, then the appellants could instead rely upon section 8(2) of the 1999 Act. They could choose to exercise their right to rely upon the arbitration agreement which was, according to the appellants, sufficiently widely drawn to encompass a dispute between Stepstone and a third party such as the appellants arising out of or connected with the Deed.

Delivering the leading judgment of the Court, Tomlinson, L.J. upheld Blair, J.'s decision not to grant a stay in favour of the appellants. However, his Lordship dismissed Blair, J.'s distinction between a right of action and a contractual defence as being a determinative factor. In Tomlinson, L.J.'s opinion, it was clear from section 1(6) of the 1999 Act that no such distinction should be made. The language of sections 1(6) and 8(1) provided that where a third party wished to avail himself of an exclusion under the contract, this would be the equivalent of him enforcing a term under the contract.

The question of whether the right to enforce the exclusion was subject to the obligation to submit to arbitration was a question of construction. Tomlinson, L.J. found that there was no express provision which made the clauses on which the third party sought to rely subject to the arbitration agreement. This was evident from the express terms of the contract. As a result, it was necessary for the Court to seek to ascertain the parties' intentions and therefore to ascertain whether the parties actually intended third parties to be bound by the arbitration agreement. In this instance, it was not possible to infer that the parties had intended that the appellants should be bound by arbitration proceedings. Referring to the distinction drawn between an indemnity and exclusion, Tomlinson, L.J. noted:

> The fact that one is a contractual right of action and one a contractual defence is in my view relevant but not in itself determinative. It is relevant because when construing the

[47] *Fortress*, [2013] EWCA Civ 367, para. 103.

> agreement in order to ascertain the intention of the parties thereto, it is easier to conclude that the parties intended enforcement of the contractual indemnity by a third party to be subject to the arbitration provision than it is to conclude that the parties intended reliance on the contractual exclusion by a third party to be likewise subject to the arbitration provision.[48]

Tomlinson, L.J. found that neither the indemnity nor the exclusion clauses employed express language to the effect that both were subject to the arbitration agreement; such an intention could only be inferred. But inferring such an intention from the contract would, according to his Lordship, have far-reaching consequences as he explained:

> In each case that result can only be achieved by way of inference. It is however to impute to the parties a really very far-reaching intention if it is to be inferred that they positively intended to bring about the result that third parties would be bound by the outcome of arbitration proceedings which they had not themselves initiated in order to secure a benefit apparently conferred upon them by the Agreement.[49]

Thus, due to these 'far-reaching consequences', only clear language could bring about the result which the appellants desired. As Tomlinson, L.J. explained:

> very clear language is I think required to bring about the result that the right of a third party to avail himself of an exclusion clause in an agreement to which he is not party is in turn subject to an arbitration clause in the same agreement. In my judgment there is no such clear language in the Partnership Deed.[50]

Agreeing with Tomlinson, L.J., Toulson, L.J. also drew a distinction between a procedural qualification of a substantive right given to a third party under section 8(1) and the grant of a procedural right under section 8(2) of the 1999 Act. Under section 8(1), the third party was entitled to a substantive benefit under the contract, subject to a procedural condition that the third party may enforce it only by a particular process, i.e., arbitration. Under section 8(2), a term of the contract gives a unilateral right to the third party to require that a dispute should be submitted to arbitration, so treating the third party as a party to an arbitration agreement with the party to the contract if and when the third party exercises the right.

A number of observations can be made on the Court of Appeal's decision. The methodical approach which Tomlinson, L.J. adopted in construing the contract when seeking to apply section 8(1) seems sensible. The first step was to consider the express terms of the contract when trying to ascertain the intentions of the parties: did the exclusion clause make clear the parties' intentions to bind

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48 *Ibid.* para. 36.
49 *Ibid.*
50 *Ibid.*

the appellants to the arbitration agreement? The next step which Tomlinson, L.J. took in attempting to ascertain the intention of the parties was to consider whether that intention could be extracted from construing the rest of the contract. However, Tomlinson, L.J. quite correctly identified concerns with doing this because, in the absence of clear language, the intentions of the parties could merely be inferred. The process of inference may provide a result which accords with the parties' intentions and, as a consequence, may produce the correct result for all concerned. But equally inference may produce a result which the parties may never have intended and this would be unacceptable. Further, the 'far-reaching' consequences which inference of the parties' intentions would have provided were well argued by Tomlinson, L.J. These were consequences which would have produced results which no commercial party would have intended before the contract was concluded nor would they have been able to foresee those consequences if a dispute was to arise in the future.

Tomlinson, L.J.'s judgment in requiring clear language to be employed where exclusion clauses in favour of a third party are to be subject to an arbitration agreement is to be welcomed. This principle can, it is submitted, be extended to apply to the application of section 8(1) to all terms in favour of third parties which are purported to be subject to an arbitration agreement. This principle also reinforces the author's arguments in respect of the court's ruling in *Nisshin*. It will be recalled that in that case, Coleman, J. relied upon the Explanatory Notes when seeking to interpret and apply section 8(1). With respect, the approach which Coleman, J. should have adopted was to consider the language of the commission clause and to resolve whether the parties intended to make that clause subject to the arbitration agreement by ascertaining whether that intention was reflected in the words of the term.

However, despite referring to *Nisshin*, the Court of Appeal in *Fortress* failed to clarify the approach adopted by Colman, J. Colman, J. relied upon the Explanatory Notes and, as a consequence, the assignment analogy to justify his decision that Cleaves were entitled to resolve their dispute with Nisshin through arbitration.[51] There was no real attempt by Colman, J. to ascertain the true intentions of the parties by construing the contract, and this was not dealt with by Tomlinson, L.J. who, correctly, approached the interpretation of section 8 from a purely constructive viewpoint. Although *Fortress* will be binding precedent for future cases which focus on section 8, the approach of Colman, J. remains unaltered by the Court of Appeal.

[51] *See* paras 24 and 25 of Tomlinson, LJ's judgment.

6 OPTIONS FOR REFORM

The analysis of section 8, in particular section 8(1), has revealed the potential difficulties it presents for arbitration. There are two competing factors surrounding section 8. On the one hand, there is the policy rationale that a third party should not take a benefit under a contract without being subjected to any necessary burdens which the parties to the main contract have agreed and this would include referring any future disputes to an arbitral tribunal. On the other hand, there is, as has been argued in this article, a need to protect the institution of arbitration as a consensual, private alternative dispute resolution process which is underpinned by the principle of party autonomy. How, therefore, can an appropriate balance be achieved between these two competing factors? What are the options for reform? What mechanisms can be employed to introduce greater clarity and understanding of section 8(1) which is balanced with safeguarding arbitration? How can greater certainty, transparency and fairness be introduced for the main party to the contract and a third party who wishes to enforce his rights?

It is submitted that two options can be considered. The first option is to remove section 8 entirely from the 1999 Act with the effect that arbitration agreements are no longer subjected to the controls of the 1999 Act. The second option is to amend section 8 so that an arbitration agreement is clearly stated to be separate and autonomous from the main agreement, and by providing that, if the main parties to a contract intend to make the enforcement of a term by a third party subject to arbitration, then those parties (i.e., the main party to the contract and the third party) must enter into a separate arbitration agreement. Let us consider these options in more detail.

Removing section 8 from the scope of the 1999 Act appears to be the most obvious method of resolving some of the potential difficulties which currently exist with the current regime. Removing section 8 with the effect that arbitration agreements are no longer within the scope of the 1999 Act would introduce a clear balance between the freedom of the parties to the main contract to freely negotiate the terms of their contract, including the conferring of any right on a third party, and protecting arbitral practice and principles. Where a dispute does arise between a party to a contract and a third party who is enforcing a term under the contract, then both parties will be free to resolve their dispute as they see fit. The parties would have the full range of dispute resolution processes available to them from litigation through the traditional court process, arbitration, mediation or other forms of alternative dispute resolution.[52] Furthermore, removing arbitration agreements from the scope of the 1999 Act would mean that

[52] Including negotiation and conciliation.

third parties from foreign jurisdictions will not be taken by surprise that they have been bound to resolve disputes through arbitration and that the jurisdiction of the national courts has been ousted. Finally, this option would also address the problems which the Law Commission raised with controlling arbitration agreements, a problem which Tomlinson, L.J. in *Fortress* also reiterated and emphasized when he said:

> The Commission foresaw grave difficulties in approaching an arbitration agreement on the basis that it could be regarded as conferring a procedural benefit on a third party and that it could also constitute a procedural condition on the third party's right to enforce the substantive promise contained in the contract in which the arbitration agreement appears . . . This case demonstrates that the Commission's fears were not unfounded.[53]

For those who support section 8, it may be argued that the underlining policy rationale is justified, that third parties should not be permitted to simply take a benefit under a contract without being bound by any burdens provided under the contract in enforcing that term. If section 8, in particular section 8(1), is to be retained then there are steps which can be taken to introduce a greater degree of clarity and certainty in its application and to bring it in line with internationally accepted arbitral principles and practices. Thus, the second option for reform relates to amending the wording of section 8 by adopting a two stage process. This option, which the author refers to as the 'amending option', aims to achieve two principal objectives. First, any amendments to section 8 should have the aim of loosening the current grip which the 1999 Act has upon arbitration agreements. The second objective is to reflect the true consensual nature of arbitration agreements and, more significantly, the principle of party autonomy. Let us consider the amending option in more detail.

It is clear that the 1999 Act retains a 'grip' on arbitration agreements and this is evident from an analysis of the wording of section 8(1)(a). That section, it will be recalled, provides that a third party's right to enforce a substantive term 'is subject to' an agreement to arbitrate any disputes which may arise relating to the enforcement of that substantive term. This grip is unnecessary and contrary to the inherent nature of arbitration agreements and the policy rational which underpins the institution of arbitration for the reasons previously discussed in this article. By using the terms 'subject to' in section 8(1)(a) the 1999 Act regards the main contract and the arbitration agreement as dependent upon one another or, to put it another way, it regards the main contract and the arbitration agreement within it as one whole contract. By doing this, the 1999 Act fails to appreciate the unique nature of the arbitration agreement as a separate agreement which is, in fact,

[53] *Fortress*, *supra* n. 47, para. 1.

autonomous from the main contract. Consequently, section 8(1)(a) undermines the doctrine of separability.

In respect of the amending option for reform, the following two stage process should be adopted:

1. Remove the words 'subject to' from section 8(1)(a) in order to free arbitration agreements from being dependent on the main agreement.
2. Replacing the words 'subject to' with the option that, in the event of a future dispute which relates to the enforcement of the third parties rights, the parties 'may' refer that dispute to arbitration.

Although the first stage of the amending option appears to be straightforward it is, nevertheless, significant. The consequence of removing the words 'subject to' from section 8(1)(a) means that any right conferred on a third party is no longer conditional on referring future disputes to arbitration. Therefore, the arbitration agreement is given its true status as an autonomous contract and one which is separate and distinct from the main contract and therefore survives and continues to bind the parties in the event that the main contract comes to an end. This approach would bring section 8(1) in line with the doctrine of separability.

The second stage is to replace the current wording of 'subject to' arbitration with the requirement that the main party and the third party 'may' refer their dispute to arbitration. The effects of this amendment will mean that the parties are given the choice of whether to refer their dispute to arbitration or whether to refer their dispute to another dispute resolution process which may include litigation through the domestic courts. As a consequence of this amendment, arbitration agreements will be preserved as truly reflecting the consent of the parties to proceed to arbitration rather than having the undesired effect of unilaterally binding a third party to engage in a dispute resolution process to which it may not have agreed to if it had been privy to the initial contractual negotiations. Therefore, section 8(1) should be amended so that: (i) it clearly provides that an arbitration agreement is separate and autonomous from the main agreement; (ii) if parties to the main contract wish for a third party to participate in arbitration then the main party to the contract and the third party must both expressly agree to this when the dispute arises; (iii) if the main party and the third party agree to refer their dispute to arbitration then both parties must enter into a separate written arbitration agreement in the form of a submission agreement.

An argument against the amending option may be that the liberty of the parties to freely negotiate contractual terms will be restricted. It will mean that the parties to the main contract will not be permitted to subject certain contractual rights to the obligation to submit to arbitration. This may be perceived as undermining the 'benefit-burden' argument which underpins section 8(1).

However, it is submitted that the main parties to the contract will be at liberty to agree to provide a third party with rights under the contract and require the party to the main contract and a third party to enter into a separate arbitration agreement. By adopting the amending option, it will simply mean that the parties must enter into a separate agreement to resolve any disputes which may arise. This approach will, in particular, overcome the difficulties which have been discussed in relation to section 1(3) of the 1999 Act where the third party may not be in existence at the time the contract is concluded or where the third party forms part of a group or a certain class.

By requiring the parties to enter into a separate submission agreement, it is intended to introduce a greater degree of transparency and fairness between the party to the main contract and the third party. A submission agreement is concluded after a dispute arises between the parties – it is negotiated 'after the event', unlike an arbitration clause which is negotiated alongside the other terms of the contract. Requiring the parties to enter into a submission agreement will provide the parties with the opportunity to carefully negotiate a stand-alone arbitration contract which contains detailed terms as to how the dispute is to be resolved. The parties will have time to carefully consider every step of the intended arbitration, including issues such as the applicable procedural rules, the location of the seat of arbitration and the reasons for this, the substantive law which will govern the issues in dispute and other related matters. The submission agreement will be detailed and reflect the parties' consensus on all matters of the intended arbitration. Thus, requiring parties to conclude a separate arbitration agreement will provide both parties with opportunities to discuss and decide on all aspects of the intended arbitration.

The analysis presented in this article demonstrates that section 8 sits uncomfortably with key arbitral practices and principles. Removing arbitration agreements from the grip of the 1999 Act or, if it is to remain, amending it in accordance with the two stage process discussed above will have the benefit of preserving the principle of party autonomy.

Author Guide

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Since its 1984 launch, the Journal of International Arbitration has established itself as a thought provoking, ground breaking journal aimed at the specific requirements of those involved in international arbitration. Each issue contains in depth investigations of the most important current issues in international arbitration, focusing on business, investment, and economic disputes between private corporations, State controlled entities, and States. The new Notes and Current Developments sections contain concise and critical commentary on new developments. The journal's worldwide coverage and bimonthly circulation give it even more immediacy as a forum for original thinking, penetrating analysis and lively discussion of international arbitration issues from around the globe.

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