THE ARBITRATOR'S MANDATE*:*

To Follow the Law, or Do Justice & Equity?

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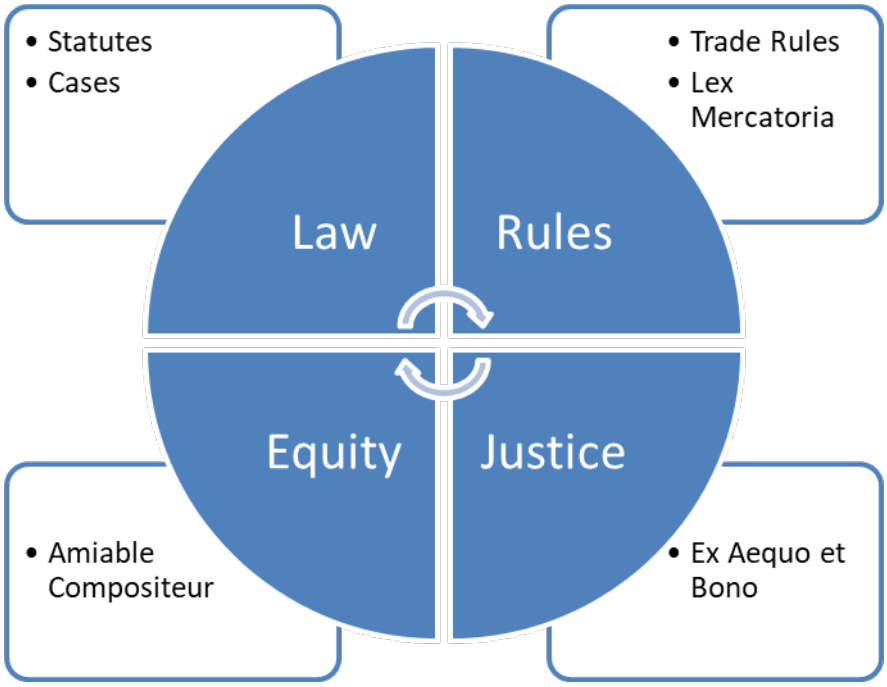
ADR Study Group - March 2015



Implications of the Question

1. Are these mutually exclusive concepts?
2. Achieving a fair outcome through the law.
3. Can justice and equity ever be delivered by deviating from the law?
4. If a "legal" outcome is not fair, may an arbitrator intentionally disregard the law to do what is just and equitable?

Party Expectations

1. Predictability.

2. Who decides what is fair, just and equitable?

3. If the law is not followed, can an outcome be predictable?

4. Is my concept of fairness the same as the parties?

The Arbitrator's Authority (International)

1. UNCITRAL Model Law, Article 33(2): "The arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorized the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration."

2. *See*, ICDR Rule 31(3); ICC Rule 21(3); SIAC Rule 27.2; JAMS Rule 30.1; HKIAC Rule 35.2; LCIA Rule 22.4: "The Arbitral Tribunal shall only apply to the merits of the dispute principles deriving from "ex aequo et bono", "amiable composition" or **"honourable engagement"** where the parties have so agreed in writing."

3. *See*, *however,* CIETAC, Article 49.1: "The arbitral tribunal shall independently and impartially render a fair and reasonable arbitral award based on the facts of the case and the terms of the contract, in accordance with the law, and with reference to international practices."

4. If the parties have not expressly authorized the tribunal to do what is "just, fair and equitable," the UNCITRAL Model Law provides, at Article 33(1), that "[t]he arbitral tribunal shall apply the law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable."

5. Article 38(2) of the Statute of the International Court of Justice provides that the court may, if the parties agree, make decisions *ex aequo et bono.*

6. Article 21(s) of the ICC Rules (as in effect 1 January 2012) provide: "The arbitral tribunal shall assume the powers of an amiable compositeur or decide ex aequo et bono only if the parties have agreed to give it such powers."

7. Article 31(3) of the ICDR Rules (as in effect 1 June 2014) provide: "The tribunal shall not decide as amiable compositeur or ex aequo et bono unless the parties have expressly authorized it to do so."[1]

[1] NB: Article 31(1) of the ICDR Rules provides that the arbitrator(s) "shall" apply the law.

8. LCIA Rules (as in effect 1 October 2014) provide:

> "22.3 The Arbitral Tribunal shall decide the parties' dispute in accordance with the law(s) or rules of law chosen by the parties as applicable to the merits of their dispute. If and to the extent that the Arbitral Tribunal decides that the parties have made no such choice, the Arbitral Tribunal shall apply the law(s) or rules of law which it considers appropriate.
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> 22.4 The Arbitral Tribunal shall only apply to the merits of the dispute principles deriving from "ex aequo et bono", "amiable composition" or "honourable engagement" where the parties have so agreed in writing."

9. SIAC Rules of 2013 provide the following:

> 27.1 The Tribunal shall apply the rules of law designated by the parties as applicable to the substance of the dispute. Failing such designation by the parties, the Tribunal shall apply the law which it determines to be appropriate.
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> 27.2 The Tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorised the Tribunal to do so.
> 27.3 In all cases, the Tribunal shall decide in accordance with the terms of the contract, if any, and shall take into account any usage of trade applicable to the transaction.

10. HKIAC Rules (effective 2013) provide:

> **Article 35 – Applicable Law, Amiable Compositeur**
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> 35.1 The arbitral tribunal shall decide the substance of the dispute in accordance with the rules of law agreed upon by the parties. Any designation of the law or legal system of a given jurisdiction shall be construed, unless otherwise expressed, as directly referring to the substantive law of that jurisdiction and not to its conflict of laws rules. Failing such designation by the parties, the arbitral tribunal shall apply the rules of law which it determines to be appropriate.
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> 35.2 The arbitral tribunal shall decide as amiable compositeur or ex aequo et bono only if the parties have expressly agreed that the arbitral tribunal should do so.

35.3 In all cases, the arbitral tribunal shall decide the case in accordance with the terms of the relevant contract(s) and may take into account the usages of the trade applicable to the transaction(s).

11. JAMS International Rules (effective 1 August 2012) provide:

Article 18. Applicable Law(s)

18.1 The Tribunal will decide the merits of the dispute on the basis of the rules of law agreed upon by the parties. In the absence of such an agreement, the Tribunal will apply the law or rules of law that it determines to be most appropriate.

18.2 The procedure applicable to the arbitration will be the procedure set forth in these Rules and in the arbitration law of the place of arbitration, unless the parties have expressly agreed upon another procedure, or upon the application of another arbitration law, provided any such agreement is deemed enforceable by the law of the place of arbitration.

18.3 In all cases the Tribunal will take account of the provisions of the contract and the relevant trade usages.

12. JAMS Rules further provide:

Article 30. Remedies

30.1 The Tribunal may grant any remedy or relief, including, but not limited to, specific performance of a contract, which is within the scope of the agreement of the parties and permissible under the law(s) or rules of law applicable to the dispute or, if the parties have expressly so provided, within the Tribunal's authority to decide as *amiable compositeur* or *ex aequo et bono*. The Tribunal will decide a dispute *ex aequo et bono* or as *amiable compositeur* only if the parties have expressly authorized it to do so.

13. What happens in actual practice? Less than 5% of arbitration clauses authorize the tribunal to act *ex aequo et bono*, or as *amiable compositeur*.

<u>The Arbitrator's Authority (Domestic)</u>

1. AAA Rule 46(b): "The arbitrator need not render a reasoned award unless the parties request such an award in writing prior to appointment of the arbitrator or unless the arbitrator determines that a reasoned award is appropriate."

2. AAA Rule 47(a): "The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties, including, but not limited to, specific performance of a contract."

3. Are there limits to the arbitrator's decision-making authority? Gary Born, a well-known international arbitrator, noted: "Historically, arbitration in some jurisdictions (particularly the United States) bore many resemblances to arbitration *ex aequo et bono* or *amiable compositeur*. Arbitrators were not required to give reasoned awards, nor to apply statutory protections, and their decisions were not reviewable for errors of law or fact. In some contemporary commercial contexts, domestic U.S. arbitration retains various of these features, even without being denominated arbitration *ex aequo et bono*.[2]" G Born, *International Commercial Arbitration* (2d ed. 2014 Wolters Kluwer), Chapter 19.

4. Professor Thomas Stipanowich, another well-known arbitrator and scholar, wrote: "The Survey data indicate that where legal issues are in play, experienced arbitrators tend to be conscientious in paying heed to them and addressing them in a manner consistent with applicable law. All respondents claimed, usually or always, to "carefully read and reflect upon legal arguments and briefs presented by counsel." Nearly all asserted that, in the absence of an agreement to the contrary, they "do [their] best to ascertain and follow applicable law in rendering an award." On the other hand, more than a quarter of respondents "feel free to follow [their] own sense of equity and fairness in rendering an award even if the result would be contrary to applicable law," at least some of the time. Moreover, nearly nine-tenths of respondents acknowledged that, at least sometimes, they "negotiate with other members of a tribunal respecting the quantum of damages to be awarded." In order to understand the precise import of these responses and their implications for users, further investigation and discussion is appropriate." Stipanowich, Kluwer Arbitration Blog (6 February 2015) *A Recent Survey of Experienced U.S. Arbitrators Highlights Areas for Further International Study and Discussion*.

Enforcement, Vacatur & Judicial Limits on Arbitral Authority

Domestic

1. *First State Insurance Company v. National Casualty Company*, No. 14-1644, slip. op. (1st Cir. Mar 20, 2015) – a reinsuance claims payment protocol case. Dispute arose concerning the terms and conditions under which reinsuance claims were to be paid. Following an arbitration award in which the arbitral tribunal construed the various reinsurance agreements, a challenge to enforcement was made

[2] *See J.B. Harris, Inc. v. Razei Bar Indus. Ltd,* 1999 WL 319330, at *2 (2d Cir. 1999) (rejecting public policy objection to forum selection clause providing that "the arbitrator will not be bound by the substantive law and laws of procedure" on grounds that "this particular provision . . . is completely unremarkable in the arbitration context[, as] arbitrators are presumptively free from principles of substantive law or rules of evidence")."

pursuant to Section 10(a)(4) of the FAA (arbitrators exceeded their authority) based on the *Oxford/Stolt-Nielsen* "manifest disregard of the law" theory. The First Circuit (Justice Souter, Ret., sitting) ruled that not only did the reinsurance contracts include an "honourable engagement" clause, the arbitrators had construed the underlying agreements and, therefore, acted within the scope of their contractually delineated powers."

International

2. New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Article V(1)(c) [*see,* FAA Section 207] provides that recognition of a foreign arbitral award may be refused where "the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced."

3. In *International Standard Electric Corp. ("ISEC") v. Bridas Sociedad Anonima Petrolera Industrial Y Comercial*, 745 F.Supp 172 (S.D.N.Y. 1990), ISEC argued that enforcement of the award should be refused because the arbitral tribunal had determined damages based upon equitable principles and had, therefore, acted as *amiable compositeur* without the parties' express consent. It also argued that this constituted a manifest disregard of the law. The Court noted that "manifest disregard" is a domestic arbitration defense to enforcement, and that it had no power to revisit the panel's fact finding, or to review *de novo* the tribunal's determinations.

Conclusion

Arbitrators are rarely granted the authority to act *ex aequo et bono* or as *amiable compositeurs* – and this is as it should be. Fundamental to the dispute resolution process is the ability of the parties to analyze the facts and law and determine the most likely outcome. If the arbitrator's decision is untethered from the law, predictability is easily lost. While there are some rare circumstances – usually involving very niche commercial transactions and relationships – where preservation of relationships warrant acting as *amiable compositeur* – that is the exception to the rule and the authority to so act must be clearly conferred.

Recent studies have analyzed arbitration award data to determine whether arbitrators *"split the baby."* In past years, some parties and their counsel expressed concern that the arbitration process resulted in compromise awards – something less than what might be achieved through the court system. Analysis of years of historical award data has revealed that approximately 95% of all awards are entirely in favor of

one party or the other – far different than the anecdotally expressed concerns about arbitration. While likely not related to the percentage of arbitration clauses authorizing *ex aequo et bono* or as *amiable compositeur* awards, the data provides clear evidence that parties seek legally predictable outcomes and arbitrators deliver on that expectation.