

# Kluwer Arbitration Blog

## Is Good Faith in the IBA Evidence Rules Good?

Margaret Moses (Loyola University Chicago School of Law) · Thursday, November 15th, 2012 · Institute for Transnational Arbitration (ITA), Academic Council

The addition of the good faith requirement to the 2010 IBA Rules on the Taking of Evidence in International Arbitration has been criticized in a recent law review article. In *Good Faith, Bad Faith, But Not Losing Faith: A Commentary on the 2010 IBA Rules on the Taking of Evidence in International Arbitration*, Pedro J. Martinez-Fraga asserts that by not providing a definition of good faith, the Rules accord the arbitrator “unbridled authority” and diminish party autonomy (43 Georgetown J. Int’l L. 387 (2012), at 411, 416). Martinez-Fraga has written a very thoughtful, scholarly article, but one that, in my view, does not persuade as to the alleged harmfulness of including a good faith requirement in the Rules. Before turning to the article, it is worth taking a look at the good faith requirement in the Rules, and briefly considering the use of good faith in other international instruments.

The 2010 Preamble to the Rules identifies principles that will help arbitrators and parties understand how the Rules are meant to be applied. Paragraph 1 of the Preamble explains that the Rules “are intended to provide an efficient, economical and fair process for the taking of evidence in international arbitrations, particularly those between Parties from different legal traditions.” It then adds in paragraph 3 that “[t]he taking of evidence shall be conducted on the principle that each Party shall act in good faith and be entitled to know, reasonably in advance of any Evidentiary Hearing or any fact or merits determination, the evidence on which the other Parties rely.” The Preamble thus sets forth fairness and good faith as general principles critical to the efficiency and economy of the process, needed to enable parties and tribunals to achieve the most effective means of resolving their disputes.

While the Preamble declares good faith conduct to be the proper normative standard, the Rules give teeth to that standard in Article 9 (7) by specifically providing that the arbitral tribunal can take into account whether a Party “has failed to conduct itself in good faith in the taking of evidence” in its assignment of the costs of the arbitration. This section takes into consideration the fact that when a party acts in bad faith, its tactics can increase unnecessarily the costs of the arbitration, and fairness may thus require the bad faith party to pay those costs.

The Rules’ adoption of a good faith requirement appears to be part of a trend toward viewing good faith conduct as a general principle in international transactions. A requirement of good faith is more acceptable today than, for example, when the CISG was promulgated in the 1980’s. Application of good faith under the CISG was very controversial among the drafters, resulting in an ambiguous compromise in Article 7(1) that raised questions about whether the CISG imposed

an obligation of good faith conduct on the parties. Opponents of good faith found no such obligation, but others have asserted that it is not possible to interpret the CISG in good faith without at least indirectly considering the good faith of the parties' conduct.

More recent international instruments have had no hesitation to impose a full-blown good faith requirement on the parties. The UNIDROIT Principles (Art. 1.7) and the Principles of European Contract Law (Art. 1:201) both require that a party act in accordance with good faith and fair dealing. The IBA Rules therefore appear to be supporting a trend toward considering good faith as a general principle of international commercial law.

There is, however, some push back on imposing a good faith requirement on party conduct. The reasons are not very different from those advanced during the drafting debates for the CISG.

Basically, the protest is that good faith is difficult to define, and thus leads to a lack of uniform interpretation and application. That concern appears to underpin Martinez-Fraga's article, along with the belief that the absence of a definition for good faith so increases the arbitrator's discretion that it improperly divests parties of autonomy. Curiously, Martinez-Fraga devotes almost his entire discussion of good faith to a U.S. case that he believes was wrongly decided, *ReliaStar Life Ins. Co. v. EMC* (564 F. 3d 81 (2d Cir. 2009)). The choice is curious because (a) *ReliaStar* is not an international case, but a U.S. case decided under New York law; (b) the IBA Rules were not applicable and not even mentioned in the case; and (c) the question of bad faith had nothing to do with the taking of evidence. Nonetheless, the case was perhaps selected because it may encapsulate Martinez-Fraga's worst fears about how an arbitrator might apply the good faith requirement under the Rules.

In *ReliaStar*, the arbitrators awarded costs against one party, even though the arbitration clause provided that each party would pay its own costs and fees. The Second Circuit affirmed the award. Although Martinez-Fraga vigorously attacks the decision on many different grounds, he never sets forth clearly the reasons given for affirmance. What the court said was that when the parties provided in the arbitration agreement that each would pay its own costs and fees, there was a presumption by each party that the other party would act in good faith. Because one party did not act in good faith, the Tribunal had the authority to allocate costs against the bad faith party. The court stated that if the parties had meant that they would each pay their own costs and fees even if the other party acted in bad faith, they could have said that in the agreement, but they didn't. Thus, party autonomy is not hurt for the future, at least in the Second Circuit, because a party could always say in the arbitration clause that the arbitrator cannot allocate costs against a party even if it acts in bad faith. However, parties have not rushed to put such a provision in their arbitration agreements. It is hardly in one party's interest to give the other party license to act in bad faith with impunity as to costs.

One area where Martinez-Fraga seems to misperceive the intent of both the *ReliaStar* decision and the IBA Rules is in characterizing the allocation of costs to the bad faith party as punitive. He refers to "the *ReliaStar* tenet that an arbitral tribunal has the inherent authority to award a party attorney's fees and costs as a punitive sanction based upon absence of good faith in the conduct of the arbitration." (p. 422). He also asserts that Article 9, Paragraph 7 of the IBA Rules "vests the arbitral tribunal with authority to impose punitive sanctions in the form of "costs of the arbitration" (p. 421).

However, the allocation of costs in both *ReliaStar* and under the IBA Rules does not appear to be punitive, but rather compensatory, and thus is not that different from compensatory awards in

many other jurisdictions. The Court in *ReliaStar* specifically noted that in a prior Second Circuit case it had concluded that an award based on bad faith conduct was compensatory, not penal, in nature. With respect to that prior case, *Synergy Gas Co. v. Sasso*, (853 F.2d 59 (2d Cir. 1988)), the court had observed that “if Synergy had not acted in bad faith, then [the employee] Brown would have been reinstated more than six years ago and the attorney’s fees would not have been incurred” (at 87). The court then added that with regard to the present *ReliaStar* case, the respondent, National Travelers, had never challenged the fee award on the ground that it was punitive rather than compensatory, so the court did not even consider whether the award was anything other than compensatory (at 87, n.3). It is unclear why Martinez-Fraga thought the court was approving a punitive sanction.

Similarly, there is nothing in the IBA provision in Article 9(7) that suggests that the provision is meant to be punitive rather than compensatory, particularly when coupled with the Preamble’s statement that the purpose of the Rules is to promote an efficient, economical and fair process. Article 9(7) simply states that the Tribunal, when it assigns costs, may take into account a party’s failure to conduct itself in good faith in the taking of evidence. Fairness would seem to support compensating the party who acted properly and in good faith from the burden of the inefficiencies created by the bad faith conduct of the other party. The Rules do not suggest that bad faith in the taking of evidence would shift *all* costs. Rather, bad faith conduct would be a factor for the tribunal to consider along with other factors in making a determination as to the proper cost allocation.

Although it is certainly true that good faith is not an easy concept to define, and may look different to arbitrators from different backgrounds, a rigid definition would also not be desirable. There has to be flexibility in how to deal with the circumstances of a particular case. Increasingly, there is a consensus that parties should engage in fair conduct, act honestly and with mutual trust, and meet each other’s reasonable expectations of decent behavior within a fair process. By encouraging the taking of evidence in good faith, the IBA Rules will help develop a jurisprudence with respect to the taking of evidence that focuses on transparency, good faith, and efficiency. On the other hand, putting the definition of good faith into a narrow box would seem unlikely either to cabin arbitral discretion or to make the arbitration process more fair or more efficient.

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