Kluwer Arbitration Blog

Ex Aequo et Bono: An Overlooked and Undervalued Opportunity for International Commercial Arbitration

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Ex aequo et bono[1] is a legal concept that confers on arbitrators the power to decide a dispute in accordance with their sense of fairness and good conscience, instead of rigorously applying terms of a specific body of law. The principle has been unpopular in contemporary arbitration practice because there has been a tacit understanding among arbitration lawyers that to apply *ex aequo et bono* is to ruin arbitral procedure. This blog posting challenges this perception and urges the international arbitration community to de-mystify and revitalise *ex aequo et bono*, particularly to redress the 'over-judicialisation' (encroaching formalisation) of international commercial arbitration.

'Negative' Reputation Undeserved

While *ex aequo et bono* can be found in various legal instruments[2] and institutional rules[3], it has long been perceived by some arbitration lawyers as arguably causing negative impacts on arbitral procedure: unpredictability of results and the potential for abuse of discretion (if any) by arbitrators. As to the former, it is suggested that the uncertain nature and scope of *ex aequo et bono* may undermine certainty in arbitration[4]. As to the latter, it is argued that to adopt *ex aequo et bono* is to permit arbitrators to 'ignore' the actual intentions of the parties[5]. These concerns seem to have been a major cause of the limited application of the principle in arbitration practice. According to Born, tribunals in only 2-3% of arbitration cases annually apply *ex aequo et bono*[6].

However, these criticisms of *ex aequo et bono* may be misplaced.

Commentators pointing out the unpredictability of results seem to assume that international commercial arbitration, through the strict application of legal rules, is more predictable than that of under *ex aequo et bono*. But is this assumption true?[7] Concepts such as good faith or reasonableness inherently contain a degree of discretion and vagueness. If legal norms containing such concepts are enforced, there is already no absolute certainty in the arbitrators' decision-making. Therefore, the old saying 'the only certainty is that nothing is certain' may apply to arbitration in general.

Moreover, are arbitrators allowed to overturn party intentions through applying *ex aequo et bono*,

if they must respect the principle of party autonomy? Arbitrators decide a dispute by exercising powers granted by the parties, even in arbitration adopting *ex aequo et bono*.[8] If they confer authority to decide *ex aequo et bono* on themselves and ignore the actual intentions of the parties, this would certainly constitute an undue exercise of discretion.

Such a situation would rarely happen because the parties must expressly agree to adopt *ex aequo et bono* for the principle to be applied under the UNCITRAL Model Law. Article 28(3) states that '[t]he arbitral tribunal shall decide *ex aequo et bono* … only if the parties have expressly authorized it to do so'; arbitrators are not able to rely on their idea of fairness without clear authorisation by parties. Article 28(4) also provides that 'the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction'.

In addition to these explicit limitations imposed by the Model Law, arbitrators with the power of deciding *ex aequo et bono* must observe applicable mandatory rules of law. For example, the award should not violate mandatory rules of the seat of arbitration. This is because an important duty for arbitrators is to issue an enforceable arbitral award. According to the 2018 QMUL Survey and many other empirical studies, enforceability of arbitral awards is one of the most valuable characteristics of arbitration. Parties expect arbitrators to issue an enforceable decision.

What these limitations clarify is that *ex aequo et bono* under the Model Law mandates arbitrators to implement the principle of party autonomy thoroughly but flexibly. The arbitrators are not allowed to abuse their discretion and ignore the express intentions of the parties.

Potential in *Ex Aequo et Bono* to Respond to 'Over-Judicialisation'

In fact, there can be benefit in using *ex aequo et bono* more often in international arbitration.

The flexibility inherent in *ex aequo et bono* has potential to improve the practice of international commercial arbitration, by redressing excessive formalisation in arbitral procedures.

Although international commercial arbitration was originally developed as a cost-effective and flexible dispute resolution system,[9] it can be seen as expensive and inefficient in some cases. In particular, the increasing number of procedural guidelines and the importation of litigation-style techniques have possibly made arbitration more cumbersome. In fact, international arbitration institutions revise their rules every few years, almost always adding new provisions. Professional associations, in turn, draft new guidelines, sometimes introducing new procedural steps. Due to the development of information technology, the amount of evidence submitted during an arbitral procedure is sharply increasing. While the aim of these initiatives is not to make arbitration burdensome but to decrease procedural ambiguities[10] Procedural Lex Mercatoria: The Past, Present and Future of International Commercial Arbitration, the efforts can often (unfortunately) exacerbate procedural complexities.

However, this may not be the direct cause of delay in arbitral proceedings. Unless otherwise agreed by parties, arbitrators have no legal duty to observe procedural guidelines, which are default rules, and litigation-style techniques, which are alien to arbitration. Arbitrators nevertheless appear to be forced to follow these default rules by their so-called 'due process paranoia': the 'reluctance by tribunals to act decisively in certain situations for fear of the arbitral award being challenged on the

basis of a party not having had the chance to present its case fully' (see for example, here, here, and here). In short, arbitrators' psychological state seems to be a significant underlying cause of inflexibility and delay.

Ex aequo et bono may improve this mentality of arbitrators. The primary aim in applying the principle is to give them the authority to make decisions flexibly to deliver effectively on the arbitrators' mandate to decide the dispute as granted by the parties. By agreeing to *ex aequo et bono* proceedings, at least for some types of disputes, the parties permit arbitrators to act robustly to provide efficient dispute resolution. The arbitrators, therefore, do not have to become overly sensitive to every single procedural issue. They only have to observe norms arising from the principle of party autonomy: contract terms, trade usages, and mandatory rules of law at the seat of arbitration.

This real feature of *ex aequo et bono* needs to be disseminated more broadly in the arbitration community; otherwise, it would be impossible, through *ex aequo et bono*, to cure arbitrators' due process paranoia and thereby to counter-balance the over-judicialisation of international commercial arbitration. Since the application of *ex aequo et bono* requires express agreement by the parties to resort to the principle, it is crucial to make those parties – as users of arbitration – to realise that *ex aequo et bono* has a potential to make arbitration more efficient. *Ex aequo et bono* alone is not effective enough to combat against the encroaching over-judicialisation; the parties' agreement for the tribunal to use it is essential.

Conclusion

Unlike their counterparts in the European Middle Agents, modern merchants are not inclined to resort to *ex aequo et bono*. This blog posting suggests that the contemporary business world's disinclination to use *ex aequo et bono* derives from an inadequately informed perception of the principle. Their arguably erroneous understanding is that *ex aequo et bono* hampers arbitral procedures by giving rise to irreconcilable uncertain outcomes and by encouraging arbitrators to abuse their discretion. However, uncertainties persist in arbitration under the strict application of legal terms, while *ex aequo et bono* arbitration is in fact bound by significant elements of party autonomy. Accordingly, it is unclear if we should keep emphasising the allegedly negative features of *ex aequo et bono*. This blog has instead proposed to use (or at least plan to use) the flexibility inherent in the principle in order to boost the efficiency of international commercial arbitration.

The ideas in this blog post are elaborated in Nobumichi Teramura, Ex Aequo et Bono as a Response to the 'OverJudicialisation' of International Commercial Arbitration (Kluwer Law International, 2020).

References

?1 The author is grateful to Professors Leon Trakman and Luke Nottage for their comment on early drafts of this blog article.This blog post is based on the author's PhD thesis.

?2 Article 28(3) of the Model Law.

?3 For example Article 31 of CAAI Arbitration Rules; Article 21 (3) of ICC Rules of Arbitration; Article 29.2 of ACICA Arbitration Rules; Article 22.4 of LCIA Arbitration Rules; Article 33.2 of Swiss Rules of International Arbitration; Article 27(3) of SCC Rules; Article 35.2 of HKIAC Administered Arbitration Rules; Article 31.2 of SIAC Rules; and Rule 60.3 of JCAA Rules.

?4 Karyn S. Weinberg, *Equity In International Arbitration: How Fair is Fair? A Study of Lex Mercatoria and Amiable Composition*, 12 Boston University International Law Journal 227, 246-7 (1994); Edouard Bertrand, *Amiable Composition: Report of the ICC France Working Group*, International Business Law Journal 753, 763 (2005); Regis Bonnan, *Different Conceptions of Amiable Composition in International Commercial Arbitration: A Comparison in Space and Time*, 6 Journal of International Dispute Settlement 522, 538 (2015).

?5 Emmanuel Vuillard & Alexandre Vagenheim, *Why Resort to Amiable Composition*, International Business Law Journal 643, 650 (2008).

?6 Gary Born, International Commercial Arbitration 2770 (Kluwer Law International 2nd ed. 2014).

?7 See, e.g., Edouard Bertrand, *Under What Circumstances is It Suitable to Refer Disputes to Amiable Composition*, International Business Law Journal 609, 610-11 (2008).

?8 Article 28(2) of the Model Law.

?9 Nigel Blackaby, Redfern and Hunter on International Arbitration 1,2 (Constantine Partasides, et al. eds., Oxford University Press 6th ed. 2015).

?10 Luke R Nottage, *https://dx.doi.org/10.2139/ssrn.838028?>The Procedural Lex Mercatoria: The Past, Present and Future of International Commercial Arbitration*, Sydney Law School Research Paper No. 06/51; CDAMS Discussion Paper No. 03/1E, at 5.

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