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# Ex Aequo et Bono: De-mystifying An Ancient Concept

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Leon Trakman

#### **Abstract**

The ancient concept, ex aequo et bono, holds that adjudicators should decide disputes according to that which is "fair," and in "good conscience". Despite its long history in international adjudication and even though it is enshrined in the Charter of the Permanent Court of International Justice, the concept of ex aequo et bono is often avoided on grounds that it operates outside of law, or is deemed to be contrary to law.

This article argues that the concept has a valuable and emerging significance in modern law. It is ideally suited to resolving disputes between parties who are engaged in complex and long-term relationship or in emerging fields in which the law is either inadequately developed or unsuitable to resolve complex disputes.

Tracing the evolution of the concept historically through the Medieval Law Merchant to modern times, the article sets out how ex aequo et bono might be revitalized in both international and domestic law. Arguing that ex aequo et bono operates along a continuum rather than at a fixed point between law and non-law, it illustrates how it can be both formulated and applied. It demonstrates how to relate ex aequo bono to the law of equity and how to reconcile it with "gap filling" under law. It also shows how discretion in applying ex aequo et bono can be subject to internal and external limits; and how parties can invoke it most effectively to resolve their disputes. The article concludes by presenting a methodology by which to guide the application of ex aequo et bono to such disputes.

## EX AEQUO ET BONO:

### **DE-MYSTIFYING AN ANCIENT CONCEPT**

### LEON TRAKMAN\*

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The ancient concept, *ex aequo et bono*, holds that adjudicators should decide disputes according to that which is "fair," and in "good conscience". Despite its long history in international adjudication and even though it is enshrined in the Charter of the Permanent Court of International Justice, the concept of *ex aequo et bono* is often avoided on grounds that it operates outside of law, or is deemed to be contrary to law.

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Tracing the evolution of the concept historically through the Medieval Law Merchant to modern times, the article sets out how *ex aequo et bono* might be revitalized in both international and domestic law. Arguing that *ex aequo et bono* operates along a continuum rather than at a fixed point between law and non-law, it illustrates how it can be both formulated and applied. It demonstrates how to relate *ex aequo bono* to the law of equity and how to reconcile it with "gap filling" under law. It also shows how discretion in applying *ex aequo et bono* can be subject to internal and external limits; and how parties can invoke it most effectively to resolve their disputes. The article concludes by presenting a methodology by which to guide the application of *ex aequo et bono* to such disputes.

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#### EX AEQUO ET BONO:

#### **DE-MYSTIFYING AN ANCIENT CONCEPT**

"Settlement of a dispute ex aequo et bono rather than on the basis of law, results neither from the nature of the dispute, nor from lacunae in international law, but solely from the decision of the parties to obtain such a solution." [Degan, L'equite en droit international p.239 (1970), translated by Aaron Broches, Selected Essays: World Bank, ICSID, and Other Subjects of Public International Law (Springer, 1995) at p.231].

#### INTRODUCTION

The concept, *ex aequo et bono*, is often negatively stereotyped, misunderstood, or both. It is supposed that an adjudicator, in deciding according to that which is "fair" and "good" acts "outside of the law" or more pejoratively, "acts notwithstanding the law." It is in part for these reasons that both public and private parties to international agreements often avoid resorting to *ex aequo et bono* in resolving their differences.

The result is that, absent express party consent, there is ordinarily no decision-making *ex aequo et bono*.<sup>2</sup> In limited instances adjudicators decide cases based on principles not ordinarily contained in international law, such as in assuring that treatment is humane and that remedies are proportionate; but only if such action is permitted by the applicable law. The presumption is that such principles are legitimately invoked because they are permitted by law and are not the result of an independent decision by the adjudicator to decide *ex aequo et bono*.<sup>3</sup>

Dynamic changes in international relations, typified by the growing international investment disputes, have brought the concept of *ex aequo et* 

<sup>&</sup>lt;sup>1</sup> See Black's Law Dictionary 557 (6th ed. 1990) in which ex aequo et bono is defined as: "in justice and fairness; according to what is just and good; according to equity and conscience".

<sup>&</sup>lt;sup>2</sup> For example, the ICSID Agreement expressly provides that tribunals that invoke *ex aequo et bono* in the absence of express party consent is subject to annulment. See Section 9. DECIDING ex aequo et bono, at <a href="http://www.unctad.org/en/docs/edmmisc232add5\_en.pdf">http://www.unctad.org/en/docs/edmmisc232add5\_en.pdf</a> See too infra Section II, iii.

<sup>&</sup>lt;sup>3</sup> For discussion on equitable decisions under law and *ex aequo et bono* outside of it, *see further infra* Section III. Typifying this fear that *ex aequo et bono* awards will lead to excessive damages in regard to intellectual property infringements, *see* <a href="http://www.managingip.com/?Page=17&ISS=23201&SID=669258">http://www.managingip.com/?Page=17&ISS=23201&SID=669258</a>

bono back into focus. <sup>4</sup> Parties are increasingly faced with no or little law in the applicable field, or one or both parties mistrust the law or its application to their particular dispute. Coupled with this is growing interest in the expeditious resolution of disputes in emerging areas of law like the law as it relates to the Internet, intellectual property and state-investor disputes. <sup>5</sup> Added to this is recognition that the expertise of international adjudicators may outweigh reliance on inapplicable law, and that resort to conceptions of fairness to disputing parties may be considered preferable to the alternatives. <sup>6</sup> Finally, parties engaged in long-term party relationship may be interested in resolving their disputes by *amiable composition* <sup>7</sup> or *ex aequo et bono* in order to maintain those relationship. <sup>8</sup> It is in respect of such relational agreements, as distinct from discrete transactions, that *ex aequo et bono* has the most to offer. <sup>9</sup>

The result is a mounting interest in dispute resolution *ex aequo et bono* by international organizations, notably by the International Chamber of Commerce (ICC) in 2005 in relation to international commercial dispute resolution. <sup>10</sup> One key issue for consideration relates to how the concept of

<sup>&</sup>lt;sup>4</sup> This development is also reflected in the mushrooming of investment treaties. *See e.g.* Taida Begic, <u>Applicable Law in International Investment Disputes</u> Chapter 2, Agreed Choice of Law (Switzerland, Geneva: Eleven International Pub., 2005), at <a href="http://www.iccwbo.org/policy/arbitration/id6566/index.html">http://www.iccwbo.org/policy/arbitration/id6566/index.html</a>

<sup>&</sup>lt;sup>5</sup> See infra Section II, iii.

<sup>&</sup>lt;sup>6</sup> Considerations of fairness are also appropriate between parties of unequal bargaining power, notably in employer-employee relations and in the award of monetary damages. *See e.g. Ex aequo et bono* is also used in determining non-material damages due to an employee in employment cases, such as after a considerable delay occurred before the employee's personal file was brought up to date, in <u>Gilbert Castille v Commission of the European Communities</u>, case 186/84, European Court Reports (1986), page 00497.

Amiable composition ordinarily arises when the adjudicator determines the rules governing proceedings, rather than rely on an applicable law. On the history and institutionalization of amiable compositeur, *see* Serge Braudo, "L'arbitre avec mission d'amiable compositeur" at <a href="http://interarb.com/ea/ea/ea/31#2">http://interarb.com/ea/ea/ea/31#2</a> See too <a href="http://www.unctad.org/en/docs/edmmisc232add40">http://www.unctad.org/en/docs/edmmisc232add40</a> en.pdf, section 2.4; John E.C. Brierley, "Equity and Good Conscience' and Amiable Composition in Canadian Arbitration Law", 19 Can. Bus. L.J. 461 (1991).

<sup>&</sup>lt;sup>8</sup> See further infra Broches, note 57 at p. 231, on the argument that the use of ex aequo et bono to resolve investor-state disputes can help parties engaged in ongoing relationships to settle their differences while continuing to cooperate in their long-term relationship. See too infra Section II, iii.

 <sup>&</sup>lt;sup>9</sup> "Relational" agreements, revolving around the "relationship" between the parties tend to be more informal and less legalistic than discrete "transactions". See generally I. MacNeil, I. & I.D. Campbell, <u>The Relational Theory of Contract: Selected Works of Ian MacNeil</u>. (Modern Legal Studies series, London: Sweet & Maxwell, 2001).
 <sup>10</sup> The ICC appointed a Task Force on "Amiable Composition and ex aequo et bono" in

The ICC appointed a **Task Force on "Amiable Composition and ex aequo et bono"** in September 2005 with the mandate to (1) identify the essential features of "amiable composition" and of "ex aequo et bono" and (2) to study the role of the arbitrators when acting as "amiable compositeurs" or when deciding "ex aequo et bono" (e.g. jurisdictional, procedural or substantive problems that may arise). The Task Force is co-chaired by Mr.Edouard Bertrand (France) and Mr. Ronald King (United Kingdom). See <a href="http://www.iccwbo.org/policy/arbitration/id6566/index.html">http://www.iccwbo.org/policy/arbitration/id6566/index.html</a> The ICC provides for arbitration ex aequo et bono, with the consent of the parties. See Foreign Trade Information System (SICE), Commercial Arbitration and Alternative Dispute Resolution Methods, Articles 17 & 18, at <a href="http://www.sice.oas.org/dispute/comarb/icc/rules1.asp">http://www.sice.oas.org/dispute/comarb/icc/rules1.asp</a>

ex aequo et bono might evolve in the future, including how it might be constituted to suit modern international needs.

This essay evaluates the negative conceptualization of *ex aequo et bono*. It argues against the overly artificial divide between equitable decisions that accord with law and *ex aequo et bono* that inferentially do not. A truer distinction is to evaluate adjudicative discretion along a spectrum of decision-making instead of at a single point at which a legal decision regresses into a non-legal one.

Section I considers key issues surrounding *ex aequo et bono*. Section II outlines the evolution of *ex aequo et bono* historically and in modern public and private international law. Section III evaluates the tension between equitable and *ex aequo et bono* decision-making. Section IV explores "gap filling" in the exercise of adjudicator discretion. Sections V and VI set out internal and external limits on *ex aequo et bono*. Section VII examines the impact of *ex aequo et bono* upon party autonomy. Section VIII proposes guidelines in which *ex aequo et bono* might operate

The essay concludes that the viability of *ex aequo et bono* depends on the confidence with which parties adopt it and how effectively and fairly adjudicators apply it in accordance with practical reason.

#### I. THE PROBLEM STATED

Parties to international law disputes -- both public and commercial – ordinarily resolve disputes *ex aequo et bono* only as an exception, not as the rule. The vast majority of decisions are resolved according to the parties' choice of law. <sup>11</sup> Any resort to *ex aequo et bono* occurs only if they expressly choose it in substitution for, or in addition to their choice of law. <sup>12</sup>

Under international law, the power of an international tribunal to decide *ex aequo et bono* is restricted.<sup>13</sup> The tribunal must have regard to "the general principles of international law, while respecting the contractual obligations of the parties and the final decision of international tribunals that are binding upon the parties."<sup>14</sup> The choice of the parties to adjudicate *ex aequo et bono* must be expressly made and will not be implied.<sup>15</sup>

As a matter of policy, critics of adjudication *ex aequo et bono* conceive of it as involving diplomatic decision-making more fitting to a legislature than an adjudicative tribunal. <sup>16</sup> Skeptical of judicial resort to *ex aequo et bono*, the

<sup>13</sup> See generally infra Sections II, i.

<sup>&</sup>lt;sup>11</sup> See generally infra Section VII.

<sup>&</sup>lt;sup>12</sup> See infra Section IV.

<sup>&</sup>lt;sup>14</sup> *See* Article 26, European Convention on the Peaceful Settlement of Disputes, (1957), at <a href="http://www1.umn.edu/humanrts/peace/docs/europeace.html">http://www1.umn.edu/humanrts/peace/docs/europeace.html</a>

<sup>&</sup>lt;sup>15</sup> See infra Section III.

<sup>&</sup>lt;sup>16</sup> These factors account for a tendency to expressly forbid decisions *ex aequo et bono*. On a decision that expressly forbids a tribunal from so acting, *see* <a href="http://webfarmext.un.org/hrmtribunal/unat\_edit1\_jurisprudence.asp?Subject\_index1=Legal+principles&Sub\_index=Equity">http://webfarmext.un.org/hrmtribunal/unat\_edit1\_jurisprudence.asp?Subject\_index1=Legal+principles&Sub\_index=Equity</a>

late Judge Sir Ernst Lauterpacht noted that, deciding *ex aequo et bono* "introduces the possibility of the law being changed in accordance with justice and political requirements."<sup>17</sup>

Despite its critics, decision-making *ex aequo et bono* is formally permitted in public international law. Article 38 of the Statute of the Permanent Court of International Justice specifically entitles the Court to decide cases *ex aequo et bono* so long as the parties so choose. At the same time, the International Court has never decided a case based on *ex aequo et bono*. Is ts concern is that issues of fairness that arise outside of law ought to be resolved in the political arena. The overriding view is that, to decide *ex aequo et bono* is to diminish the standing of the Court. To recast itself into a conciliator is to clothe it with powers it ought not to have. For it to replace legal principles with open-ended conceptions of fairness is to compromise its mandate as a judicial body.

For the most part, however, the principle of *ex aequo et bono* is either not mentioned in international law decision-making, or confused with conceptions of equity.<sup>23</sup> In a few cases, it is expressly forbidden, such as under the constituent treaty of the Eritrea-Ethiopia Claims Commission.<sup>24</sup>

Despite all this, there is ample evidence that *ex aequo et bono* is recognized in decision-making, both internationally under Article 38 of the Charter of the Permanent Court, and also through its accretion into multiple domestic

http://www.unmeeonline.org/index.php?option=com\_content&task=view&id=15&Itemid=50 See generally See e.g. M.C.W. Pinto, "Structure, Process, Outcome: Thoughts on the 'Essence' of International Arbitration' in The Flame Rekindled, New Hopes for International Arbitration, 6 Leiden J. Int'l L. 241 (1993), [Pinto was the Secretary-General of the Iran-United States Claims Tribunal.]

<sup>&</sup>lt;sup>17</sup> H. Lauterpacht, <u>The Function of Law in the International Community</u> (1933) at p.379. *See too* J. H. Rawlston, <u>International Arbitration from Athens to Locarno</u> pp. 22-26 (1929).

<sup>&</sup>lt;sup>18</sup> See infra text accompanying notes 25 & 26.

<sup>&</sup>lt;sup>19</sup> To the author's knowledge, no decision of the International Court to date has rested squarely on principles of *ex aequo et bono*. *But see infra* note 21.

<sup>20</sup> See further Karl C. Wellens, Economic Conflicts and Disputes Before the World Court (1922-1995): A Functional Analysis pp.270-275 (Martinus Nijhoff, 1996).

21 See Thomas M. Franke, Recueil Des Cours: Collected Courses of the Hague Academy of International Law 1993: III at p.69 et seq. (Martinus Nijhoff Publ., 1994) W. Friedmann, "The North Sea Continental Shelf Cases – A Critique," 64 Am. J. Int'l. Law 229, 235 (1970).

<sup>&</sup>lt;sup>22</sup> On the Court's avoidance of *ex aequo et bono* in deciding cases, see the opinion of Kellogg J. in <u>Free Zones of Upper Savoy and the District of Gex (France v. Switzerland)</u>, 1929, PCIJ Series A. No.22, 5-7, 21-22, 34-40.

<sup>23</sup> *But see* Alfred P. Rubin, "Secession and Self-Determination: a Legal, Moral, and

<sup>&</sup>lt;sup>23</sup> But see Alfred P. Rubin, "Secession and Self-Determination: a Legal, Moral, and Political Analysis", 36 Stan. J. Int'l. L.253,255 n.8 (2000); Phaedon John Kozyris, "Lifting the Veils of Equity in Maritime Entitlements: Equidistance with Proportionality Around the Islands", 26 Denv. J. Int'l. L. & Pol'y 319, 330 n 38 (1998); Mark W. Janis, "The Ambiguity of Equity in International Law", 9 Brook. J. Int'l L.7 (1983). See further infra Section III.

<sup>&</sup>lt;sup>24</sup>Article 4(2) of the Algiers Peace Agreement between Ethiopia and Eritrea provided: "The Commission shall not have the power to make decisions ex aequo et bono." For the text of that Agreement, *see* 

jurisdictions.<sup>25</sup> Painstaking effort is also made to recast *ex aequo et bono* decisions outside law into equitable decisions under law.<sup>26</sup> The intention of those who subscribe to its spirit but not its letter, is to reach fair decisions under the law so as to avoid a *non liquet*, carefully avoiding being seen to decide *preator legem*, outside the law.<sup>27</sup>

## II. EX AEQUO ET BONO DECISIONS IN ACTION

The section below explores the use of *ex aequo et bono* in historical and conventional trade and investment practice, firstly, in light of the Medieval Law Merchant, and secondly, under the modern law of international trade and investment. The thesis is that medieval merchant courts – rough precursors to modern international commercial arbitrators -- decided disputes *ex aequo et bono* in response to "the law" of commercial practice quite apart from "the law" of princes. Particular emphasis is given to the application of *ex aequo et bono* to international trade disputes through the United Nations Commission on International Trade Law (UNCITRAL)<sup>28</sup> and to the settlement of state-investor disputes through the International Center for the Settlement of Investment Disputes (ICSID).<sup>29</sup> Central to the discussion of *ex aequo et bono* decisions in action is the paramount interest in resolving disputes expertly, informally, expeditiously and fairly, rather than formally according to law.<sup>30</sup>

#### i. The Medieval Law Merchant

Merchant judges under the Medieval Law Merchant decided cases *ex aequo et bono* according to merchant codes devised, adopted and applied by merchant judges. These merchant judges resolved disputes among itinerant merchants at regional fairs, markets, towns and ports, quite apart from the courts and judges who administered the law of local princes. Against this background, merchant judges decided disputes *ex aequo et bono*, encompassing "fairness between the parties" and the prompt dispensation of justice. The rational was that itinerant merchants who traveled with their goods from staple to staple, guild to guild, fair to fair, and port to port should receive expeditious justice before merchant court without having to delay their mercantile journey. So significant was this interest in speedy justice that Law Merchant courts in parts of now France were named

<sup>&</sup>lt;sup>25</sup> See further infra note 18.

<sup>&</sup>lt;sup>26</sup> For an excellent discussion on the International Court's treatment – or non-treatment – of *ex aequo et bono, see* Thomas M. Franck, <u>Fairness in International Law and Institutions</u> (New York: Oxford University Press, 1995).

<sup>&</sup>lt;sup>27</sup> On the different categories of equity invoked by international tribunals, *see* Franck, *ibid.*. *See* further *generally* Section III.

<sup>&</sup>lt;sup>28</sup> See further infra in this Section, subsection ii.

<sup>&</sup>lt;sup>29</sup> *Ibid*, subsection iii.

<sup>&</sup>lt;sup>30</sup> See generally infra Section VII.

<sup>&</sup>lt;sup>31</sup> See Leon E. Trakman, <u>The Law Merchant: The Evolution of the Commercial Law</u> Chapter 1 (Littleton, Co.: Fred B. Rothman, 1981)...
<sup>32</sup> *Ibid* at p, 12.

<sup>&</sup>lt;sup>33</sup> *Ibid* at p, 16.

*piepowder* or "dusty feet" courts, presumably obligated to dispense justice before the merchant parties could shake the dust off their feet.<sup>34</sup>

In essence, the purpose of *ex aequo et bono* decisions was to use an informal, time and cost effective process so as to arrive at results that were "fair" to the parties not according to the law of the land, but in light of merchant usages and party practice.<sup>35</sup> Merchant judges decided cases on the basis of a combination of merchant codes and merchant practice, such as in grounding the "just price" on party practice and applicable trade usage.<sup>36</sup> Justice was responsive to merchant demands for expedient and fair results, along with the need to be able to continue their business activities with minimal disruption.

Far from envisaging an abstract good, the merchant "good" was attributed to merchant law devised by merchants in response to the expectations of merchants. The process of *ex aequo et bono* decision-making was intended to be market sensitive and informal, as well as responsive to the dynamics of the particular trade, region and parties. Decisions *ex aequo et bono* were to be guided, not by the naked discretion of merchant judges, nor by their personal sense of fair play, decency, or expediency. They were to be informed by the tenets of mercantile fairness, informed by the manner in which merchants conducted trade and responsive to trading relations among merchant parties. Cosmopolitan in nature and adaptable in operation, merchant law was meant to transcend the law of the realm while studiously trying to avoid conflicting with it. <sup>38</sup>

Whether merchant judges decided according to law or through discretion outside law depends on how "law" was conceived in medieval times. If merchant codes and decisions were deemed to be part of "the law" of merchants, than medieval merchant judges decided cases according to law. If law merchant codes were conceived of as operating outside law, than merchant judges exercised discretion extraneous to the law in applying those codes. In neither case did merchant judges exercise unbridled discretion. Their determinations were circumscribed by mercantile custom, usage and practice, not in disregard of them. <sup>39</sup>

The conception of *ex aequo et bono* decision-making as unprincipled or at worst as cadre justice, is a more modern incantation. It represents a derogatory reference to decisions reached in disregard of the law which, in effect, are deemed to be lawless. However imperfect the Medieval Law

<sup>36</sup> On the "just price" doctrine in the Medieval Law Merchant, *see* Trakman, *ibid* at p.8. <sup>37</sup> *Ibid. But see* Leon E. Trakman, "From the Law Merchant to E-Merchant Law", 53(3)

Toronto L.J.369 (2003).

<sup>39</sup> See Trakman, *ibid* at pp. 8-9...

<sup>&</sup>lt;sup>34</sup> *Ibid* at pp. 13,17.

<sup>&</sup>lt;sup>35</sup> *Ibid* at p. 33.

<sup>&</sup>lt;sup>38</sup> See supra Trakman, supra note 31 at pp. 8-10. See too Stephen E. Sachs, "From St. Ives to Cyberspace: The Modern Distortion of the Medieval 'Law Merchant'", at <a href="http://law.bepress.com/expresso/eps/529/">http://law.bepress.com/expresso/eps/529/</a> (disputing, inter alia, the extent to which the Medieval Law Merchant was truly independent from local law).

Merchant may have been, <sup>40</sup> accusing its merchant judges of lawlessness in deciding disputes *ex aequo et bono* is unduly harsh.

#### ii The UNCITRAL

The conception of *ex aequo et bono* has evolved into the so-called modern Law Merchant. Most notably among these is the inception of *ex aequo et bono* in the United Nations Commission on International Trade Law (UNCITRAL). Rule 33 of the UNICTRAL Rules states:

- 1. The 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.
- 2. The arbitral tribunal shall decide as amiable compositeur or ex aequo et bono only if the parties have expressly authorised the arbitral tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration.
- 3. In all cases, 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.<sup>41</sup>

Rule 33(2) specifically authorizes an arbitral tribunal to decide as *amiable compositeur* or *ex aequo et bono*. It also circumscribes the power of a tribunal by requiring that the parties expressly authorize such action, and that the applicable law permit it.

Rule 33 of the UNCITRAL is widely known and its implications are well understood including in relation to *ex aequo et bono* decision-making, <sup>42</sup> Its enactment has influenced national and state legal systems that have provided for decisions *ex aequo et bono* in their commercial codes, model laws <sup>43</sup> and

<sup>&</sup>lt;sup>40</sup> On these imperfections, *see* Trakman, "From the Medieval Law Merchant to E-Merchant Law" *supra* note 37

Law", *supra* note 37.

41 Emphasis added. *See* <a href="http://www.madaan.com/uncitral.html">http://www.jus.uio.no/lm/un.arbitration.rules.1976/33.html</a>

<sup>&</sup>lt;sup>42</sup> See e.g. <a href="http://brownwelsh.com/Archive/V0655867.pdf">http://brownwelsh.com/Archive/V0655867.pdf</a>, at pp. 9; <a href="http://www.unctad.org/en/docs/edmmisc232add40\_en.pdf">http://www.unctad.org/en/docs/edmmisc232add40\_en.pdf</a>, section 2.4. See too Brierley, supra note 7; Isaak Ismail Dore, <a href="https://www.unctad.org/en/docs/edmmisc232add40\_en.pdf">Arbitration and Conciliation Under the Uncitral Rules: A Textual Analysis</a> (Martinus Nijhoff Pub., 1986).

<sup>&</sup>lt;sup>43</sup> See e.g. <a href="http://www.jus.uio.no/lm/un.arbitration.rules.1976/33.html">http://www.jus.uio.no/lm/un.arbitration.rules.1976/33.html</a> A number of national and state legal and especially arbitration systems also expressly provide for deciding cases *ex aequo et bono*. See e.g. <a href="mailto:International Arbitration Rules of Zurich Chamber of Commerce (1989)">International Arbitration Rules of Zurich Chamber of Commerce (1989)</a>, Article 5, at <a href="http://132.204.136.33/doc/html/reg/en/2000/2000jiregen32.html">http://132.204.136.33/doc/html/reg/en/2000/2000jiregen32.html</a>; <a href="mailto:Model Clause: The Chamber of National and International Arbitration of Milan, Clause 2, at <a href="http://www.jurisint.org/doc/html/cla/en/2005/2005jiclaen12.html">http://www.jurisint.org/doc/html/cla/en/2005/2005jiclaen12.html</a>; The Commercial Arbitration Act 1984 (NSW) at <a href="http://www.austlii.edu.au/au/legis/cth/consol\_act/iaa1974276/">http://www.austlii.edu.au/au/legis/cth/consol\_act/iaa1974276/</a>. <a href="Mailto:Malta">Malta</a>'s Model Arbitration Clause, clause (g) the arbitrator shall decide ex aequo et bono' at <a href="http://www.mac.com.mt/modelarbitrationclauses.htm">http://www.mac.com.mt/modelarbitrationclauses.htm</a>. El Salvador's Commercial Code provides in Article 67: Should the partners decide not to follow the normal judicial process,

judicial decisions.<sup>44</sup> Despite its influence, however, there is limited evidence of adjudication that relies extensively on the UNCITRAL model of *ex aequo et bono* decision-making.<sup>45</sup>

#### iii. Investment Disputes

The case for deciding cases *ex aequo et bono* is especially palpable in complex investment disputes between private investors and states. New issues not anticipated or provided for at the time of concluding investor-state agreements sometimes arise when re-negotiation is unrealistic, when the parties may be interested in preserving long-term relationship, and when submitting disputes to arbitration *ex aequo et bono* may avoid having to rely on the law of the investor state. Such investment situations typify relational agreements in which the *ex aequo et bono* resolution of disputes may be most fitting.<sup>46</sup>

Provision for deciding state-investor disputes *ex aequo bono* is contained in the ICSID Convention. Mirroring to some degree Article 38(2) of the Statute of the Permanent Court of International Justice, clause 11 of the ICSID provides that any tribunal constituted pursuant to that agreement shall have the power to decide a dispute *ex aequo et bono*. The parties may presumably also request that the arbitrator act as *amiable compositeur*. However, it is more likely that the parties will authorize an arbitrator to act under Article 42(3) "to decide a dispute ex aequo et bono if the parties so

they shall stipulate in the articles of incorporation whether the arbitrators settling the disputes are de jure or ex aequo et bono and make the respective appointments. If the above provision is not in the instrument, it shall be understood that the partners shall opt for a ruling by two ex aequo et bono arbitrators," cited at <a href="http://www.ftaa-alca.org/busfac/comarb/El\_Salvador/quesesv\_e.asp">http://www.ftaa-alca.org/busfac/comarb/El\_Salvador/quesesv\_e.asp</a> On the use of ex aequo et bono in arbitration under the Chamber of Mediation and Arbitration of Sao Paulo, Clause 2, at <a href="http://www.camaradearbitragemsp.org.br/ingles/leis/index.htm">http://www.camaradearbitragemsp.org.br/ingles/leis/index.htm</a> On the right of parties to appoint an arbitrator to decide ex aequo et bono, see <a href="http://www.camsantiago.com/html/english/html/left/clausulas/1.htm">http://www.camsantiago.com/html/english/html/left/clausulas/1.htm</a>

Typifying the application of *ex aequo et bono* in the law of restitution, *see* Lord Mansfield in Moses v. Macferlan (1760) stating that an action in restitution lies "for money which ex aequo et bono the defendant ought to refund."

<sup>&</sup>lt;sup>45</sup> Nevertheless, Rule 33(2) of the UNCITRAL has served as a template for adopting comparable provisions in both international and domestic law. *See See too* The European Convention on International Commercial Arbitration, 1961, art. VII (2), Geneva, 1961, at <a href="http://www.law.berkeley.edu/faculty/ddcaron/Documents/RPID%20Documents/rp04011.html">http://www.law.berkeley.edu/faculty/ddcaron/Documents/RPID%20Documents/rp04011.html</a>; Rules of Procedure of the Inter-American Commercial Arbitration Commission, art. 33(2), July 1 1988, at <a href="http://www.sice.oas.org/dispute/comarb/iacac/rop\_e.asp">http://www.sice.oas.org/dispute/comarb/iacac/rop\_e.asp</a> On the adoption of *ex aequo et bono* in domestic legal systems, *see supra* note 43.

<sup>&</sup>lt;sup>46</sup> On such relational agreements, *see supra* note 9.

<sup>&</sup>lt;sup>47</sup> See generally Christopher H. Schruer, <u>The ICSID Convention: A</u>
Commentary (Cambridge, UK: Cambridge Un. Press, 2000).

<sup>&</sup>lt;sup>48</sup> Clause 10 provides: Any Arbitral Tribunal constituted pursuant to this agreement shall apply. specification of system of law [as in force on the date on which this agreement is signed][subject to the following modifications:...]. Clause 11 stipulates: "Any Arbitral Tribunal constituted pursuant to this agreement shall have the power to decide a dispute ex aequo et bono." *See too* **Trilon v. Guinea**, Award 21 April 1986, ICSID Reports 17 where it was specifically stated here: "...the disagreement shall be settled *ex aequo et bono* in accordance with the provisions of Article 42(3)..."

agree."<sup>49</sup> The parties may also have resort to *dépeçage* in resolving different issues according to different laws.<sup>50</sup>

Reaching a decision ex aequo et bono under the ISCID Convention does not preclude the arbitral tribunal from applying an applicable law. The ICSID still provides the parties with a choice of law that is binding on the ICSID arbitrator. However, the parties remain free to authorize the resolution of their disputes in whole or part ex aequo et bono through the initial or a supervening agreement, including during the course of arbitral proceedings. 51 They may also limit ex aequo et bono decision-making in accordance with a binding treaty or other agreement. 52

A few ICSID decisions illustrate the resort to ex aequo et bono in stateinvestor practice. In Agip v. Congo, the Congo Government proposed in its Counter-Memorial that the Tribunal should act as informal amiable compositeur. Agip did not agree. As a result, the Tribunal considered itself bound to decide in accordance with the applicable law only and not as an *amiable compositeur.* 53

In **Benvenuti** v. **Congo**, the Claimant proposed in the course of arbitration proceedings that the Tribunal decide ex aequo et bono which the Respondent rejected.<sup>54</sup> During the arbitration the Parties agreed to attempt to arrive at a settlement by amiable compositeur, failing which they authorized the Tribunal "to render its award as quickly as possible by judgment ex aequo et bono. 55 After the failure of negotiations, the Tribunal applied Article 42(3) of the ICSID Convention and decided ex aequo et bono as agreed to by the parties.<sup>56</sup>

<sup>&</sup>lt;sup>49</sup> This resort to Article 42(3) is a reasonable interpretation in light of the ICSID Convention, notably Article 25(1). Article 23 provides: "Consent of the parties is the cornerstone of the jurisdiction of the Centre. Consent to jurisdiction must be in writing and once given cannot be withdrawn unilaterally (Article 25(1))." See further History, Vol. 1 at pp.194-196, ISCID Convention; http://www.worldbank.org/icsid/basicdoc/partBsection05.htm

50 Dépeçage in private international law refers to cases in which different issues in the same

case are governed by the laws of different states. Illustrating the application of *dépecage* in relation to state-investor disputes, see Taida Begic, supra note 4, Chapter IV (on the use of dépeçage under the ICSID).

For a decision in which a court held that ICSID arbitrators can only decide *ex aequo et* bono where they are expressly so authorized by the parties, see Case No 34 Sch 10/05, Higher Regional Court of Munich, at

<sup>&</sup>lt;a href="http://www.kluwerarbitration.com/arbitration/arb/home/ipn/default.asp?ipn=80629">http://www.kluwerarbitration.com/arbitration/arb/home/ipn/default.asp?ipn=80629</a> This is inferred by reading together ICSID Article 42(1) entitling the parties to choose the applicable rules of law with ICSID Article 42(3) entitling the parties to consent to an award ex aequo et bono.

Award, 30 November 1979, 1 ICSID Reports 318.

<sup>&</sup>lt;sup>54</sup> Award, 15 August 1980, 1 ICSID Reports 342. Claimant made the proposal at the first session of the hearing on 14/15 June 1978, but rejected by the Respondent (p. 338); an agreement was formally reached by the Parties on 5 June 1979 and communicated to the Tribunal (p.342). <sup>55</sup> *Ibid* at p.342.

<sup>&</sup>lt;sup>56</sup> *Ibid* at p.349.

More controversial is whether *ex aequo et bono* decision-making can be reached in the absence of party consent under the ICSID, such as on grounds of commercial expediency. The short answer is that the agreement of the parties *is* required in order to for ICSID arbitrators to entertain decisions *ex aequo et bono*. Arbitrators who decide *ex aequo et bono* in the absence of express party consent risk being accused of exceeding their jurisdiction and having their awards annulled.<sup>57</sup>

## III. EQUITY VERSUS EX AEQUO ET BONO

In arbitration *ex aequo et bono*, the arbitrator is not bound by law rules or principles, but he could base his determination on equity and make his award on whatever basis he deems fair and reasonable, without even being bound to make legal reasonings [sic] for his findings.<sup>58</sup>

A feature of international and domestic law alike is the distinction that is sometimes drawn between decisions based on the law of equity and decisions *ex aequo et bono*. Whereas decisions in equity are deemed to be *preator legem*, that is, part of the law, decisions *ex aequo et bono* are imputed to an extra-legal realm. The rationale behind this distinction is that adjudicators may "fill gaps" in the law based on principles of equity, but not based on notions of equality that are not reduced to principles and rules of law. Whereas equity is part of an applicable legal system, notions of equality associated with *ex aequo et bono* are deemed to reside in a moral, social, or political realm that is external to the law.

Those who support the distinction between decisions in equity and decisions *ex aequo et bono* treat equitable decision-making as part of international or domestic law with its own body of equitable rights and duties and legal relationships. <sup>62</sup> They differentiate this body of equitable law from the non-

<sup>&</sup>lt;sup>57</sup> See generally Broches, <u>Convention, Explanatory Notes and Survey</u>, p.666; Delaume, L'Affaire p.55; A. Giardina, "A Self-Contained, Non-National Review System," <u>in</u> <u>International Arbitration in the Twenty First Century: Towards "Judicialization" and <u>Uniformity</u> R.B. Lilich & C.N.Brower, Eds. 199-212 (1984); Schreier, <u>Decisions</u>, *ex aequo et bono* p.53 et seq.; <u>Klockner v. Cameroon</u>, Award, 27 October 1983, ICSID Reports 59.</u>

<sup>&</sup>lt;sup>58</sup> Mohsen Mohebi, <u>The International Law Character of the Iran-United States Claims</u> <u>Tribunal</u> (Martinus Nijhoff Publ., 1999) at p. 116 & citing E. Fouchard, Commercial L'Arbitrage International 1965, No. 559).

<sup>&</sup>lt;sup>59</sup> See hereon Thomas M. Franck, supra note 26, at pp. 47-80.

<sup>&</sup>lt;sup>60</sup> This distinction is also made in the most fertile field of *ex aequo et bono* decision-making, namely, investment disputes. *See infra* Section II, iii.

<sup>&</sup>lt;sup>61</sup> On the relationship between decision-making in accordance with the law and *ex aequo et bono* relating to recovering lost profits, *see* John Y. Gotanda, "Recovering Lost Profits in International Disputes", Georgetown J.Int'l.Law (Fall 2004), text accompanying note 242-245.

<sup>&</sup>lt;sup>62</sup> See e.g the request by the Australian Government for ex aequo et bono proceedings in order to "create new rights" in its trade dispute with the United States, at <a href="http://www.dfat.gov.au/trade/negotiations/disputes/217">http://www.dfat.gov.au/trade/negotiations/disputes/217</a> Australia rebuttal submission.html #\_ftn3

legal relationships they associate with *ex aequo et bono* adjudication. <sup>63</sup> As the late Justice Lauterpacht of the International Court asserted: "adjudication *ex aequo et bono* amounts to an avowed creation of new relations between the parties". <sup>64</sup> As such "it differs clearly from the application of the rules of equity, which form part of international law as indeed, of any legal system." <sup>65</sup> Lauterpacht's assumption was that tribunals that decide *ex aequo et bono* create new relationships outside the law and in doing so, are not constrained by existing legal rights and duties. <sup>66</sup>

Despite this distinction between equitable and *ex aequo et bono* decisions, legal commentators disagree on the nature of the distinction. For some like Judge Lauterpacht, decisions in equity and decisions *ex aequo et bono* are quite distinctive. As the Court pronounced in the <u>Fisheries Jurisdiction</u> case, equitable decision-making "is not a matter of finding simply an equitable solution, but an equitable solution derived from the applicable law." 68

For others like Mohsen Mohebi, <sup>69</sup> the words "equity" and "ex aequo et bono" are used interchangeably; and they appear to be conflated. <sup>70</sup> For yet others, the wide latitude accorded to adjudicators to decide ex aequo et bono is comparable to the exercise of discretion invoked by common law judges in equity. <sup>71</sup>

The structural distinction between equitable and *ex aequo et bono* decision-making is overstated. The demarcation line between equitable discretion in law and discretion unrestrained by law is often difficult to draw. What differentiates them is primarily the pronouncement or inference by adjudicators themselves that they are deciding according to law or *ex aequo et bono*, whether or not they are doing so in fact. A truer differentiator is not whether discretion is grounded formally in equity or *ex aequo et bono*, but in how adjudicators use discretion in particular cases. That use of discretion depends, not on adjudicators claiming that they are "filling gaps"

<sup>&</sup>lt;sup>63</sup> See e.g. Friedmann, hereon in the <u>North Sea Continental Shelf</u> cases, *supra* note 21. For a view that the modern Law Merchant is administered *ex aequo et bono*, quite apart from the law, *see* Klaus Peter Berger, "Lex Mercatoria Doctrine and the UNIDROIT Principles of International Commercial Contracts", Law & Policy in Int'l. Bus. (Summer 1997).

 <sup>&</sup>lt;sup>64</sup> Sir Hersch Lauterpacht, <u>The Development of International Law by the International</u>
 <u>Court</u> 213 (Grotius Publications, Ltd, 1982, original publisher: Stevens & Sons, Ltd., 1958)
 <sup>65</sup> *Ibid*.

<sup>&</sup>lt;sup>66</sup> See e.g. Taida Begic, supra note 4 at 228-230.

<sup>&</sup>lt;sup>67</sup> See supra note 17.

<sup>&</sup>lt;sup>68</sup> See Fisheries Jurisdiction, I.C.J. Reports 1974, p. 33, para. 78.

<sup>&</sup>lt;sup>69</sup> See supra note 58.

<sup>&</sup>lt;sup>70</sup> See e.g. Sir Gerald Fitzmaurice, clause 39 at

 $<sup>\</sup>underline{http://untreaty.un.org/ilc/documentation/english/a\_cn4\_sr442.pdf}$ 

<sup>&</sup>lt;sup>71</sup> See generally M. Lachs, "Equity in Arbitration and in Judicial Settlement of Disputes" in "The Flame Rekindled, New Hopes for International Arbitration", 6 Leiden J. Int'l L. 323 (1993). But see Edward McWhinney, "International Arbitral and Judicial Processes, and the Atrophy of the Permanent Court of Arbitration", Etudes de Droit International en L'Honneur de Pierre Lalive 577 (1993).

in law to avoid a *non liquet* than on how they exercise their discretion in fact. <sup>72</sup>

Arguably, "gap filling" under the law of equity and decision-making *ex aequo et bono* directed at fairness between the parties operate at different stages along the same continuum, rather than by endorsing a formal divide between the two. <sup>73</sup> Even when parties grant adjudicators the authority to decide *ex aequo et bono*, such as under Article 42(1) of the ICSID Convention, the arbitral awards themselves inculcate an amorphous mixture of decision-making by equity under the law and discretion beyond it. The authority of adjudicators to intertwine an applicable law with *ex aequo et bono* decision-making is explicitly provided for by reading together Article 42(1) and 42 (3) of the ICSID. <sup>74</sup>

In summary, those who insist on a strict division between equity within the law and fairness outside the law achieve structural symmetry at the expense of the substantive ends which both conceptions of equity under law and fairness outside law share. Those shared ends include arriving at fair results suited to each case. If *ex aequo et bono* decisions are directed at redressing injustice, than they surely embody comparable ends to those sought through the law of equity.

A preferable approach is to recognize that the key issue under consideration is not whether adjudicators exercise discretion in equity or *ex aequo et bono*, but how discretion is exercised in fact and whether it complies with limits imposed upon that exercise. <sup>75</sup>

#### IV. GAP FILLING

A view sometimes expressed is that an adjudicator who "fills gaps" in the law acts in terms of the law. An adjudicator who decides *ex aequo et bono* does not "fill a gap" in the law, but engages in action unrelated to law. Illustrated in relation to investor-state disputes under the ICSID, "the

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<sup>&</sup>lt;sup>72</sup> See further Franck, supra note 26.

<sup>&</sup>lt;sup>73</sup> Thomas M. Franck identifies at least three different conceptions of equity. "Corrective equity", "broadly conceived equity" and "common heritage equity", where "corrective equity" is identified with procedural fairness, "broadly conceived equity" in some rules of the UN Convention on the Law of the Sea of 1982, and in the impending rules on the Non-Navigational Uses of Watercourses. Franck associates the "common heritage equity" over certain natural resources over the patrimony of all humanity, as exemplified by the deep sea bed of the moon and Antarctica. Franck, *supra* note 26 at 47-80.

<sup>&</sup>lt;sup>74</sup> Article 42(1) of the Convention provides that a Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. The parties are free to agree on rules of law defined as they choose. They may refer to a national law, international law, a combination of national and international law, or a law frozen in time or subject to specified modifications. On Article 42(3), *see supra* note 47. *See generally* <a href="http://www.unmeeonline.org/index.php?option=com\_content&task=view&id=15&Itemid=15.">http://www.unmeeonline.org/index.php?option=com\_content&task=view&id=15&Itemid=15.</a>

 $<sup>\</sup>frac{50}{75}$ On internal and external limits imposed on the exercise of discretion *ex aequo et bono*, *see infra* Sections V & VI.

function of filling *lacunae* [gaps] is different from the application of equity under Article 42(3)."<sup>76</sup>

The notion that discretion that does not "fill gaps" in the law is outside of law, is based on several assumptions. The first is that adjudicators who decide *ex aequo et bono* may exercise discretion based on objective conceptions of fairness such as those embodied in trade practice, or upon their own subjective views. The second is that, in both case, adjudicators may not be acting in terms of the law. The third is that these adjudicators may be challenged for not complying with the law in so deciding. The conclusion is that, in exercising discretion thus, they may be acting not only outside the law, but also contrary to it.

This conclusion is debatable. As a preliminary matter, whether or not an adjudicator exercises a discretion that is deemed to "fill gaps" in the law in the interests of justice or arrive at a fair result outside of the law, the exercise of discretion in both cases is ordinarily motivated by comparable ends: to treat the parties evenhandedly and to arrive at a just decision. <sup>79</sup>

As a practical matter, too, the demarcation line between discretion in accordance with law or outside law ignores the continuum along which discretion is exercised in fact. The key issue is not to establish that exact point at which an adjudicator "fills gaps" in the law or acts outside it. The key issue is to determine *when*, *why* and *how* that adjudicator exercises discretion. That determination is established in light the nature of the discretion exercised, the context in which it is applied, and its impact on party relations. Nor does the stage at which that discretion is deemed to be excessive reside at an exact point between equity in law and *ex aequo* bono, but along a variable continuum.

Only at extremes along that continuum is the exercise of discretion in accordance with or outside the law. For example, discretion that clarifies a simple ambiguity in a statute or regulation is likely to comport with law. A discretion that protects a party's interests that are not ordinarily recognized as legal rights may arise outside the law. 82 Most cases lie at neither

82 See further supra Section III.

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<sup>&</sup>lt;sup>76</sup> The use of the word "equitable" in Section 9 is intended to refer to decisions *ex aequo et bono* as distinct from the law of equity. *See* Section 9. DECIDING ex aequo et bono, at <a href="http://www.unctad.org/en/docs/edmmisc232add5">http://www.unctad.org/en/docs/edmmisc232add5</a> en.pdf

<sup>&</sup>lt;sup>77</sup> See Carlos Garcia Bauer, "La Controversia Sobre el Territorio de Belice y el Procedimiento Ex-Aequo et Bono", 54(1) Am. J. Intl.Law 1, 205 (Jan., 1960) [Argument that gap filling is not what ex aequo et bono does; the intention is not to avoid a non liquet.] <sup>78</sup> This restriction on adjudicative discretion is sometimes inferred from Article 42(3) of the ISCID. .See further infra Section II, iii.

<sup>&</sup>lt;sup>79</sup> See further supra Section VII.

<sup>80</sup> See supra Section IV and infra Section VIII.

<sup>&</sup>lt;sup>81</sup> On the relationship between legal culture and discretion in decision-making in international commercial arbitration in particular, *see* Leon E. Trakman, "Legal Traditions and International Commercial", Am. Rev. Int'l. Arb.(2007 upcoming),at <a href="http://works.bepress.com/leon\_trakman/1/">http://works.bepress.com/leon\_trakman/1/</a> text accompanying notes 25 & 167. *See further infra* Section IV-V *See supra* Section III and *infra* Section VIII.

extreme: and it is in relation to most cases that the division between "gap filling" under law and discretion outside of law is most doubtful. 83

Operating along a spectrum of discretion does not render decisions *ex aequo et bono* contrary to law; instead it reaffirms as much as it circumscribes the application of law according to the values that are ascribed to party practices and the customs surrounding them. It also ensures the coexistence, not the antipathy, between the application of law *stricto sensu* and the functioning of discretion beyond it. It also transcends the distinction between "gap filling" to avoid a *non liquet* and adjudicative discretion to avoid an injustice. 84

## V. EXTERNAL LIMITS ON EX AEQUO ET BONO

When has an adjudicator engaged in the unreasonable exercise of discretion *ex aequo et bono*? Alternative phrased, when has an adjudicator moved so far along the spectrum as to have crossed the boundary between a practically reasonable and an unreasonable use of discretion?

Whatever the limits on discretion may be, the rationale that the power to decide *ex aequo et bono* somehow permits adjudicators to decide wholly at will, flies in the face of practical reasonableness in decision-making. <sup>85</sup> Determining when discretion *ex aequo bono* is excessive depends on a functional test that subjects discretion to external and internal limits that are grounded in practical reason. <sup>86</sup>

Imposing an external limit on discretion arises as a matter of construction in the relational context in which it is exercised, and not *a priori* as a principle of law. <sup>87</sup> At its narrowest, that limit requires that attention be given to the practices of the parties. At its broadest, it anticipates consideration of the analogous practices of others that have crystallized into common usages, shared habits and emerging customs. Clause 33(3) of the UNCITRAL Rules provides as much in stipulating of *ex aequo et bono* that: "in all cases, 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*". <sup>88</sup>

If the adjudicative decision is to be "fair", it must be fair against the background of the practical reasonableness of the respective claims of the parties. If it is to be "just", it must produce consequences that are just in light of customs and usages that are related to the interests of those parties. If it is to be practically reasonable, it must be reasonable in light of the

84 See further text accompanying note 27.

<sup>86</sup> See further infra Sections V & VI.

88 Emphasis added. See further http://www.jus.uio.no/lm/un.arbitration.rules.1976/33.html

<sup>&</sup>lt;sup>83</sup> See further infra Section VIII.

<sup>&</sup>lt;sup>85</sup> This is apparent on an examination of cases in which *ex aequo et bono* arises, such as under the ICSID. *See e.g.* The **Congo** cases, *supra* notes 53-56.

<sup>&</sup>lt;sup>87</sup> On the rationale that *ex aequo et bono* discretion is more fitting in relational agreements than discrete transactions, *see supra* note 4.

interdisciplinary context surrounding the dispute, not because of the wholly personal conceptions of fairness of whosoever happens to be the adjudicator.89

#### VI. INTERNAL LIMITS ON EX AEQUO ET BONO

The exercise of discretion is also circumscribed by internal limits. 90 Adjudicators are subject to internal rules that circumscribe the process by which they ought to reason "fairly" and in "good conscience". 91

Like external limits, internal limits are grounded in practical reason. The test of practical reason is to determine whether the process of decision-making falls short, as a matter of practical reason, of that which is "just" and "fair" in light of the relationship between the parties and the context surrounding their relationship. An example is a partial or inconsistent process of reasoning in which one party is subject to an excessive penalty compared to that which would arise had another fairer process been followed. 92

Precepts of due process of law may influence how internal limits apply to ex aequo et bono decision-making, such as by providing a reasonable opportunity for a party to be heard and present a case. However, internal limits set on the exercise of discretion ex aequo et bono is also distinguishable from due process. In particular, the process of deciding ex aequo et bono is grounded in notions of common sense, practical expediency and fairness that are not necessarily attributed to law. 93

Ultimately, internal limits upon discretion ex aequo et bono depend on a functional not a formal process of reasoning. They hold that, no matter how informal and expeditious, adjudicative proceedings should be transparent and applied evenhandedly to the parties.<sup>94</sup>

<sup>91</sup> It is arguable, but not self-evident, that UNICTRAL Rule 33 anticipates such internal rules to govern the process of decision-making ex aequo et bono. See further Section IX. <sup>92</sup> On guidelines in determining that which is excessive, see further infra Section VIII

See further supra in this Section.

<sup>&</sup>lt;sup>89</sup> There is ample authority that international commercial arbitrators who are expressly authorized by the parties to decide as amiable compositeurs or ex aequo et bono do so on the basis of international commercial custom and usage, as distinct from principles of law. See e.g. Berthold Goldman, "La lex mercatoria dans les contrats et l'arbitrage internationaux: réalité et perspectives" [Lex Mercatoria in international contracts and arbitration: reality and prospect], 1979 Journal du droit international 1; E. Loquin, L'Amiable Composition en droit comparé et international (Librairies Techniques,

See further supra Section VIII.
90 See further Section VI.

<sup>&</sup>lt;sup>93</sup> It is understandably difficult to arrive at internal rules by which measure concepts like fairness and good conscience. However, it is equally difficult to arrive at internal rules to govern "the rule of law", "natural justice" and "due process of law" For a preliminary discussion of the internal rules of ex aequo et bono arbitration, see J. Brian Casey, Arbitration Law of Canada: Practice and Procedure (Juris Publ., 2005), Clause 1.3.6. See too Christopher Liebscher & Alice Fremuth-Wolf, Eds., Arbitration Law and Practice in Central and Eastern Europe (Juris Publ., 2006), section 6.7.

#### VII. PARTY AUTONOMY

However much *ex aequo et bono* is rationalized along a spectrum of discretion and is subject to internal and external limits, adjudicators can only act *ex aequo et bono* if they enjoy the confidence of those who are the subject of their decisions. The parties need to know, not only that internal and external limits can be placed on adjudicative discretion, but also that adjudicators will apply those limits in fact. <sup>95</sup>

A problem that must be faced is that even parties who favor *ex aequo et bono* decision-making may choose an adjudication process in broad terms only, without providing the particular means by which adjudicators are to decide a dispute. This raises the question as to whether and how parties can be helped, not only to refine *ex aequo et bono* clauses in their agreements, but also to better appreciate how such a recourse may benefit them. Part of the solution is to develop a coherent conception of *ex aequo et bono* decision-making that earns the respect of those who ultimately are free to choose whether and how to adopt it.

Parties also need to have more viable reasons for resorting to *ex aequo et bono* decision-making than their trust in adjudicative discretion or even their wish to avoid the vagaries of an applicable law. They need to know that the adjudicator will pay due regard to their particular relationships and will reach a determination that is practically reasonable. They should recognize when *ex aequo et bono* decision-making best suits their particular ends, as when it can operate informally and expeditiously and is guided by a sense of fair play. Parties also need to feel comfortable that both the adjudicative process and the result reached can preserve their long-term relationship on the one hand, yet be enforceable on the other. <sup>98</sup>

Adjudicators also need to be cautious not to overreach in the exercise of discretion, given the risk of having their decisions nullified on grounds of having acted *ultra vires*. As is apparent from Article 33(2) of the UNCITRAL, adjudicators may decide *ex aequo et bono* only if the parties have expressly so agreed and only if that recourse is permitted by the applicable law. <sup>99</sup>

Ultimately, the viability of *ex aequo et bono* decision-making resides in the capacity of adjudicators to adhere to processes that respond to practical sensibility, rather than to formal rules of law.

<sup>&</sup>lt;sup>95</sup> This is consistent with the fact that the parties are free to choose decision-making *ex aequo et bono*, and would ordinarily be disinclined to choose it if it is perceived as giving rise to unbridled adjudicative discretion.

<sup>&</sup>lt;sup>96</sup> The words used to empower adjudicators to decide *ex aequo et bono* ordinarily state only that the parties can authorize such action, and on occasions, that the adjudicator can so decide when the applicable law permits it. *See generally infra* Section II.

<sup>&</sup>lt;sup>97</sup> See further supra Sections III-IV.

<sup>&</sup>lt;sup>98</sup> This is particularly so in relation to investor-state disputes under the ISCID. *See further infra* Section II, iii.

<sup>&</sup>lt;sup>99°</sup>See further infra Section II, ii.

### VIII. GUIDELINES IN APPLYING EX AEQUO ET BONO

Guiding the application of ex aequo et bono decision-making is the need: (i) to evaluate it in light of each relational context and not in the abstract; (ii) to encompass within it "fairness" between the parties in their circumstances; (iii) to embody in relation to the parties an assessment of the wider context of conventions, customs and usages, including legal usages that impinge upon the practices of those parties; (iv) to engage in an expeditious process of decision-making; and (v) to arrive at results that are transparent and evenhanded in their treatment of the parties. 100

Far from being wholly arbitrary, the foundations of ex aequo et bono are situated in realistic decision-making that is directed at resolving practical but often complex problems. The decision-maker is bound neither to apply nor to disregard the law as a matter of principle, but to exercise discriminating judgment on the practical reasons by which to decide each case. Those practical reasons are informed by specific patterns of fact, by identifiable party practices and by applicable customs and usages. 101 The practical reasons that guide decisions ex aequo et bono may also justify adopting alternative processes of dispute resolution, including but not limited to those that are provided for by law. 102

Distinguishing formally between ex aequo et bono and equitable decisions in law is doubtful at best and confusing at worst. Even granting wide latitude to adjudicators to decide ex aequo et bono may include reliance on principles of law, as when legal principles like freedom of contract inform the usages and practices upon which adjudicators rely. Practical reason may well be determined in law, not by a determination to exclude law. <sup>103</sup>

The rationale that ex aequo et bono invites adjudicators to engage in executive law-making that is better left to parliament overstates the division between making law and applying it. There is ample evidence of "gaps" in law being "filled" by adjudicators who exercise discretion of the widest latitude. Against this background, an ex aequo et bono discretion that is circumscribed by practical reason, informed by common sense, and applied in light of practice and usage is assuredly more evenhanded and transparent

<sup>100</sup> See further supra Section VI.

<sup>101</sup> These rules of practice, in turn, are grounded in practical reasonableness. This conception of practical reasonableness is a tangible attribute of the Modern Law Merchant. See generally Harold J. Berman & Felix J. Dasser, "The 'New' Law Merchant and the 'Old': Sources, Content, and Legitimacy," in Thomas E. Carbonneau, ed., Lex Mercatoria and Arbitration (Juris Publ., 1990) at p.21; A. Claire Cutler, Private Power and Global Authority: Transnational Merchant Law in the Global Political Economy (Cambridge: Cambridge Univ. Press 2003) at p.116. See too supra, Section VI.

<sup>102</sup> Conciliation is one such alternative process, but it is by no means the only one that might be applied. See John Graham Merrills, International Dispute Settlement p. 110-111 (Cambridge, UK, Cambridge Un. Press 2005). Merrills suggests that conciliation in the Rainbow Warrior case [New Zealand v. France (1990) 80 I.L.R.p.499] is comparable to arbitration ex aequo et bono in the Free Zones case, cited infra note 21. <sup>103</sup> See too supra Section V.

than a comparatively unchecked discretion supposedly exercised under the law of equity. <sup>104</sup>

#### **CONCLUSION**

Conceptual, historical and practical considerations alike infer that adjudicators who decide *ex aequo et bono* inevitably must act within permissible and practical limits. Those limits are determined pragmatically, not in terms of strict legal doctrine, but according to a functional analysis of the context in issue. The permissible reach of *ex aequo et bono* depends, not simply on legal rules, but upon applicable usages and determinative customs and usages which may, but need not be explicated through legal rules.

A pervasive requirement of decision-making *ex aequo et bono* is compliance with the dictates of practical reasonableness. That reasonableness is grounded in the efficaciousness of the process of decision-making viewed in light of the reasonable application of relevant practices and usages to the case at hand. The legitimacy of an *ex aequo et bono* decision does not depend on the formal legitimacy of the discretion but on its practical application. The measure of a just decision does not hinge on an explicitly articulated principle, rule or even standard of law, but upon notions of common sense, fairness and efficacy. <sup>105</sup>

This approach has the benefit of paying regard, not only to legal rights and duties, but also to important interests that are not ordinarily protected as rights. It can also help to salvage party relationships in the face of potentially complex and protracted disputes. <sup>106</sup>

Condemning such *ex aequo et bono* decision-making on grounds it operates not only outside the law but contrary to it does more than challenge adjudicative activism. It discourages adjudicators – and the parties who empower them – from pursuing the fair resolution of disputes when it is most needed, when the law fails to respond adequately to the need for justice.

Those who prefer to wait for the law to respond to injustice and social inequity rather than resort to *ex aequo et bono* decision-making may have to wait indefinitely. Law reform may be impeded by political inaction, or it may be fragmentary.

This article makes the case for a functional discretion that rises above the formal division between the law of equity and *ex aequo et bono*. It argues for a practical process of reasoning that operates along a continuum of

<sup>&</sup>lt;sup>104</sup> The distinction between *per se* reasonableness and practical reasonableness is primarily related to context. It is in the context of party practice that reasonableness is measured. *See further* Trakman, **The Law Merchant**, chapters 3 & 4, *supra* note 31.

On the distinction between "interests falling short of rights" and *per se* rights, *see* Leon E. Trakman, <u>Rights and Responsibilities</u> ch.2 (Toronto: Un. Toronto Press, 1999).

discretion. It advocates functional ways of resolving practical problems in which established legal solutions may be ill-adapted or simply, impractical.

