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Syed Khalid Rashid

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Effective reform possibilities in International Commercial Arbitration

Integrating 'equity' and 'mediation' into international commercial arbitration to make it more economical and just

Syed Khalid Rashid

International commercial arbitration is now generally believed to suffer from some of the same problems which it came to rectify in international commercial litigation. Prominent among these problems are *rigidity*, *excessive cost* and *protractedness*. An attempt has been made in this article to suggest that integration of 'equity' and 'mediation' into international commercial arbitration may make it more cost-effective, speedy and just.

Some 17 years ago, Lord Mustill expressed his grave concern about numerous problems, other than the ones mentioned above, confronting international commercial arbitration, and the urgent need for effecting necessary reforms.¹ Otherwise he feared arbitration would be overtaken by competitors like mediation. Arbitration, he said 'can and should grasp the opportunities which stand before it (to bring reforms). There is no room for complacency'.²

But nothing appears to have been done to effect any reform. It is suggested in this article that a step towards reformation and revitalization of international commercial arbitration may consist of integrating and amalgamating into it 'equity' and 'mediation'.

What 'equity' means in the context of this article

'Equity', in the context of this article, does not mean that body of

rules, formulated and administered by the Court of Chancery, to supplement the rules and procedure of the common law. Here 'equity' means the principle which confers on the arbitrator the discretionary power for the liberal construction or application of a contractual obligation, in order to avoid *excessive hardship* and *injustice*.

The 'equity' which is being suggested carries a narrower meaning than *amiable composition*, which confers on the arbitrator broader powers to apply *his or her own sense of fair play, justice and good conscience*. Where parties have empowered the arbitrator to act as

liberally interpret the contractual obligation of a party to arbitration in situations where strict compliance appears to bring injustice. The suggested 'equity' is contemplated to form part of the law of arbitration. Its meaning is not that which is given to the expression — *amiable composition*, and which depends wholly on the permission of the parties. In the case of 'equity' suggested here, there is no need for the consent of parties, because it forms an integral part of the law governing arbitration. As in the case of equity in common law, a judge needs no authorisation, nor consent

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amiable compositeur, they have indeed conferred on him or her a very wide discretionary power, which is not the case in the suggestion made here. The suggested integration of equity would amount to allowing an arbitrator, in his or her own right and without being so empowered by the parties, to

from anyone, for applying equity where he or she thinks fit. Equity is built into law and cannot be detached from it. It provides occasions to interpret law liberally in situations where liberal interpretation is called for. It may serve to fulfill law, not to destroy it.

Which 'equity' is opposed by English courts?

A point worth clarification is that the 'equity' suggested in this article for arbitration is different from the one opposed by the English courts. The suggested equity carries a restricted meaning wherein an arbitrator is allowed to give a liberal interpretation only to a contractual obligation clause which if literally interpreted and applied may produce unjust and harsh results. English courts, on the other hand, show their opposition to a situation which 'purported to free arbitrators to decide without regard to law and according, for example, to their own notions of what would be fair'.³ The nature of this opposition is explained by Megraw J in the following words:

[It] is the policy of the law in this country [UK] that, in the conduct of arbitrations, arbitrators must in general apply a fixed and recognizable system of law, which primarily and normally would be the law of England, and that they cannot be allowed to supply some different criterion such as the view of the individual arbitrator or umpire *on abstract justice or equitable principles*, which, of course, does not mean 'equity in the legal sense of the word at all'.⁴

In numerous other similar judgments,⁵ the English courts have expressed their opposition to 'abstract justice' or 'some home-made law' which tries to replace the whole corpus of the law of the land.⁶ Apparently, the resistance and hesitation showed by the English courts against the application of equity in arbitration is due to this possibility of investing in the arbitrator a virtually unfettered power of discretion. However s 46(1)(b) of the English *Arbitration Act 1996* now provides that 'the arbitral tribunal shall decide the dispute, *if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the (arbitral) tribunal*'. This amounts to importing

amiable composition into the Act without saying so.⁷

The case for 'equity'

Common law has always taken pride in having given to the world the concept of equity, which confers on law its vitality and enables it to meet the demands of justice.

English courts in the task of

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defining the scope of 'equity clause', a term used for *amiable composition* or *ex aequo et bono*, have failed in giving a unanimous verdict. Their interpretations fluctuated⁸ until the enactment of the *Arbitration Act 1996*. Up until two centuries ago and also recently, some of the English courts were very clear that arbitrators need not apply law strictly if it produced harsh results.⁹ Back in 1791 it was held in an English case:

(The) arbitrator has a greater latitude than the court in order to do complete justice between the parties. For instance, he may relieve against a right which bears hard upon one party, but which having been acquired legally and without fraud, could not be resisted in a Court of Justice.¹⁰

This judicial approach is also found extensively in the Islamic, French and American Legal Systems. *Quranic* emphasis on doing justice (4:58) is the basis of *amiable composition* in Islamic law of — *tabkim* (arbitration).¹¹ Until the 18th century French law allowed arbitrators to decide in accordance with justice, equity and good conscience; the *Code*

of *Civil Procedure 1806*, however, subjected the application of *amiable composition* to the consent of the parties.¹² In US, arbitrators are empowered to apply *amiable composition* by virtue of Title 9: United States Code: *Arbitration Act 1947*, C 3932 SI, 61 State 669.

The American courts have repeatedly upheld the validity of

liberal construction and laid down the policy that 'an arbitration clause in contract, such as charter party, must be given broadest possible interpretation as to subject-matter',¹³ and that the 'Federal policy is to construe liberally arbitration clause, to find that they cover disputes reasonably contemplated by language, and to resolve doubts in favour of arbitration'.¹⁴ And 'Courts should not, by hair-splitting decisions, hamstring (arbitration) operation'.¹⁵

In a report of the International Court of Justice, the contours of 'equity' came to be defined in the following words:

The justice of which equity is an emanation is not abstract justice but justice according to the rule of law: which is to say that its application should display consistency and a degree of predictability; even though it looks with particularity to the peculiar circumstances in an instant case, it also looks beyond it to principles of more general application. This is precisely why the courts have, from the beginning, elaborated equitable principles as being, at the same times,



means to an equitable result in a particular case, yet having a more general validity and hence expressible in general terms.¹⁶

Equity becomes necessary to ensure justice between the parties, so that one party is not allowed to take advantage at the expense of the other. There is indeed no justice possible without allowing equity to play its part.

Sometimes, natural causes beyond the control of humans create undue difficulties for a party to a business contract. In applying a principle of law, equity ought to be allowed to intervene to ensure justice. The basis of equity is not intuition taken in the abstract. Equity neither represents the precision of mathematics or physics, nor is it a work of fiction, 'but creates a link between the law as a letter and life as a phenomenon of nature'.¹⁷

The complexities of contemporary life and commercial transactions may give birth to situations, which if tackled with law alone, may produce unjust results. Such situations may include: a change in the economic condition of a country or party to an extent where a strict performance of a contractual obligation may appear as

right, should be allowed to apply equity wherever it appears necessary to do so. This should never be interpreted as empowering an arbitrator to select and apply 'any rule' in accordance with his or her whims and fancies. On the contrary, it simply amounts to empowering an arbitrator with the discretion to refrain from enforcing a contractual obligation, which if applied blindly, may cause hardship and injustice.¹⁸

The occasions to do so may indeed be few and far between, but empowering an arbitrator to do so would certainly add a new meaning to international commercial arbitration, making it more humane and just. Till now, the worldwide use of *amiable composition* has given no occasions for complaint of either miscarriage of justice or arbitrariness on the part of the arbitrator. This is indeed a verifiable fact if we look at the experiences of all those countries which have adopted the UNCITRAL Model Law. Thus, if the arbitrators are allowed to apply equity in their own right, it may not create any problem. Recognition of *amiable composition* shall in fact facilitate the adoption and acceptance of equity.

The arbitrators, in their own right, should be allowed to apply equity wherever it appears necessary to do so. This should never be interpreted as empowering an arbitrator to select and apply 'any rule' in accordance with his or her whims and fancies.

unduly harsh and unjust; a diligent, though not strict, performance of a contractual obligation; an adverse effect on the best interest of a party, of things done in good faith. An arbitrator's authority to apply equity in such circumstances should be recognized, and should not be dependent on the authorisation by the parties. The arbitrators, in their own

Integrating mediation into arbitration

My second suggestion to enhance the efficacy and cost-effectiveness of international commercial arbitration is to integrate mediation into arbitration. It is not med-arb that is suggested. Here mediation becomes part and parcel of arbitration. It is with compulsory mediation that the process

starts, to be finished in as short a time as possible. Where mediation fails then it should be up to the parties to go to arbitration with either the same person who acted as mediator, or to bring in a new person to act as arbitrator, who must also be empowered to go on trying to bring settlement between the parties during the entire course of arbitral proceedings.

Integration of mediation into arbitration may bring great savings of cost and time, and may also help to keep intact the friendly relationship between the parties. The positive results gained in the US after the enactment of the Federal legislation — *Alternative Dispute Resolution Act 1998* (HR 3528) — are well known. In high-value disputes where stakes are very high, no party may like to go straight to arbitration, which is costly, protracted and acrimonious, if an easier, speedier and cheaper option like mediation is compulsorily made available. On the basis of success achieved by mediation in settling dispute, it may be safely assumed that a good percentage of disputes may end up in settlement and may never proceed to arbitration.

ayat 35 of *S_rah Al Nisa* of the *Quran* mentions conciliation (*sulh*) along with arbitration:

If ye fear a breach
Between them twain,
Appoint two arbiters,
One from his family,
And the other from hers;
If they wish for peace,
Allah will cause
Their reconciliation ...

From the verse it may be inferred that the arbitrator has to try reconciliation. Article 1850 of the *Mejelle (Majallah Al-Ahk_m-I-Adliyy_h)* of the Ottoman Civil Code provides:

Should the parties have authorized the arbitrators ... to conciliate then, the agreement of the arbitrators is deemed to be a compromise ... which the parties must accept.

The role of the arbitrator is to act as the agent of the parties who, instead of negotiating directly, have entrusted this job to their agent in order to obtain a compromise. Article 1851 of the *Mejelle* echoes this when it provides:

If a third party settles a dispute (put to arbitration) without having been entrusted with this mission by the

unsuccessful, followed by a final offer by each side, one or other of which the mediator-turned-arbitrator must choose.¹⁹

There could be still more models to suggest the form of the possible integration of mediation into arbitration. This is something that may be worked out in detail later on. Either of the parties be given the

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parties, and if the latter accept his settlement, the award shall be enforced by application of Article 1453 [Art 1453: ratification is equivalent to agency].

Where parties fail to succeed in mediation, they should be given an option to once again go for mediation whenever they so wish. The arbitrator should help them in their mediation efforts throughout the arbitration proceedings. If the parties so wish, they should be allowed to mediate some issues and arbitrate others. Or, mediate, then arbitrate some unresolved issues, then return to mediation; or, mediate, if unsuccessful, ask for an 'advisory opinion' by the mediator which is binding as an award unless either party vetoes the opinion within a limited period of time. Another med-arb variation which is growing in popularity is mediation, if

choice to opt for any out of numerous alternatives, or the choice may be limited to one or two models. Consideration of certainty demands limiting of the choice to a single model.

There appears a clear leaning in favour of mediation, mainly due to cost factors and the discovery process. In Japan, the use of mediation during the arbitral process is regarded 'as a better way of resolving disputes'.²⁰

The Arbitral Tribunal may, at any stage of the arbitration proceedings, mediate between the parties for the whole or a part of the disputes.²¹

Chinese law of Arbitration (Art 51) firmly encourages combining mediation with arbitration. In CIETAC (China International Economic and Trade Arbitration Commission) arbitrations:

... conciliation has been conducted by the CIETAC arbitrators during



arbitration proceedings in almost 50% of the cases under their cognizance. The success rate is 40%–50%. So far, no complaint and dissatisfaction can be traced from the parties and their lawyers who have participated in the combined arbitration–conciliation process.²²

The laws in many other countries including Sri Lanka, India, Singapore, Australia, Canada, the Netherlands, and rules governing arbitration in South Korea, Germany, Slovenia, Hungary, Croatia, Austria, Switzerland, France, former CMEA countries and Rules of WIPO

may cause hardship or even injustice. Terms of a contract formulated to deal with situations existing at a given time may work unfairly where circumstances drastically change. Equity may come in handy in such situations to mitigate the severity of contractual obligations. Let arbitrators apply equity in such situations. The long history of the application of equity by the courts shows that its application is not unfettered discretion.

Where parties wish to allow an arbitrator to act as *amiable compositeur*, they may so allow.

Law often needs the assisting hand of equity and the discretion that accompanies it, to do justice in some cases where strict application of law may cause hardship or even injustice.

Mediation approve the combining of mediation and arbitration.²³

In an amalgamation of mediation and arbitration, if parties do not wish to accept the same person who acted as mediator to continue acting as arbitrator too, a time limit should be prescribed within which each party should give notice to reject the nomination of this person. A different person may be appointed as arbitrator once the mediation part comes to an end.²⁴ However, a better option would be to go for the same person, as this may bring in savings in time and cost and the advantage of familiarity with facts. Only in a case where either party has expressed reservations about the neutrality of the mediator should a different person be brought in to serve as arbitrator.

Conclusion

Law often needs the assisting hand of equity and the discretion that accompanies it, to do justice in some cases where strict application of law

Thereby empowering the arbitrator to apply his or her *personal sense of fair play and justice*. It is a very wide discretionary power which the parties may not always wish to give to the arbitrator. What is suggested here is to take out equity from this list of powers because the basis of equity is not pure discretion, as is the case with 'fair play' and 'personal sense of justice.' Inducting it into arbitration will not affect the certainty of the law of arbitration, as may be argued in case of *amiable composition*.

Integration of equity into arbitration will help to make it more just and equitable, and will give a humane face to arbitration. It is left to the parties to use the arbitrator's personal discretion and sense of fair play, by allowing him or her to decide *ex aequo et bono*. By integrating equity into arbitration, it becomes part of arbitration law.

Countries all over the world have embraced mediation, incorporating it into their laws, combining it with arbitration and making it legally

possible to do so by enacting laws to this effect.²⁵

There is a need to embrace mediation as an integral part of arbitration. Such a move would be part of the reform in arbitration law which is perceptible in every part of the world. Med-arb is now part of the legal framework in India, Hong Kong, Singapore, Sri Lanka and others. It reflects the philosophy of introducing a more simple, and cost effective means of resolving disputes. Section 30(1) of the Indian *Arbitration and Conciliation Act 1996*, for example, says that it is not incompatible with arbitration proceedings for an arbitral tribunal to encourage settlement of the dispute, at any time during the arbitral proceedings. My suggestion is to go a step further and to integrate mediation into arbitration.

According to PG Lim, former director of the Kuala Lumpur Regional Centre for Arbitration:

There seems to be a convergence of attitudes in the Asia Pacific region with regard to combining mediation with arbitration in the same dispute. There is a leaning in favour of mediation/conciliation brought about in the main by growing dissatisfaction with arbitration mainly because of the cost factor and the discovery process ... the combination of the two procedures (mediation and arbitration) has more advantages than keeping them apart ...²⁶ ●

Syed Khalid Rashid is a Professor of Law, Ahmad Ibrahim Kulliyah (Faculty) of Laws, at the International Islamic University, Malaysia and can be contacted at <skhalid@iiu.edu.my>.

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Endnotes

1. See, Michael John Mustill, 'Arbitration: history and background' (1989) 6 *Journal of International Arbitration* 43 at 55.
2. Above note 1.
3. *Home Insurance Co and St Paul Fire and Marine Insurance Co v Administration Asigurarilor de stat*,

[1983] 2 Lloyd's LR 674 at 677.

4. *Orian Cia Esponda de Seguros v Belfort Mij* [1962] 2 Lloyd's Rep 257 at 264. *David Taylor & Son Ltd v Baruet Trading Co* [1953] 1 WLR 563 at 568.

5. For example, *David Taylor & Son Ltd v Barnett Trading Co* [1953] 1 WLR 563 at 568 and *Home and Overseas Insurance Co Ltd v Mentor Insurance Co (UK) Ltd (in liquidation)* [1990] 1 WLR 153.

6. *Czarnikow v Roth Schwidt & Co* [1922] 2 KB 478.

7. There is a view that 'the reason why the term *amiable composition* or deciding the case *ex acquo et bono* is not used is because "the expressions do not derive from English law or arbitration practice and it was felt inappropriate to incorporate them into the Act"' Rutherford and Sims, *Arbitration Act 1996: A Practical Guide* (1996), para 46.4, cited in Hong-Lin Yu, 'Amiable composition — a learning curve', (2000) 17(1) *Journal of International Arbitration* 79–98 at 95.

8. For judicial views expressed against *amiable composition*, See, for example, *Czarnikow v Roth Schmidt & Co* [1922] 2 K B 478; *David Taylor & Son Ltd v Barnett Trading Co* [1953] 1 WLR 562 at 568; *Orion Compania Espanola de Seguros v Belfort Maatsehappij Voor Algemene Verzekgringeen* [1962] 2 Lloyd's Rep 257; *Home & Overseas Insurance Col Ltd v Mentor Insurance Co Ltd* [1989] 1 Lloyd's LR 473.

9. See, for example, *Knox v Symmonds* (1791) 1 Ves. Jun 369 (30 ER 390; *Rolland v Cassidy* (1888) 13 AC 770; *Jager v Tolme and Runge* [1916] 1 KB 939; *Board of Trade v Cayzer Irvine & Co* [1927] AC 610 at 628–629.

10. *Knox v Symmonds* [1791] 30 ER 390 at 391.

11. See, El-Ahdab, Abdul Hamid, *Arbitration With Arab Countries*, 2nd ed p 1 (Kluwer Law International, The Hague, 1999). Also by the same author, 'General introduction on arbitration in Arab countries', in *International Handbook on Commercial Arbitration*, citing Al-Mawardi', *Adab al-Qadi*, vol 2, p 382.

12. RH Christie, 'Amiable Composition in French and English Law' (November 1992) *Arbitration* p 259 at 263.

13. *Fox v The Giuseppe Mazzine*, DC NY 1953 110 F Supp 212.

14. *Metro Indus Painting Corp v Terminal Const Co CA* 2 1961 287 F 2d 382.

15. *Insurance Agents' Intern. Union AF of LV Prudential Ins Co DC Pa* 1954 122 F Supp 869. See also, *Lundgren v Freeman*, Ca Or 1962, 307 F 2d 104.

16. 1985 *International Court of Justice (ICJ) Report*, p 39 (para 45).

17. Arbitral award of Judge Manfred Lachs in the arbitration between *Guinea v Guinea Bissau*, p 124.

18. See, Syed Khalid Rashid, 'Some contentious issues in international commercial arbitration', (2005) 13 *IUMLJ* 147 at 159.

19. David C Elliott, 'Med-arb: fraught with danger or ripe with opportunities', (1996) 62 *Arbitration* 175 cited in Haig Oghigian, 'Discussion on arbitrators acting as mediators', (2002) 68 *Arbitration* 42.

20. Kenji Tashiro, 'Conciliation or mediation during the arbitral process — a Japanese view' (1995) 12(2) *Journal of International Arbitration* at 120.

21. Section 28 of the Rules of the Maritime Arbitration Commission of the Japan Shipping Exchange Inc.

22. Tang Houzhi, 'Is there an expanding culture that favours combining arbitration with Conciliation or other ADR procedures?' *ICCA Seoul Arbitration Conference 1996*, p 101 at 102.

23. Above note 22 at 102–108, where some details of the various enactments and rules could also be found.

24. Christian Buhning-Uhle, *Arbitration and Mediation in International Business: Designing Procedures for Effective Conflict Management*, (Leiden, 1996), at p 369.

25. See, PG Lim (Ms), 'The growth and use of mediation throughout the world: recent developments in mediation/conciliation among common law and non-common law jurisdictions in Asia', (1998) 4 *Malayan Law Journal*, at cxi.

26. Above note 25.