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## GENERAL PRINCIPLES OF LAW AND EQUITY AS A BASIS FOR DECISION-MAKING IN ARBITRATION

### Abstract

*The present article discusses the bases for decision-making with particular focus on general principles of law and equity. The article draws the distinction between general principles of law, principles of equity, amiable composition, and lex mercatoria, and suggests possible difficulties regarding annulment and enforcement of arbitral awards. The article addresses primarily Polish law, but refers also to foreign legal systems and arbitral case-law.*

### Keywords

*basis for decision-making – amiable composition – equity – general principles of law – lex mercatoria – party autonomy*

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The arbitrators' competence to decide on the basis of general principles of law and equity follows in Polish law from Article 1194 § 1 of the Code of Civil Procedure (hereinafter referred to as CCP)<sup>1</sup>. This provision provides that "the arbitral tribunal shall settle the dispute in accordance with the law applicable to the relationship in question, or if explicitly so authorized by the parties, in accordance with the general principles of law or the principles of equity"<sup>2</sup>.

Decision-making based on general principles of law differs from decision-making based on principles of equity. General principles of law are namely formulated *a priori* and constitute certain objective and abstract principles accepted in most legal systems, usually developed over the centuries. Principles of equity are, however, difficult to formulate in abstract terms. They usually become clear while considering specific factual circumstances<sup>3</sup>. The arbitral tribunals' competence to decide according to general principles of law and equity means that arbitrators are not obliged to apply the dispositive provisions of the law<sup>4</sup>. However, the arbitrators' discretion is limited, where they have to decide on the basis of general principles of law, whereas it is not limited when the arbitral decision is based on principles of equity. As emphasised in Polish doctrine by B. von Hoffmann, arbitral tribunals which "develop the law" based on general principles of law differ from tribunals deciding as *amiable compositeurs*. The former do not focus solely on the resolution of a particular dispute. Rather, these tribunals assess a general legal dispute and establish rules as if they were the legislator<sup>5</sup>. Polish law indeed emphasises the difference in application of general principles of law and

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<sup>1</sup> English version of this code is available here: Code of Civil Procedure, Part Five, as amended 28.07.2005 [in:] J. Paulsson (ed.), *International Handbook on Commercial Arbitration*, Deventer: Kluwer Law International 1984 (last updated: 08.2006 Supplement No. 46), pp. 1–16.

<sup>2</sup> *Ibid.*

<sup>3</sup> Cf. D. Mazur, *Prawo właściwe w międzynarodowym arbitrażu handlowym* [Law Applicable in International Commercial Arbitration], *Kwartalnik Prawa Prywatnego* [The Private Law Quarterly] 2003, vol. 1, p. 143.

<sup>4</sup> Cf. J. Gentinetta, *Die lex fori internationaler Handelsschiedsgerichte*, Bern: Stämpfli 1973, p. 204.

<sup>5</sup> B. von Hoffman, *O stosowaniu "legis mercatoriae" w międzynarodowym arbitrażu handlowym* [On Application of Lex Mercatoria in International Commercial Arbitration], *Problemy Prawne Handlu Zagranicznego* [Legal Problems of Foreign Trade] 1988, vol. 12, pp. 14, 25.

principles of equity (Article 1194 § 1 CCP). A similar conclusion is justified regarding the general principles of law and *lex mercatoria* and equity<sup>6</sup>. The arbitral decision-making based on general principles of law does not necessarily mean that arbitrators will apply *lex mercatoria*. However, it is difficult to indicate the differences between these two categories, not in the least because many authors consider these two bases for decision the same.

In other legal systems, the division between the general principles of law and equity is visible less clearly. Swiss law, for instance, refers to rules of law and equity. Article 187 of the Swiss Private International Law states that an arbitral tribunal should rule according to “*règles de droit*” chosen by the parties and that the parties may authorise the tribunal to rule according to *equity*<sup>7</sup>. French law, similarly allows the tribunal to rule according to *règles du droit*, both systems thus implicitly allowing also for general principles of law as the basis for decision, at least if the general principles are part of the legal system<sup>8</sup>. Also legal doctrine in these countries recognises the arbitral competence to adjudicate according to general principles of law<sup>9</sup>.

Polish doctrine considers the following principles as transnational general principles of law: freedom of contract in international trade, principle of *rebus sic stantibus*, *pacta sunt servanda*, the principle of good faith, prohibition of abuse of subjective rights, the principle of cooperation between the creditor and debtor to perform the contract, the principle of liability for breach of contract and damages, prohibition of contradicting the effects of own behaviour or prior acts of will (*venire contra factum proprium nemini licet*), the principle that the impossible excludes obligation (*impossibile nulla obligatio*), the principle of protection of acquired rights, the principle of protection of trust<sup>10</sup>.

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<sup>6</sup> A. F. Lowenfeld, *Lex Mercatoria: An Arbitrator's View*, Arbitration International 1990, vol. 6, issue 2, p. 141.

<sup>7</sup> Article 187(1) and (2) of the Swiss PIL.

<sup>8</sup> See *infra*.

<sup>9</sup> Cf. e.g. P. Burckhardt, P. Groz, *The Law Governing the Merits of the Dispute and Awards ex Aequo et Bono*, [in:] E. Geisinger, N. Voser (eds), *International Arbitration in Switzerland: A Handbook for Practitioners*, Alphen: Kluwer Law International 2013, p. 159.

<sup>10</sup> Cf. J. Poczobut, *Ewolucja pojęcia międzynarodowego prawa handlowego [Evolution of the Definition of International Trade Law]*, *Problemy Prawa Prywatnego Międzynarodowego [Legal Problems of Foreign Trade]* 2007, vol. 1, pp. 50, 51; J. Jakubowski, *Prawo jednolite w międzynarodowym obrocie gospodarczym [Uniform Law in International Trade]*, Warszawa:

In the international arbitration doctrine and practice i.a. the following general principles are accepted: *pacta sunt servanda* and its complementary rule of *rebus sic stantibus*, at least as long as it is interpreted restrictively, force majeure, the principle that execution of a contract implies its existence, the principle of interpretation *contra proferentem*, the obligation to mitigate damages, the principle of good faith<sup>11</sup>.

Application of the general principles of law by arbitral tribunals depends, under Polish law, in any case on the parties' authorisation. Arbitrators cannot base their decision on this basis if they have not been explicitly authorised to do so by the parties. Article 1194 § 1 of the Polish CCP is unequivocal in this respect. It clearly stipulates that the parties must grant the arbitrators the competence to adjudicate on the basis of general principles of law. In other legal systems this may be approached differently. As mentioned *supra*, the Swiss and French laws on international arbitration state for example that the parties may chose "rules of law" as the basis for the arbitral decision. On the other hand, in these legal systems, the parties may *authorise* the arbitral tribunals to rule according to equity or as *amiable composition*. It follows thus that in these legal systems, general principles of law constitute a different basis for decision than equity. The choice of general principles of law understood as *rules of law* is subject to the same requirements as choice of law clauses. Accordingly, in theory in these systems, arbitrators could also be authorised to rule according to general principles of law implicitly. Arbitrators must in any case determine first precisely the scope of

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Państwowe Wydawnictwo Naukowe 1972, p. 152; J. Jakubowski, [in:] J. Jakubowski, M. Tomaszewski, A. Tynel, A. W. Wiśniewski, *Zarys międzynarodowego prawa handlowego* [Overview of International Trade Law], Warszawa: Państwowe Wydawnictwo Naukowe 1983, p. 24. See also M. Pilich, *Dobra wiara w Konwencji o umowach międzynarodowej sprzedaży towarów* [Good Faith Under the Convention on International Sale of Goods], Warszawa: C. H. Beck 2006, p. 25; M. Konopacka, *Dobra wiara w prawie umów* [Good Faith in Contract Law], [in:] *Polskie prawo prywatne w dobie przemian. Księga jubileuszowa dedykowana Profesorowi Jerzemu Młynarczykowi* [Polish Private Law in the Era of Changes. Liber Amicorum for Professor Jerzy Młynarczyk], Gdańsk: Wydawnictwo Uniwersytetu Gdańskiego 2005, p. 54.

<sup>11</sup> N. Wühler, *Application of General Principles of Law*, [in:] A. J. van den Berg (ed.), *Planning Efficient Arbitration Proceedings: The Law Applicable in International Arbitration*, ICCA Congress Series, vol. 7, The Hague, Boston: Kluwer Law International, pp. 565–573; P. Lalive, *Arbitrage en Suisse et "Lex mercatoria"*, ASA Bulletin 1987, p. 172.

the parties' choice of law clause<sup>12</sup>. On the other hand, decision-making according to equity requires the parties' explicit authorisation. An explicit requirement for authorisation in Polish law implies that the parties cannot express their will impliedly and that the arbitrators cannot derive from this any authorisation. Polish law on arbitration does not specify the form for this explicit authorisation. However, it should be concluded that it should be in writing. Other legal systems address this issue similarly if a specific party's authorisation for some decision basis is required: generally, no specific requirements concerning the form of the authorisation to decide in equity are mentioned<sup>13</sup>. The doctrine for instance in Switzerland accepts nevertheless that the authorisation may be both explicit and tacit<sup>14</sup>. Some arbitration rules may, however, require that authorisation be given explicitly. This is the case, for instance in Swiss Rules of International Arbitration<sup>15</sup>. As opposed to choice of law clauses, authorisation to decide in equity or as *amiable compositeur* cannot in most systems be implied from parties' tacit actions. It is questionable whether reference to general principles of law should be considered in the same manner as reference to particular legal systems. It does not seem correct to assume that these two are identical. The assessment, as to whether decision-making based on general principles of law is allowed, is namely possible only through reference to a particular legal system. If decision-making based on general principles of law is possible only with the parties' explicit authorisation, it results from a specific legal provision. Similarly, the sole fact that the parties have chosen international arbitration as the method for the resolution of their disputes cannot lead to the conclusion that it was the parties' will to authorise arbitrators to decide based on general principles of law<sup>16</sup>. It is clear that an arbitral tribunal, which has been

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<sup>12</sup> Burckhardt, Groz, *supra* note 9, p. 163.

<sup>13</sup> See *infra* for references to the relevant legal provisions.

<sup>14</sup> Burckhardt, Groz, *supra* note 9, p. 170; D. Girsberger, N. Voser, *International Arbitration in Switzerland*, Zurich: Schulthess 2012, n. 951, 291; B. Berger, F. Kellerhals, *International and Domestic Arbitration in Switzerland*, Bern: Stämpfli 2010, n. 1326, 379 et seq.

<sup>15</sup> T. Zuberbühler, K. Müller (eds), *Swiss Rules of International Arbitration: Commentary*, The Hague: Kluwer Law International 2005, p. 298.

<sup>16</sup> Cf. von Hoffman, *supra* note 5, p. 23; A. Bucher, *Transnationales Recht im IPR*, [in:] F. Schwind (ed.), *Aktuelle Fragen zum Europarecht aus der Sicht in- und ausländischer Gelehrter*, Wien: Österreichische Akademie der Wissenschaften 1986, p. 53.

mandated by the parties to decide the dispute according to a specific legal system, cannot apply general principles of law instead<sup>17</sup>. The application of general principles of law – compared to the application of a specific legal system – is more complicated, not in the least owing to specific rules for burden of proof<sup>18</sup>, and may cause results difficult to foresee.

The discussion of general principles of law entails a rather essential, but not fully clarified, theoretical issue. It is namely necessary to consider whether general principles of law must be treated as legal norms or rather merely as directives of behaviour. A two-fold solution seems appropriate. Firstly, some of the principles are reflected in some national laws. These principles can be considered legal norms, generally accepted and common to the so-called civilised legal systems. As an example, norms concerning the sanctity of international agreements can be noted<sup>19</sup>. Secondly, some general principles of law result from international arbitral practice, which is why they function in international trade. This assumption leads to the conclusion that the general principles of law established through arbitral case-law may constitute directives of behaviour. The formulation of these principles in arbitral practice has allowed them to subsequently transpire into national legal systems and become part of them. The conclusion that general principles of law are not legal norms, unless when they undoubtedly form part of a specific legal system, is furthermore supported by the argument that some general principles are not norms ready for immediate application. Certain principles can namely collide with each other. For instance, the principle of contract autonomy may collide with the

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<sup>17</sup> Cf. von Hoffman, *supra* note 5, p. 24.

<sup>18</sup> *Ibid.*, p. 16.

<sup>19</sup> This position is supported by T. Ereciński, K. Weitz, *Sąd arbitrażowy [Arbitral Tribunal]*, Warszawa: LexisNexis Polska 2009, p. 325. Legal doctrine also mentions that general principles of law accepted by civilised nations are not lower in the hierarchy of the sources of law than international agreements or general customs. They are thus not merely of subsidiary character in respect of other sources, but are equal as far as their binding force is concerned, cf. W. Czapliński, A. Wyrozumska, *Prawo międzynarodowe publiczne. Zagadnienia systemowe [Public International Law. Systemic Issues]*, Warszawa: C. H. Beck 2004, p. 98; T. Jasudowicz, *O zasadach ogólnych prawa uznanych przez narody cywilizowane – garść refleksji [On General Principles of Law Accepted by Civilised Nations – a Handful of Thoughts]*, [in:] *Pokój i sprawiedliwość przez prawo międzynarodowe [Peace and Justice Through International Law]*, Toruń: Dom Organizatora TNOiK 1997, p. 141.

principle of trade protection<sup>20</sup>. For these reasons the first approach may not be generally supported. On the other hand, the proposition that general principles of law were considered legal norms would support legal certainty, which is indeed one of the purposes of law. In case, namely, an issue arose as to whether to apply the law or general principles of law, the second approach leads to the following conclusion: the law if the focus is on the law's certainty, and general principles of law if the focus is on justice.

Without any further analysis of the aspects of the codified general principles of law, it is interesting to make note here of the ICC arbitral practice. In many cases the principle of good faith was mentioned as one of the most important transnational principles. A further principle developed by arbitral case-law is the principle of prohibition of corruption. This principle has been discussed in a number of cases, however the most notable is the Hilmarton case<sup>21</sup>, one of the first known arbitral cases to explicitly discuss this principle. The parties in this case were a French company Omnium de Transaction et de Valorisation (OTV) and Hilmarton, a British company. The parties signed an agreement, which gave Hilmarton the task of business and tax consulting as well as the administrative coordination of a project. When Hilmarton demanded payment according to the agreement, OTV refused. Subsequently, Hilmarton requested an ICC arbitral tribunal to resolve the issues. OTV argued i.a. the nullity of the agreement based on alleged bribery of the Algerian officials. The parties' agreement was indeed found null and void due to the violation of public policy. Moreover, the arbitrator G. Lagergren held the dispute not to be arbitrable as it arose out of a contract<sup>22</sup> of which the subject-matter was illegal<sup>23</sup>. Hilmarton subsequently sought annulment of the arbitral award before the Swiss Federal Tribunal, which was granted. The Federal Tribunal held that the award was arbitrary and that no proof

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<sup>20</sup> Cf. K. Lorenz, *Methodenlehre der Rechtswissenschaft*, Berlin: Springer 1983, p. 420; quote after von Hoffman, supra note 5, p. 16.

<sup>21</sup> ICC Case No. 5622, Rev. Arb. 1993.

<sup>22</sup> Currently, this position concerning arbitrability of disputes arising out of illegal contracts is universally dismissed in arbitration doctrine.

<sup>23</sup> A. El. Kosheri, Ph. Leboulanger, *L'arbitrage face a la corruption et aux trafics d'influence*, Rev. Arb. 1984, vol. 3.

of bribery by Hilmarton of the Algerian officers was in fact established. Meanwhile, however, the case was also reviewed by the French courts, including the French Court of Appeal, which granted the enforcement of the arbitral award. Also in other ICC cases (Nos. 2730 and 3913) the issue of dishonest practices was discussed. The latter case clearly demonstrated that bribery resulted in nullity of the contract. The prohibition of corruption in arbitral case-law seems to have developed in the light of the similarities of solutions to this issue in various legal systems. Currently, the principle of prohibition of corruption is considered only in the light of public policy<sup>24</sup>.

The principle of good faith, however, has proved essential in arbitral case-law not only because of its significance<sup>25</sup>, but also because it is applicable to various circumstances. In this context ICC Case No. 5056 of 1968<sup>26</sup> should be noted. The arbitral tribunal in this case held: “the principle of good faith does not allow a party to sign the document evidently containing the contractual terms, then to take advantage of the other party’s services performed according to these terms and at the same to question its own obligations due to the fact that the contract was concluded with a company that was supposed to be established, whereby its establishing depended on the will of this party”<sup>27</sup>. Also ICC

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<sup>24</sup> Cf. U. Roguzińska, *Klauzula porządku publicznego w kontroli a posteriori orzeczeń międzynarodowego arbitrażu handlowego* [Public Policy in the A Posteriori Review of International Commercial Arbitration Awards], Wrocław 2005, p. 65 (unpublished PhD thesis). See also M. A. Zachariasiewicz, *Zasada dobrej wiary jako kryterium oceny zachowania stron w toku negocjacji w ujęciu prawoporównawczym (culpa in contrahendo)* [The Principle of Good Faith as a Criterion for Evaluation of Parties’ Behaviour During Negotiations in Comparative Law (Culpa in Contrahendo)], [in:] *Rozprawy prawnicze. Księga pamiątkowa Profesora Maksymiliana Pazdana* [Legal Theses. Liber Amicorum for Professor Maksymilian Pazdan], Kraków: Zakamycze 2005, p. 1513.

<sup>25</sup> For more about the principle of good faith see Pilich, *supra* note 10, p. 41; Zachariasiewicz, *supra* note 24, p. 1501; also K. Przybyłowski, *Dobra wiara w polskim prawie cywilnym (ogólne uwagi o pojęciu)* [Good Faith in Polish Private Law (General Remarks on Its Definition)], *Studia Cywilistyczne* [Civilistic Studies] 1970, vol. XV, p. 3; J. Gajda, *Pojęcie dobrej wiary w przepisach kodeksu cywilnego* [The Definition of Good Faith in the Provisions of the Civil Code], *Studia Prawnicze* [Legal Studies] 1997, no. 2, p. 54; B. Janiszewska, *Pojęcie dobrej wiary w rozumieniu obiektywnym a zasady współżycia społecznego* [The Definition of Good Faith in the Objective Meaning and the Principles of Social Relations], *Przegląd Ustawodawstwa Gospodarczego* [Economic Legislation Review] 2003, no. 9.

<sup>26</sup> ICC Case No. 5056.

<sup>27</sup> The authors’ free translation.



Case No. 5904 of 1989<sup>28</sup> referred to the principle of good faith. The arbitral tribunal held that “lex mercatoria, to which application the parties’ consented, requires the contracts to be performed in good faith. This principle requires the buyer to select the most appropriate sanction in case of seller’s default”<sup>29</sup>. The principle of good faith as an aspect of public policy has also often been invoked in cases concerning the arbitrability of disputes involving states or state organs<sup>30</sup>. Also state courts, which have reviewed arbitral awards, have addressed this issue. An example can be found in the judgment of the Paris Court of Appeals of 25.11.1993 in the case of *Société Paco Rabanne Parfums et Société Paco Rabanne v. Société les maisons Paco Rabanne*<sup>31</sup>. The Court of Appeals refused to annul the award, emphasising implicitly that the principle of good faith forms part of public policy: “an arbitral tribunal does not violate the principle of the *débat contradictoire* where it refers to the principle of contract performance in good faith – transnational public policy – that was mentioned during the debate”<sup>32</sup>. The same Court of Appeal discussed the principle of good faith as part of public policy also in another judgment<sup>33</sup>: “Considering that contract performance in good faith is a general principle of public international law (...), in respect of which the arbitrator has the particular obligation to respect it (...). Furthermore, considering in respect thereof that the arbitral tribunal held correctly, not in order to violate international public policy but to the contrary – in order to respect it, that to take into account the judgment of Ivory Coast which establishes the party’s insolvency (...) violates the general principle of performing contracts in good faith”<sup>34</sup>.

The resolution of international disputes based on general principles of law is a particularly useful tool, as it allows for thorough analysis of the problem from an entirely different perspective than if the dispute were to be resolved only on the basis of the law. The application of general

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<sup>28</sup> ICC Case No. 5904.

<sup>29</sup> The authors’ free translation.

<sup>30</sup> Cf. Roguzińska, *supra* note 24, p. 71.

<sup>31</sup> Rev. Arb. 1994.

<sup>32</sup> The authors’ free translation.

<sup>33</sup> Judgment of 12.01.1993 in case *Republic of Ivory Coast et al. v. Société Norbert Beyrard*, Rev. Arb. 1994.

<sup>34</sup> Cf. Roguzińska, *supra* note 24, p. 264.

supranational principles may, however, provoke certain questions in the light of Polish law (Article 1194 § 1 CCP). It is namely uncertain, if general principles of law may be applied only if the dispute results from an international transaction, i.e. in the case of international arbitration, or also in domestic arbitration. This issue may indeed be resolved based on the literal interpretation of Article 1194 § 1 CCP, which refers generally to “general principles of law”. As such, general principles of law encompass all principles of law, both those resulting from national as well as from international or foreign law and common rules of legal thinking. Some of the general principles of law are of a supranational character. However, it is unquestionable that some of them are codified in domestic laws (e.g. the principle of freedom of contract, in Polish law embodied in Article 353<sup>1</sup> of the Civil Code). It may thus be concluded that also national arbitration provides for the possibility for arbitral tribunals to adjudicate on the basis of general principles of law, unless these principles are unknown to the particular legal system. To conclude otherwise would mean firstly that the bases for arbitral decision-making would be significantly limited. Secondly, the said article does not provide for any such limitations. Nor does it suggest that the basis for decision-making would be limited depending on a particular type of arbitration.

The most debatable issue concerning the application of extra-legal bases for decision-making is not the issue of the competence of arbitral tribunals, but the understanding of the basis itself. A few preliminary remarks are appropriate in order to thoroughly investigate this issue. Firstly, the term *equity* can be understood in many ways even if its meaning is analysed in the context of a specific legal language. Secondly, the meaning of this term is seriously emotionally charged<sup>35</sup>. The classic definition of equity implies that a given decision is equitable when it equitably corrects the judgement which otherwise should be rendered

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<sup>35</sup> Cf. J. Wróblewski, *Wartości a decyzja sądowa* [Values and Judicial Decision], Wrocław-Warszawa-Kraków-Gdańsk: Zakład Narodowy im. Ossolińskich 1973, p. 204; See also H. Piętka, *Słuszność w teorii i praktyce* [Equity in Theory and Practice], Warszawa: Instytut Wydawniczy Kasy Mianowskiego 1929, p. 55.

on the basis of the norms applicable to cases of this type<sup>36</sup>. In this sense, equity refers to the so-called independent definition. Another approach is the so-called relative approach. It differs from the classic approach in that it is understood as a characteristic of a decision or of a norm, while it assumes compatibility with another norm. In theory, it is very difficult to differentiate equity from justice, as equity *sensu largo* is a synonym of justice<sup>37</sup>. Equity may not intervene generally in order to do justice, but it will do so only when the prerequisites for such intervention are fulfilled. Equity understood as a legal criterion can be evaluated in a functional sense, i.e. by reference to the function it fulfils in the legal system. It is accepted that decision-making based on principles of equity constitutes a fundamental tool for resolving conflicts between law and morality, arising where the morally accurate, abstract and general norm is in conflict with the moral evaluation of the specific circumstances subject to decision-making<sup>38</sup>.

From the arbitral tribunal's viewpoint, the term *equity* is taken into consideration when reference is made to the *principles of equity*. Another phrase seems also appropriate, namely that arbitrators deal with the *principles flowing from equity*. Both phrases in fact mean the same thing, however some legislators, as in Poland (Article 1194 § 1 CCP), have opted for the phrase "principles of equity"<sup>39</sup>. In other legal systems, these terms

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<sup>36</sup> The classic concept of equity refers to justice – see Aristotle, *Etyka Nikomachejska* [*Nicomachean Ethics*], Warszawa: PWN 1956, p. 198.

<sup>37</sup> Cf. Wróblewski, supra note 35, pp. 205–209; see also I. Szabó, *Pojęcie słuszności w różnych systemach prawnych* [*Equity in Various Legal Systems*], *Państwo i Prawo* [State and Law] 1971, issue 5, p. 673; K. Sójka-Zielińska, *Zasada słuszności wobec teoretycznych założeń kodyfikacyjnych XIX w.* [*Equity and Theoretical Underpinnings of the XIX Century's Codifications*], *Państwo i Prawo* [State and Law] 1974, issue 2, p. 30; E. Rott-Pietrzyk, *Klauzula generalna rozsądku w prawie prywatnym* [*The General Principle of Equity in Private Law*], Warszawa: C. H. Beck 2007, p. 80.

<sup>38</sup> Cf. I. C. Kamiński, *Słuszność i prawo. Szkic prawnoporównawczy* [*Equity and Law. A Comparative Review*], Kraków: Zakamycze 2003, p. 37.

<sup>39</sup> Cf. L. Łabędzki, *Międzynarodowy arbitraż handlowy* [*International Commercial Arbitration*], Warszawa: Polska Izba Handlu Zagranicznego 1984, p. 158; S. Dalka, *Sądownictwo polubowne w PRL* [*Arbitration in Communist Poland*], Warszawa: Wydawnictwo Prawnicze 1987, p. 86; J. Sobkowski, *Stosowanie prawa materialnego w sądownictwie polubownym według kodeksu postępowania cywilnego i regulaminów Kolegium Arbitrów przy Polskiej Izbie Handlu Zagranicznego* [*The Application of Law on the Merits in International Arbitration according to the Code of Civil Procedure and Rules of the Arbitral Court with the Polish Chamber of International Trade*], *Ruch Prawniczy, Ekonomiczny i Socjologiczny* [Legal, Economical and Sociological Review]

differ significantly. Some refer only to *equity*; some do not mention it even explicitly like in the English Arbitration Act of 1996, whereas French law for instance only speaks of *amiable composition*<sup>40</sup>. In theory, the phrase *principles of equity* assumes the existence of some system of equity rules, according to which the assessment of a given case is made. One cannot specifically reasonably assume that adjudicating according to the principles of equity means nothing and that it is not to be given any, however fleeting, meaning. This meaning can in fact be rather abstract. The abovementioned provision of the Polish CCP is an example of a reference to equity in a legal text. It does not indicate the equity of a purpose, but uses equity as a factor to determine the basis for arbitral decisions. Referring to principles of equity as a basis for decision-making requires furthermore that these principles are distinguished from the general clauses which in their turn refer to equity. The essence of general clauses is to open the legal system to non-legal criteria, i.e. criteria that have not been incorporated into the legal system and the contents of which have not been precisely defined<sup>41</sup>. General clauses allow for juridical criteria, whereas decision-making based on principles of equity consists in searching for a solution to an existing dispute, according to the directives of equity and justice, regardless of the legal norms binding at the same time<sup>42</sup>.

Adjudication based on principles of equity must furthermore be clearly differentiated from mediation and conciliation. Adjudication referring

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1980, issue 3, p. 70; I. C. Kamiński, *Zasady słuszności jako podstawa orzekania w obrocie cywilnym i handlowym* [*Principles of Equity as Basis for Decision-Making in Civil Law and Trade*], Państwo i Prawo [State and Law] 1993, no. 4, p. 48; T. Ereciński, [in:] T. Ereciński, J. Gudowski, *Komentarz do kodeksu postępowania cywilnego. Część pierwsza. Postępowanie rozpoznawcze* [*Commentary on the Code of Civil Procedure. Part one. The Proceedings on the Merits*], Warszawa: Wydawnictwo Prawnicze LexisNexis 2004, p. 397.

<sup>40</sup> See below for examples of legal provisions concerning decision-making according to equity.

<sup>41</sup> Cf. L. Leszczyński, *Zagadnienia teorii stosowania prawa. Doktryna i tezy orzecznictwa* [*Some Issues on the Theory of the Application of the Law. Doctrine and Case Law*], Kraków: Wolters Kluwer 2002, p. 44; L. Leszczyński, *Stosowanie generalnych klauzul odsyłających* [*The Application of General Clauses*], Kraków: Zakamycze 2001, p. 21; See also M. Safjan, *Klauzule generalne w prawie cywilnym (przyczynek do dyskusji)* [*General Clauses in Civil Law (An Incentive for Discussion)*], Państwo i Prawo [State and Law] 1990, issue 11, p. 48.

<sup>42</sup> Cf. A. Lizer-Klatka, *Pojęcie orzekania na zasadach słuszności w międzynarodowym arbitrażu handlowym* [*Decision-Making Based on Equity in International Commercial Arbitration*], Państwo i Prawo [State and Law] 2000, issue 1, p. 61; Ereciński, Weitz, *supra* note 19, p. 326.

to specific bases does not imply seeking a settlement, but rather the resolution of a specific dispute. An arbitral award, even if it was rendered based on principles of equity, is binding for the parties, particularly so if it has been approved by the state court. A settlement reached in mediation does not have this force.

Adjudication based on equity is allowed not only in Polish law, but also in other legal systems. A few examples of arbitration laws in the countries commonly regarded as the most important centres for international arbitrations in light of their supportive arbitration laws and case-law illustrate the different approaches. In France<sup>43</sup>, Article 1497 of the Code of Civil Procedure provides that arbitrators may decide as *amiable compositeurs* if expressly authorised by the parties. Interestingly, French law generally allows arbitrators to adjudicate according to the “*règles de droit*” as opposed to the “law” chosen by the parties<sup>44</sup>. This formulation clearly allows thus the parties to choose any law as applicable to the dispute, i.e. also supranational law such as *lex mercatoria*<sup>45</sup>. In Switzerland<sup>46</sup>, “The parties may authorize the arbitral tribunal to rule according to equity”<sup>47</sup>. In England, interestingly, the Arbitration Act of 1996 grants such arbitrators’ competence only implicitly<sup>48</sup>. The relevant provision is Article 46(1)(b) and states: “if the parties so agree, in accordance with such other considerations as are agreed by them or determined by the tribunal”.

Also other systems typically allow for decision-making based on equity. Article 1051(3) of the German ZPO should be noted, according to which the parties can release the arbitrators from deciding according to any law and authorise them to decide based on the principles of equity. Also Article 822 of the Italian Code of Civil Procedure provides for

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<sup>43</sup> France has explicitly designed its legislation in order to support international arbitration. See e.g. Ph. Fouchard, *Rapport de synthèse*, Rev. Arb. 1992, pp. 381, 382; G. Carducci, *The Arbitration Reform in France: Domestic and International Arbitration Law*, Arbitration International 2012, vol. 28, issue 1, p. 128.

<sup>44</sup> Article 1496 of the French CCP.

<sup>45</sup> In this sense also Carducci, *supra* note 43, p. 153.

<sup>46</sup> E. Geisinger, J. Raneda, *Legislative Framework*, [in:] Geisinger, Voser (eds), *supra* note 9, p. 1.

<sup>47</sup> Article 187 (2) of the Swiss Private International Law.

<sup>48</sup> Cf. also J. F. Poudret, S. Besson, *Comparative Law of International Arbitration*, London: Sweet & Maxwell 2007, p. 620.

the possibility of deciding based on equity, on the condition that both parties have agreed to it. Similar solutions are incorporated also in Article 34(1) of the Spanish Law on Arbitration.

Adjudication based on principles of equity is thus a commonly accepted method for decision-making. It allows the arbitral tribunals for the application of extra-legal criteria in resolution of disputes. Review of the solutions in foreign legal systems suggests that a further distinction must be made, namely between decision-making *ex aequo et bono* and as *amiable compositeur*<sup>49</sup>. This distinction is clearly visible in Article 28 (2) of the UNCITRAL Model Law and in some legal systems, of course particularly those based on the Model Law. In France, for instance, the concept of *amiable composition* is mentioned as an exception, as opposed to arbitration based on law and it is admissible only with the parties' consent. In Switzerland, however, decision-making based on equity has a different meaning from that in France<sup>50</sup>. *Ratio legis* of *amiable composition* allows arbitrators to mitigate the consequences of the application of contractual solutions as required by law, in light of the parties' interests or concerns of justice. *Amiable composition* allows the parties to waive the traditional benefits of the application of the law. On the other hand, it is generally accepted that an *amiable compositeur* may of course adjudicate solely on the basis of legal rules i.e. without mitigating their effects, if he considers it appropriate in the given case in the light of equity, justice, the parties' joint interests, or other values considered jointly by the parties as to be important<sup>51</sup>. Accordingly, decision-making based on principles of equity differs from *amiable composition* in that the arbitral tribunals must make an equitable evaluation according to subjective criteria, i.e. what forms in their perception a just resolution of the dispute<sup>52</sup>. Furthermore,

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<sup>49</sup> This distinction is also emphasised in doctrine. See e.g. M. Rubino-Sammartano, *Amiable Compositeur (Joint Mandate to Settle) and Ex Bono et Aequo (Discretionary Authority to Mitigate Strict Law): Apparent Synonyms Revisited*, *Journal of International Arbitration* 1992, vol. 9, issue 1, p. 16.

<sup>50</sup> Cf. A. Wach, *L'amiable composition jako samodzielna forma rozwiązywania sporów [L'amiable Composition as an Independent Form of Dispute Resolution]*, *Radca Prawny [Attorney at Law]* 2004, no. 6, p. 124.

<sup>51</sup> *Ibid.*, p. 125.

<sup>52</sup> Cf. Lizer-Klatka, *supra* note 42, p. 64; Ereciński, Weitz, *supra* note 19, p. 326; R. Briner, *Special Considerations Which May Affect the Procedure (Interim Measures, Amiable Composition,*

decision-making *ex aequo et bono* compared to *amiable composition* implies broader freedom in disregarding legal norms in the light of equity imperatives<sup>53</sup>. As emphasised by A. Wach in Polish doctrine, an *amiable compositeur*, not being authorised to render a decision solely on the basis on equity, may, however use it and indeed often does so in practice. In accomplishing his mission, he may, in particular, mitigate the consequences of the application of a certain law, including the parties' law, in order to arrive at a just and equitable solution. This solution will to some extent disregard the rights and obligations formulated imperatively in the specific contract<sup>54</sup>. In order to further emphasise the difference between the legal concepts of equity and *amiable composition*, it has to be noted that in case of a decision *ex aequo et bono*, arbitrators are obliged to search for the just and equitable solution to the dispute, whereas in the case of *amiable composition*, it is the mere possibility and not obligation. Accordingly, arbitral tribunals can, but are in no way obliged to, make use of it<sup>55</sup>. In Polish law, however, these two concepts are not distinguished. Some authors suggest that this may constitute an argument to allow decision-making based on both versions of equity mentioned in Article 1194 § 1 CCP<sup>56</sup>. In our opinion, this position is too far-reaching. Firstly, *amiable composition* interprets equity in a slightly different way and secondly, the scope of authorisation for arbitrators is different. In the case of reference to principles of equity as the basis for decision-making in the light of Article 1194 § 1 CCP, arbitrators should be free from any legal norm, whereas their understanding of equity and justice is rather abstract. Decision-making as *amiable compositeurs*, however, does not free arbitrators from deciding on the basis of the law. Their understanding of equity takes here a different turn from that in decision-making based on equity. Also P. Lalive emphasises this difference in some sense, where he states that arbitration based on equity is disconnected from what constitutes law and as such it differs from *amiable composition* according to French law,

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*Adoption of Contracts, Agreed Settlement*), [in:] van den Berg (ed.), supra note 11, pp. 362–373; Zuberbühler, Muller (eds), supra note 15, p. 298.

<sup>53</sup> Cf. Lizer-Klatka, supra note 42, p. 64.

<sup>54</sup> Wach, supra note 50, p. 125.

<sup>55</sup> Cf. Lizer-Klatka, supra note 42, p. 64.

<sup>56</sup> Cf. Ereciński, Weitz, supra note 19, p. 326.

which allows arbitral tribunals to mitigate the consequences of the application of the law<sup>57</sup>. The interpretation of the Polish Article 1194 § 1 CCP in a broader way is not appropriate, especially since it may cause confusion in the understanding of some concepts. Therefore, in our opinion, as the Polish legislator has opted for the principles of equity, this reference should not be interpreted in a broad way. Rather, this interpretation should be restrictive. The essence of decision-making on the basis of equity gives arbitral tribunals a certain leeway transcending the legal norms<sup>58</sup>. Decision-making on the basis of equity and without reference to the law may, however, in no case violate public policy. Arbitral competence always lies within the boundaries of the parties' competences and because the parties may never transgress upon public policy, *a fortiori*, also arbitrators may not do this<sup>59</sup>. If, however, such circumstances should arise, an arbitral award could be annulled or refused enforcement precisely owing to violation of public policy. Decision-making on the basis of equity may of course not justify the violation of the rights of defence and the parties' right to request annulment of an arbitral award. The precise scope of these rights differs, however, in various legal systems. As a consequence, all circumstances must be evaluated *a casu ad casum*.

Similar problems with regard to the annulment and enforceability of arbitral awards may arise in the case of awards based on general principles of law or *lex mercatoria*. Currently, most legal systems and their courts principally allow enforcement of such awards as long as they do not violate international public policy<sup>60</sup>.

Referring to the annulment of arbitral awards, the issue arises as to which public policy should be taken into account in evaluating possible violations: of the place of enforcement, the place of decision-making,

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<sup>57</sup> P. Lalive, [in:] P. Lalive, J. F. Poudret, C. Reymond, *Le droit de l'arbitrage interne et international en Suisse*, Lausanne: Payot 1989, p. 400.

<sup>58</sup> Cf. Mazur, *supra* note 3, p. 146.

<sup>59</sup> Cf. O. Chukwumerije, *Choice of Law in International Commercial Arbitration*, Westport, Connecticut: Quorum Books 1994, p. 119.

<sup>60</sup> See e.g. Judgment of the Landgericht Hamburg of 18.09.1997, *Yearbook Commercial Arbitration* 2000, vol. XXV, pp. 710, 712; D. W. Rivkin, *Enforceability of Arbitral Awards Based on Lex Mercatoria*, *Arbitration International* 1993, vol. 9, issue 1, pp. 74-75; J. Lew, *Applicable Law in International Commercial Arbitration*, New York: Oceana Publications 1978, p. 123.



of the legal system of the proper law or perhaps of an autonomous legal order. In the case of an arbitral award based on equity, it does not seem relevant to consider all legal systems, but only the one that constitutes the basis for this award<sup>61</sup>. Decision-making based on equity requires not only the parties' consent but also, more generally, the admissibility of such decision-making in a specific legal system. On the other hand, possibly also the public policy of the enforcement state should be taken into account, particularly where proper law allows for decision-making on the basis of equity and the law of the state of enforcement does not. In practice, arbitrators indeed often consider the place of potential enforcement of the award, particularly when this place is predictable.

A further interesting issue arises in the context of equity as a basis for arbitral decision-making, namely whether the possibility of deciding on the basis of equity may influence the nature of an arbitral award in the theoretical sense. The issue is really whether the fact that the parties choose the basis for decision-making somehow contradicts the jurisdictional theory, according to which positive law stands above the arbitrator's personal views of justice and equity. From the viewpoint of the theory of autonomy of will, the parties, when opting for a decision based on equity, are aware that they waive the certainty offered by positive law and choose uncertainty and unpredictability of the decision. However, these circumstances cannot be decisive in order to determine the legal theory of the arbitral award. This will be indeed decided in the light of other issues rather than solely with reference to the basis for decision-making.

The differences between equity and *lex mercatoria* have already been suggested above. Furthermore, Article 1194 § 2 of the Polish CCP obliges arbitral tribunals to consider trade usages. Other legal systems similarly require arbitrators to always take trade usages into account. For instance, Article 1496 of the French Code of Civil Procedure provides for that an arbitral tribunal *tient compte dans tous les cas des usages du commerce*. Many institutional arbitration rules contain similar solutions. For instance, Article 21 (2) of the ICC Arbitration Rules stipulates that "The arbitral

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<sup>61</sup> Cf. I. C. Kamiński, *Uprawnienia sędziów i arbitrów orzekających na podstawie reguł słuszności* [The Competence of Judges and Arbitrators Deciding Based on Equity], *Problemy Prawne Handlu Zagranicznego* [Legal Problems of Foreign Trade] 2000, vol. 19/20, p. 75.

tribunal shall take account of the provisions of the contract, if any, between the parties and of any relevant trade usages". The application of trade usages may cause many difficulties in practice. It is in particular unclear to what extent these usages should be taken into account if both parties provided for their application, for instance by submitting their dispute to an ICC arbitration and thus subjecting their dispute to the above-mentioned rule of Article 21 (2) of ICC Rules, and if at the same time, the proper law also requires the trade usages to be taken into account. In such circumstances it may be particularly unclear if the reference to ICC Rules incorporates indeed the trade usages to the parties' contract<sup>62</sup>.

In the light of the above, circumstances may arise where an arbitral tribunal will on the one hand decide on the basis of equity and on the other hand consider supranational trade usages. Should this lead to a conflict in the sense that a usage makes it impossible to apply a criterion of equity, the arbitral tribunal obviously cannot base its decision on both factors at the same time. This results from the fact that principles of equity have priority over trade usages. Trade usages indeed do not constitute an autonomous basis for an arbitral decision-making. In addition, trade usages are created by specific factual circumstances, which over the years have developed into a supranational system of its own. Application of principles of equity assumes, in its turn, the necessity to consider the specific circumstances of each case in an individual way<sup>63</sup>, and not in a general way as could be the case in the event that a specific usage was applied. The authorisation to abandon the strict application of the letter of the law and to consider the parties' joint interests in the case of reference to equity is the most important aspect. In a case, however, where the application of a usage leads in effect to a just solution, nothing prevents this norm from being applied in an arbitral dispute, even where they decide based on equity. A similar approach is for example found in Article 28 (4) of the UNICTRAL Model Law. However, this provision also provides for the application of trade usages not only in cases of decision-making on the basis of equity but also *amiable composition*.

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<sup>62</sup> T. Ayoglu, *Application of Trade Usages in International Institutional Arbitration – Some Reflections*, ASA Bulletin 2012, vol. 30, issue 3, pp. 539–547.

<sup>63</sup> Cf. Lizer-Klatka, *supra* note 42, p. 68; Erciński, Weitz, *supra* note 19, p. 327.

In this context, a further question of the application of the contractual terms arises. As A. Lizer-Klatka emphasises, in Polish doctrine, the issue arises whether arbitrators should always consider the terms of the parties' contract, or if they can revise and develop them, finding solutions for the future<sup>64</sup>. There seems to be no consensus in this respect in the international doctrine: according to one view, arbitrators are not allowed to disregard the contractual terms. This view is particularly popular in Swiss doctrine. According to the second view, however, arbitrators are allowed to revise the contractual terms<sup>65</sup>. This issue becomes particularly relevant in international arbitration as well as in arbitration where the tribunal is authorised to decide as *amiable compositeur*. This issue can indeed be resolved quite simply in the light of party autonomy and public policy. Undoubtedly, where dispositive provisions are at stake, arbitrators, through the delegation of powers that otherwise belong to the parties, may, rather than determine the consequences of application of these provisions, also refer to other relevant bases in order to resolve the dispute. Following this view, one can say that the arbitrators' competence to revise the parties' contract means that arbitrators have the same competences in relation to this contract as in relation to the dispositive provisions of the applicable law. The powers of *amiable composition* reflect the parties' powers, whereby the parties waive their powers and grant these powers to arbitrators. The opponents of this view suggest, however, that it is irreconcilable with the fundamental principle of the sanctity of the parties' contract<sup>66</sup>. This has also been underscored in arbitral case-law. An example is offered by ICC Case No. 3267 of 1979, which stated: "In spite of the fact that some legal scholars are of the opinion that arbitrators empowered to decide in amiable composition can revise the provision of the parties' common will, it is a commonly accepted principle that the primary duty of an arbitrator, also adjudicating as amiable compositeur, is the application of the parties' contract, unless it is clearly established that the contractual terms are unequivocally contrary to the actual parties' will or that they violate public policy. In the arbitral tribunal's opinion, this principle is

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<sup>64</sup> Lizer-Klatka, *supra* note 42, p. 67.

<sup>65</sup> Cf. Lizer-Klatka, *supra* note 42, pp. 67, 68.

<sup>66</sup> Cf. Roguzińska, *supra* note 24, p. 275.

the fundamental condition for the security of international trade”<sup>67</sup>. Similarly, in ICC Case No. 3938 of 1982, the arbitral tribunal considered: “according to the dominant doctrine and practice of international commercial arbitration, an arbitrator *amiable compositeur* remains bound by the contract (...). Considerations that may lead the *amiable compositeur* to mitigate the effects of the application of dispositive provisions of law in specific circumstances are inapplicable in respect of the contract, a special regulation arising out of the parties’ own will”<sup>68</sup>. Additional arguments against the arbitral competence to revise the contractual provisions are furthermore found in Article 28 (4) of the UNCITRAL Model Law. This issue, of fundamental theoretical and practical importance, has also often been considered in the case-law of state courts in annulment and enforcement proceedings. It has been particularly visible in the case-law of French courts, perhaps unsurprisingly when one considers the origin of the concept of *amiable composition*. In fact, the issue of arbitral competence to revise the parties’ contract in international arbitration has been approached with caution in the light of the unquestionable principle of *pacta sunt servanda*, which is considered part of supranational public policy<sup>69</sup>. Indeed, in this respect any revision of the parties’ contractual framework seems to violate public policy in its supranational understanding. On the other hand, however, the possibility of modifying the parties’ contractual clauses in the light of equitable concerns, without the actual renegotiation of the contract, seems to remain in compliance with the principles of *amiable composition*. In any event, in order to avoid any doubt as to the scope of arbitral decision-making it is advisable to provide an appropriate clause in the arbitration agreement<sup>70</sup>.

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<sup>67</sup> Authors’ free translation.

<sup>68</sup> Authors’ free translation after Roguzińska, *supra* note 24, p. 277.

<sup>69</sup> Cf. Roguzińska, *supra* note 24, p. 277, referring to several judgments of French courts.

<sup>70</sup> J. Paulsson, N. Rawding (eds), *The Freshfields Guide to Arbitration Clauses in International Contracts*, Alphen aan den Rijn: Kluwer Law International 2010, p. 30.

