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Editorial	103
In the News / Actualité	
STEN VERHOEVEN / ICJ Advisory Opinion on the Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territories	106
ROEMER LEMAITRE / Transdniestria before the European Court of Human Rights	111
CEDRIC RYNGAERT / The US Supreme Court's Decision in <i>Sosa v. Alvarez-Machain</i>	116
DOUGLAS W. CASSEL / The United States Supreme Court Rulings on Detention of 'Enemy Combatants' – Partial Vindication of the Rule of Law	122
Recurring Themes / Thèmes récurrents	
<i>100 Years of International Law / Cent ans de droit international</i>	
SIR ROBERT JENNINGS / The Imbalance of the International Law System	126
CHRISTOPH SCHREUER / Preventing the Past	131
RICHARD GOLDSTONE / Advances in International Human Rights Law	136
M.C.W. PINTO / Making International Law in the Twentieth Century	141
ELLEN HEY / International <i>Public</i> Law	149
ALI MEZGHANI / La démocratisation d'un «droit savant»	163
PATRICK WAUTELET / Le droit international privé au vingtième siècle – Quelques observations	169
HOWARD M. HOLTZMANN / 100 Years of International Arbitration	174
LOUISE BARRINGTON / International Arbitration: When "Second Choice" is Best	180
Work in Progress / Travaux en cours	
PIERRE-LAURENT CHATAIN / The World Bank's Role in the Fight against Money Laundering and Terrorist Financing	190

International Arbitration: When “Second Choice” is Best

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Since the time of Moses, who advised his people to “choose some wise, understanding and respected men from each of your tribes and I will set them over you,”¹ societies have relied on arbitration to settle their disputes. Mediterranean traders used arbitration to get a quick, expert decision on the merchandise they were trading. The English passed their first Arbitration Act in 1698. But it has been in the last century that modern arbitration has developed into a universally recognized and accepted mechanism for dispute settlement, both domestically and internationally.

Considering England's domination of sea trade until the end of the 19th century, it is hardly surprising that the London Court of International Arbitration (LCIA) is the oldest existing arbitral institution in the world. Dating from 1892, it was the creation of merchants distrustful of the state courts' capacity to decide international commercial disputes. The merchants created their own system of private justice, under which the disputants agreed to submit their differences to a knowledgeable and respected neutral party who was neither lawyer nor judge, who represented no state legal system, but who would produce an efficient and practical result. The arbitral decisions of that time were based not as much on legal principles as on practicalities, such as whether the merchandise corresponded with the contract description or whether the quality or quantity was that which had been promised.

Stockholm's Chamber of Commerce and the International Chamber of Commerce (ICC) set up their own arbitration courts in 1917 and 1923, respectively, as a service to their members. In the intervening decades, arbitration – both institutional and *ad hoc* – has become a growth industry.

More Trade = More Disputes

Over the past century, with the development of transportation and communications, the volume of international business transactions has exploded at a rate those early arbitration pioneers might never have imagined. Containerships, subterranean pipelines, and massive cargo planes have shrunk the international business world to a

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¹ Deuteronomy, 1:9-18.

single community. Today's deals are made across continents in a matter of moments, by telephone, internet, SMS and other split-second technologies. Inevitably, the multiplied volume of international trade brings with it a multiplication in disputes. In its first year of existence, the ICC Court received 36 requests for arbitration and conciliation.² Today, eighty years later, that number hovers at around 600 annually. CIETAC, the Chinese arbitration commission, received nearly 1000 notices of arbitration in a single peak year. CIETAC's three offices now handle about 700 new cases per year, despite competition from over 150 other arbitration commissions around the Peoples' Republic.

Why this Growth? Arbitration's Advantages

A former Secretary-General of the ICC Court refers to arbitration as everyone's "second favorite dispute resolution mechanism." Stephen Bond points out that, in an international transaction, each party would doubtless prefer to settle disputes on home territory, where the courts, judges, procedure and language are familiar. However, if the state court of a host country is required to decide a conflict between that country and a foreign investor, questions arise about its ability to render an independent and fair decision. Many foreign investors, sadder but wiser, now insist on arbitration clauses in their contracts. They stipulate private dispute resolution, usually in a neutral forum, equally inconvenient to both parties, where neither party has its residence or office. The neutral venue and the ability to choose at least one member of the decision-making body are distinct reassurances to foreign investors.

Arbitration procedure is flexible and it is usually confidential. For the middle years of the twentieth century, it was hailed – in the United States at least – as a "faster, cheaper, more efficient" mode of dispute resolution. Faced with expensive and complex discovery procedures, interminable court lists, adjournments, egregious jury awards, and two levels of appeal, many litigants – both domestic and international – chose arbitration for a rapid commercial solution which would allow them to end the conflict and carry on with the business of making money. Without fanfare; bailiffs, gowns or wigs, and in a language (or languages) understood by the disputants, an arbitral tribunal was an efficient mechanism for dealing discreetly and expeditiously with most disputes.

Although the International Court of Justice, as the principal judicial organ of the United Nations, is the authoritative forum for deciding inter-state disputes under

² ICC Court Bulletin, vol. 10 No.1, Spring 1999. ICC received 5 requests in 1921 and 9 in 1922, prompting it to create the Court in 1923.

public international law, many states still prefer arbitration, sometimes administered by institutions such as the Permanent Court of Arbitration at The Hague.

Perhaps, however, the most cherished advantage of arbitration is its portability. Not only can an arbitration take place in any location the parties choose; the resulting decision is a binding award that is, at least in theory, enforceable today in virtually every trading country around the world.³ An initiative of the ICC and the United Nations, the New York Convention, with 134 ratifications to date, is the most successful international treaty in history.

New Scope for Arbitration

From those “sniff and taste” commodities arbitrations at the turn of the twentieth century there has been substantial expansion in the types of disputes that may be resolved by arbitration. Well into the 1980s and 1990s, there were a number of “no-go” areas for arbitration, but these barriers are falling.

Bankers, for example, accustomed to the all-or-nothing approach to dispute resolution, perceived arbitration as an inappropriate process by which the decision-maker would “cut the baby in half” – relying on compromise rather than on strict legal rights. This reticence is diminishing, as bankers have come to realize that today’s arbitration awards are based on legal rights, just as a court decision would be. What’s more, the intricate multi-party financial montages of today’s international projects tend to blur traditional lines, requiring technical knowledge to unravel disputes. State judges rarely have that depth of financial experience, so instead of attempting to “educate the judge,” bankers often prefer to entrust these difficult disputes to an arbitrator who already understands the workings of the marketplace.

Intellectual property and competition issues, because they involve *erga omnes* rights, long remained within the sole competence of state courts. The first chink in the bastion of state authority in this area came when courts began to recognize arbitrators’ competence for deciding the effects, if not the validity of patents and copyrights. Today, the World Intellectual Property Organization (WIPO) in Geneva, offers dispute resolution and advisory services, and provides parties with suggested candidates for appointment as arbitrators. One particularly fertile area is domain name disputes, which WIPO, along with three other organizations worldwide, is mandated to arbitrate.⁴

³ In theory, enforceability is nearly universal, thanks to the 1958 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). In practice, some problem areas remain.

⁴ Others are: Hong Kong International Arbitration Centre and CIETAC in Asia, CPR in New York, and National Arbitration Forum in Minneapolis.

Competition law, or anti-trust disputes, have also until recently been the sole preserve of state courts. Like intellectual property disputes, the resulting decisions may have far-reaching repercussions, not only for the disputing parties, but also for their market and consumers. The protective interest of the state has been the rationale for reserving such disputes to national courts. This too has been evolving since the *Mitsubishi* case,⁵ with a number of arbitrators deciding cases involving the application of national or EU competition regulations. An ICC Arbitration Commission Working Party, led by Swiss jurist Marc Blessing, has studied this phenomenon around the world. It sees arbitration evolving into a tool to enforce behavioral commitments of companies, and to award damages to third parties injured by violations of competition regulations.

As new areas open up for arbitration, a number of specialized arbitration *ad hoc* institutions have appeared. The nine-member Iran-United States Claims Tribunal was set up in 1981 as a bilateral mechanism for dealing with claims between the governments and nationals of the two parties arising out of the events surrounding Iran's Islamic Revolution, and it is still in existence. The original Claims Resolution Tribunal for Dormant Accounts in Switzerland, which completed its work in 2001, had the task of arbitrating over 12,500 claims filed by non-Swiss nationals, many of whom were victims of the Nazi Holocaust of the Second World War. Many later international claims commissions have adopted more administrative claims processing procedures which are less time-consuming than arbitration. However, arbitration still plays a role, for example, at the Eritra-Ethiopia Claims Commission currently being administered by the Permanent Court of Arbitration.

The International Centre for Settlement of Investment Disputes (ICSID), which is the dispute resolution institution associated with the World Bank, administers the arbitration of disputes between governments and foreign investors. For its first twenty years, the ICSID arbitration jurisdiction was contractual: parties to an investment contract would insert an arbitration clause. Recently however, most cases are arising out of state parties' consents to arbitration, contained in investment promotion and protection agreements (IPAs). These agreements are either bilateral (BIT) or multi-lateral (MIT) investment treaties, in which contracting states agree in advance to submit to arbitration the claims of unhappy investors in their countries. NAFTA, MERCOSUR, ASEAN – all these multilateral trade agreements contain similar arbitration submissions.

⁵ *Mitsubishi Motor Corp v Soler Chrysler Plymouth*, 473 US 614, L.Ed 2d, 444 (1985). See M. S. Kurkela, *Competition Laws in International Arbitration: The May, The Must, The Should and the Should Not*, JFT6/2003, 609-21.

The catchword is “arbitration without privity,” since a whole class of investment disputes is covered by a blanket submission, constituting that state’s agreement to arbitrate. The unhappy investor “agrees” to arbitrate by its act of instituting an arbitration claim under the IPPA dispute resolution clause, despite the fact that there may be no arbitration clause in the investment contract itself; in fact the investment contract may provide for an entirely different mode of dispute resolution.

With over 2000 BITs and MITs in force around the world today, the number of ICSID cases has multiplied.⁶ These cases, rather than focusing on breaches of contract, are far more likely to concern the effects of civil war in the host state, or expropriation, discriminatory treatment and denials of justice. With the development of these treaties, private parties for the first time have had standing to assert their claims directly, without having to persuade their own country’s diplomats to take up their cause. The political implications are far-reaching. In some countries, there is a considerable groundswell of opposition to the idea of having privately-appointed arbitrators, in secret proceedings, make decisions which may cost host governments millions of dollars in compensation to disappointed foreign investors.

Another newcomer to the arbitration world is sport. With global publicity and enormous sponsorship and endorsement possibilities, sport has become a multi-billion dollar business. The difference between a Gold and a Silver Medal at the Olympics may mean millions of dollars to an athlete. The Court of Arbitration for Sport was founded in 1996 for the Atlanta Olympics, and it renders urgent decisions within twenty-four hours, often deciding whether an athlete will be allowed to compete.

Arbitrability and the Jurisdiction of the Arbitrator

Back in the 1920s, most national legal systems did not recognize a contractual clause which submitted, in advance, any disputes for resolution by arbitration. This extraordinary “opting out” of the state court system, with its corresponding renunciation of the state’s right to administer justice for its nationals, could only be exercised *after* a dispute had arisen. For this reason, the ICC included in its original arbitration rules a document called Terms of Reference. Terms of Reference served a dual function: they constituted the submission of a specific dispute to arbitration under the ICC rules, and they defined the issues to be resolved. Long after the legal necessity for Terms of Reference disappeared, ICC’s Terms of Reference remain an integral part of its procedure.

⁶ While not the only forum for IPPA arbitration, ICSID has seen the most dramatic increase in its cases with the advent of IPPAs.

Over the latter half of the twentieth century, most states have modified their attitude to commercial arbitration, many of them embracing it as a complement to ease their own overworked legal systems. The modern view is that where parties to a contract are able to agree in advance that any disputes arising under their agreement will be submitted to arbitration, the state courts will respect that agreement, stepping back in favor of allowing the arbitration process. This stance has been enshrined in the New York Convention.⁷

Well into the twentieth century, many state courts jealously guarded their right to decide disputes between their citizens. Arbitration was the exception to the rule, and it was viewed with no little suspicion by national judges. A reluctant respondent wishing to delay or derail the proceedings would attack the jurisdiction of the arbitral tribunal. This entailed an application to the court where the arbitration was to proceed, which it could not do until a judge had decided on the merits of the application. Thus, even a completely frivolous assault could delay the arbitration for months or even years as the preliminary issue languished on a state court's trial list. To deal with this perversion of justice, many countries, over the latter decades of the twentieth century, incorporated into their legislation or case law a doctrine now known as *kompetenz-kompetenz*, which gives the arbitral tribunal the autonomy to decide on whether it has jurisdiction to proceed.

Another ploy of the recalcitrant respondent was to attack the validity of the contract containing the arbitration clause. The reasoning was that if the contract itself was void, then the submission to arbitration contained in it must also be void. Again, this tactic involved an application to a court and thus could delay the arbitration for months or years. Many states, either in their judicial decisions or by reforms to their arbitration statutes, now have express provisions for the *separability* of the arbitration clause; even where the underlying contract is void, the submission to arbitration within it may stand alone, so that the arbitral tribunal retains the power to decide the effects of that invalidity.

Role of International Organizations in Developing Arbitration

Originally, arbitration was an *ad hoc* affair. Parties would select a neutral who they agreed was suitably qualified to resolve their dispute, and among themselves they would all work out the rules they would follow. A major step forward came with the UNCITRAL Rules for International Arbitration (1976)⁸ which, for the first time, provided practitioners and parties to *ad hoc* arbitrations with a universally

⁷ New York Convention, Art. II(3).

⁸ See www.uncitral.org.

acceptable set of rules for administering their cases. Throughout the twentieth century, Chambers of Commerce and regional organizations realized the value of arbitration, publishing their own sets of rules for arbitration and providing varying levels of administrative assistance and practical advice to the parties and the arbitrators. Rare is the country today that does not have an arbitration centre dedicated to the study, promotion and sometimes administration of private justice. Although confidentiality prevents any meaningful count, it is probably safe to say that the trend is toward institutional procedures.⁹

Technology

No history of anything would be complete without reference to the impact of technology. Today's modern international arbitrators use e-mail to supplement or replace mail and fax. Many use CDs or mobile data storage units to organize and transport huge files of information in their pockets. Video-conferencing may eliminate the need for travel by some witnesses. The ease with which "soft copies" can be shared and amended is a boon to tribunal members as they deliberate.

Current Trends

Until the 1990s, arbitrators usually got work because they were part of an elite, highly respected group of practitioners known for their expertise. Arbitrators learned by doing; by assisting acknowledged masters with advocacy or as tribunal secretaries. In the past fifteen years, however, with the proliferation of trade, disputes and arbitration cases, the circle is widening. Many specialists will still arbitrate only a single case; they are chosen for their expertise rather than their desire to arbitrate on a continuing basis. Others have chosen to make a career of arbitration, working full time on a variety of cases, and to prepare themselves by formal study of arbitration practice. There are now dozens of undergraduate and graduate courses and diplomas offered at universities and law schools around the world, producing a new profession of arbitrators. Access to these courses also gives more non-specialists at least a passing knowledge of the advantages and characteristics of the process, and will doubtless in the long run lead to more arbitration clauses in contracts.

New players in the arbitration field also include the parties themselves. Those who used to be respondents in ICC arbitrations are now coming back as claimants. These new players are from African and Arab countries, Eastern Europe and Latin America and, to some extent, Asia. Women, chronically absent from the field, are

⁹ Some countries, such as the People's Republic of China, do not recognize *ad hoc* arbitration. China's arbitration law recognizes only institutional arbitrations.

now appearing in gradually increasing numbers, as both advocates and arbitrators.¹⁰ The day is yet to come when parties will choose a three-woman tribunal, but progress is real.

Growth in trans-border trade is increasing in both quantity and complexity. The disputes arising from international commercial activities are evolving in tandem with the underlying contracts, so that it is not unusual to hear of multi-billion dollar disputes involving ten, twenty or even sixty parties. Last year, about one-third of the new requests handled by the ICC Court involved more than two parties. Case management is today a major issue for arbitrators and counsel.

Countless scholarly tomes have contrasted the various legal systems of the world. International arbitration provides an opportunity for harmonization. The flexibility of the international arbitration process often leads to a "marrying" of at least two different legal cultures, sometimes producing a hybrid which brings the best of both worlds. Civil lawyers may live in terror of having to cross-examine a witness, but they sometimes find the discovery process very useful in gathering their proof. Common law lawyers, accustomed to the traditional "battle of experts," may be pleasantly surprised if an arbitrator suggests a single, tribunal-appointed expert, or the joint examination of the experts from both sides, or at least a common brief to the experts appointed by all parties.

Has Arbitration Reached its Limits?

Certainly, arbitration has come a long way since its modern origins in the Middle Ages, transformed from a lay person's forum into a sophisticated procedure employing countless advocates, arbitrators and experts. In fact, therein originates a major criticism of arbitration today. Clients especially see arbitration as mimicking litigation and re-creating some of the very faults it was meant to displace. Clients who chose arbitration for efficiency are often finding themselves embroiled in lengthy discovery proceedings, interminable interim motions, and an avalanche of documentation. Far from being the "faster, cheaper, more flexible" process vaunted thirty years ago, arbitration risks becoming just as turgid, expensive and rigid as state litigation. The alarm has been sounded, and many arbitration professionals and institutions are responding with ideas for streamlined case management, arbitrator guidelines, simplified or expedited rules for smaller cases, as well as the

¹⁰ See Barrington, "Arbitral Women: A Study of Women in International Commercial Arbitration", in *A Better Way to Justice* (Kluwer 1997); and Goldhaber, "Madame Law Presidente", in *American Lawyer/Focus Europe*, Summer 2004.

use of alternate dispute resolution procedures such as mediation, mini-trial, or adjudication to complement arbitration.

Parties who choose arbitration for its confidentiality hope to avoid “airing dirty laundry in public.” When secret formulae, delicate mergers, or superstar personalities are in play, discretion may prove critical to a successful resolution. Recent decisions in Sweden, the United States and Australia, however, have raised doubts about confidentiality, causing arbitration professionals to question the foundations for secrecy, which is now in some jurisdictions not such a watertight assumption as had been assumed.¹¹

With the proliferation of international construction consortia, joint ventures, syndicates, and other multi-partite agreements, very often a dispute between two of the actors will affect another dispute between the same or additional parties. As a consensual mechanism, arbitration depends on the accord of the parties and is thus often ill-suited for multi-party disputes. The ICC, responding to the infamous *Dutco*¹² decision, has provided a special rule for cases where multiple parties cannot agree on an arbitrator. Some national legislatures have also responded to this shortcoming by providing for court-ordered consolidation of arbitration cases.¹³ Still, in most jurisdictions, multiple parties can present perplexing problems.

Perhaps the most serious difficulty encountered today by practitioners of international arbitration is still enforcement. While the New York Convention has done wonders to achieve “portability” of arbitration awards,¹⁴ there are still many jurisdictions where enforcement remains a pious hope. In some countries that proudly proclaim themselves as signatories to the New York Convention, a successful party must still depend on the voluntary execution of an award by the losing party. Obligated to apply to the courts, the winning party will frequently encounter a series of obstacles, both visible and invisible. Judges in some jurisdictions (whether protectionist or corrupt) are loath to enforce an award for a vast sum, made by a tribunal in some faraway land, at the expense of their fellow citizens. In

¹¹ See L. Kuppanchetti, “Confidentiality in Arbitration Proceedings”, in *Alban Tay Mahtani & de Silva Newsletter*, available at www.atmdlaw.com.sg.

¹² The French Cour de Cassation, in 1992 annulled an ICC award in the case of *Siemens et al v. Dutco*.

¹³ For example, the Hong Kong Arbitration Ordinance, Cap 341, section 6B.

¹⁴ An international arbitration award is still far more “portable” than the judgment of a foreign court. To enforce a judgment, the applying party has to institute in the enforcing state new proceedings, based on the foreign judgment, effectively giving the losing party a second chance at defending its case.

Mainland China for example, successful enforcement depends on the amount of the award and the province where enforcement is sought.¹⁵

Conclusion

From Moses to MITs, arbitration has expanded and evolved substantially. Today, after a gestation period of nearly a century, we are witnessing the birth and infancy of a modern *arbitration profession*. Arbitration is barely developed in many jurisdictions, and with more players entering the field and new subjects considered arbitrable, there is an ever-increasing supply of cases, as well as of people, technology and techniques for handling them.

Some developments are dramatic. The sudden expansion of private justice through BITs and MITs into the realm of investor-state disputes has fueled the polemic about the power of multinational investors to hold “sovereign” states to ransom, a debate raging globally in both local daily newspapers and rarified professional exchanges. Other changes, such as procedural harmonization and the “professionalization” of arbitration, are more subtle.

The increasing complexity and timelines involved have certainly prompted disputants to demand that arbitral institutions and practitioners seek ways to minimize expense and maximize efficiency in arbitration proceedings. Parties are also exploring other ways to end their conflicts. ADR is already widely accepted in the U.S., Canada, U.K. and Australia, and it does siphon off a substantial number of cases that might otherwise be arbitrated. But the supply is as infinite as man’s capacity for conflict.

The evolution of the profession of arbitration is a dynamic and rich history. At each step of development, new challenges emerge. Provided the arbitration community continues to face and address those challenges, arbitration – everyone’s second choice – will remain a viable and trusted dispute resolution mechanism for the next century at least.

¹⁵ See R. Peerenboom, *Seek Truth from Facts: An Empirical Study of Arbitration Awards in the PRC*, 49 Am. J. Comp. L. 249.