



## **Columbia FDI Perspectives**

Perspectives on topical foreign direct investment issues by  
the Vale Columbia Center on Sustainable International Investment

No. 33, December 14, 2010

Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)

Editor: Ken Davies (Kenneth.Davies@law.columbia.edu)

Managing Editor: Amanda Barnett (barnett.amanda@law.columbia.edu)

### **The pernicious institution of the party-appointed arbitrator**

by

Hans Smit\*

As arbitration has grown by leaps and bounds, so has the role of the party-appointed arbitrator. Surprisingly, this has not led to increased inquiry into the appropriateness of having arbitrators appointed by the parties in general, or in arbitrations against states in particular. In my judgment, party-appointed arbitrators should be banned unless their role as advocates for the party that appointed them is fully disclosed and accepted. Until this is done, arbitration can never meet its aspiration of providing dispassionate adjudication by those with special skills and experience in a process designed to combine efficiency with expertise.

The incentive of the party and its counsel is to appoint an arbitrator who will win the case for them. That incentive will be particularly strong when its case, on its merits, is not particularly strong. It may well be argued that it is a lawyer's duty to appoint someone who is most likely to obtain the best result for the client, regardless of whether, objectively, the law and the facts favor its case. Once selected, an arbitrator's personal incentive is to secure reemployment by providing his or her party with a favorable outcome.

This is not necessarily bad. In US domestic arbitration, a party-appointed arbitrator is exactly that: an advocate on the panel. If that is clear, fully disclosed and accepted, it adds another option to the arbitral process. But in international arbitration, the party-appointed arbitrator is expected to be objective and impartial. I believe the reality is that many, if not most, of those party-appointed arbitrators respond to their personal incentives and become to a certain extent party advocates within a system that expects them to behave objectively. The subject of repeat arbitrators, irrespective of who appoints them, poses additional difficulties to the international arbitrations system that cannot be discussed in this short article.<sup>1</sup>

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\* Hans Smit (hsmit@law.columbia.edu) is the Stanley H. Fuld Professor Emeritus of Law at Columbia Law School. The author wishes to thank Ed Kehoe, Jan Paulsson and an anonymous reviewer for their helpful comments on this *Perspective*. **The views expressed by the individual authors of this *Perspective* do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

<sup>1</sup> For further discussion of repeat arbitrators see Fatima-Zahra Slaoui, "The rising issue of 'repeat arbitrators': a call for clarification," *Arbitration International*, vol. 25, number 1 (2009), pp. 103-119.

I believe true objectivity is possible only if all arbitrators are prepared to rule against the party that appointed them exactly as if they had been sitting as sole arbitrators. In my experience, that condition is not met in most cases. I have personally encountered this pressure. While I made clear to the lawyer who selected me that I would decide the case on its merits, I could not help feeling influenced by the knowledge that the lawyer who appointed me had done so because he had judged that that would best serve his client's interests. While Alexis Mourre argued that party-appointed arbitrators are selected for their reputation of impartiality,<sup>2</sup> I disagree. I believe that lawyers feel that their duty to advocate for their clients' interests takes precedence over institutional concerns.

Even if arbitrators are willing to rule against the party that appointed them, there are still ways in which they can influence the final outcome of a case to favor their party. For example, they may try to persuade the other panel members to reduce the award in favor of their party in return for joining them in a unanimous award. This compromise will ordinarily be attractive to the chair of the panel, for his or her reputation for obtaining unanimous awards may increase the likelihood of being appointed to future panels. Even if the award is not affected, the party-appointed arbitrator may bargain for not awarding counsel fees. The panel has a great deal of leeway in that regard, and party-appointed arbitrators may save the parties that appointed them a great deal of money by eliminating counsel fees or reducing the size of the awards.

It might be argued that these are relatively minor disadvantages, that there is virtually always reason for compromise and that this is an acceptable price to be paid. But it is not only untoward compromises that the institution of party-appointed arbitrators promotes. The presence of a partisan arbitrator on a panel will normally reduce, if not eliminate, the free exchange of ideas among the members of the panel. The chair will be less receptive to arguments that appear to be moved by partisan considerations or may join one of the arbitrators, with the result that the other party-appointed arbitrators feel excluded from the deliberations. The *Lauder* arbitration against the Czech Republic provides an excellent example of these dynamics. In that case, a party-appointed arbitrator stated that he had been excluded from the panel discussion. I believe it was the response of a party-appointed arbitrator to these structural incentives that caused one of the great failures of international arbitration, the *Multinovic* arbitration.

This conflation of personal and professional incentives is particularly inappropriate in international investment disputes, in which arbitral decisions can affect the state and its people. Decisions binding them should not be rendered by privately selected arbitrators, but by arbitrators selected by truly neutral institutions. The drafters of the ICSID Convention realized this by reserving for the ICSID Secretariat the power to appoint the members of the panels that review first-instance decisions. In my judgment, all arbitrators sitting in investment disputes should be appointed by a neutral institution; bilateral investment treaties should be amended to achieve this. International investment arbitration would thus set a potent example for general emulation in international arbitrations.

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<sup>2</sup> Alexis Mourre, "Are unilateral appointments defensible? On Jan Paulsson's moral hazard in international arbitration", *Kluwer Arbitration Blog*, Oct. 14, 2010, <http://kluwerarbitrationblog.com/blog/2010/10/05/are-unilateral-appointments-defensible-on-jan-paulsson%E2%80%99s-moral-hazard-in-international-arbitration/>

For further information please contact: Vale Columbia Center on Sustainable International Investment, Ken Davies, [Kenneth.Davies@law.columbia.edu](mailto:Kenneth.Davies@law.columbia.edu).

The Vale Columbia Center on Sustainable International Investment (VCC), led by Dr. Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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