



Columbia FDI Perspectives

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

No. 35, April 15, 2011

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

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

Managing Editor: Alma Zadic (az2242@columbia.edu)

Is the party-appointed arbitrator a “pernicious institution”?

A reply to Professor Hans Smit

by

Giorgio Sacerdoti*

Some readers of the *Columbia FDI Perspective* No 33 of December 14, 2010 may have been surprised to read Hans Smit’s contribution against party-appointed arbitrators. The opening of his *Perspective* could not be expressed in more sweeping terms: “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...”

Criticisms of the appointment of arbitrators by parties are not novel, but it is surprising to see them raised by such a highly regarded and senior member of the international arbitral community as Professor Smit. I consider his views too negative: appropriate safeguards exist to take care of his concerns. He considers that, while in international commercial arbitration party-appointed arbitrators are expected to be objective and impartial (and not become advocates of the parties appointing them, as he claims is the reality in the U.S.), party-appointed arbitrators “respond to their personal incentives and become to a certain extent party advocates.” I do not believe that the responsible, reputable lawyers available for such appointments are amenable to these temptations, especially considering the control that arbitral institutions exercise.

The first argument for retaining the current system is based on the very nature of arbitration that distinguishes this process from adjudication by permanent courts endowed with *ex-ante* jurisdiction on litigants.

* Giorgio Sacerdoti (giorgio.sacerdoti@unibocconi.it) is Professor of International Law, Bocconi University, Milano, Italy. The author wishes to thank Emmanuel Gaillard, Loretta Malintoppi and Catherine Rogers for their helpful comments on this *Perspective*. **The views expressed by the author 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.**

By contrast, arbitration remits to the parties the choice of adjudicators. Internationally, this approach is even more attractive. Arbitration allows the parties to agree on such basic issues as applicable laws and jurisdiction, language and seat of the arbitration, avoiding hurdles that hamper the judicial solution of a transnational dispute and its enforcement. The ability to select arbitrators is prominent among the elements favoring arbitration as it reflects the expectations of the appointing party regarding nationality, language, cultural background, and legal and technical expertise. Acceptance of the ultimate result (the award) by the parties is enhanced by their trust in the arbitral process where consent – including consent regarding the adjudicator – replaces judicial authority. Various precautionary devices have been introduced, mostly through practice, to ensure that these advantages are not undermined by the parties' abuse of power.

The first such device is the general recognition that arbitrators are not agents of the parties appointing them but rather trustees who have to decide the dispute fairly, according to applicable substantive and procedural rules reflecting the common intention of the parties to resort to arbitration.

Secondly, the rules of arbitral institutions often provide for a monitoring of the selection of arbitrators by the parties. Local courts, or foreign courts under the New York Convention of 1958 where recognition is sought, are empowered to control whether basic rules of due process have been respected.

Thirdly, arbitration rules require that arbitrators be impartial and independent in general, including as regards party-appointed arbitrators toward the parties appointing them. Arbitration rules also require that arbitrators disclose situations giving rise to potential conflicts of interest. The IBA Guidelines on Conflict of Interest in International Arbitration of 2004 are intended to enhance standards as part of the development of uniform best practices. Their first General Principle states that “[e]very international arbitrator shall be impartial and independent of the parties at the time of accepting an appointment and shall remain so until the final award has been rendered.”

Prof. Smit fears nonetheless that the lack of impartiality of a party-appointed arbitrator may unduly influence outcomes. Thus, in order to reach a unanimous award, a tribunal might incline toward the argument put forward by one of the parties without proper justification. Empirical evidence from the rejection of most disqualification requests confirms that the great majority of arbitrators are serious professionals who take care and pride in being independent and impartial. If a party-appointed arbitrator is biased he or she will end up in the minority. On the other hand, there is nothing wrong if such an arbitrator shares in good faith the position of the party who has made the appointment.

Finally, one has to consider the alternatives to the appointment of arbitrators by the parties. Who would systematically make all appointments? In *ad hoc* arbitration, the issue would have no easy solution. In administered arbitration, the task entrusted to the institution in charge of the process would be challenging. Lists would have to be kept, transparency requirements for the choices would become paramount and other types of influences and pressures might derail the fairness of the process. More decisively, international commercial arbitration would lose one

of its fundamental features, becoming a kind of international quasi-judicial mechanism. Such a system could not be compelled on parties that could migrate to institutions more deferent to their choices.

As to investment arbitration, Prof. Smit's argument that arbitral decisions that can affect the State and its people "should not be rendered by privately selected arbitrators but by arbitrators selected by truly neutral institutions" carries more weight. In selecting an arbitrator in such disputes, parties may wish to look more closely at the general profiles of candidates and at their positions on relevant issues. To avoid a "conflation of personal and professional incentives" in investment arbitration that institutions can detect, it has been suggested that advocates be barred from acting as arbitrators.

So, on balance, let's not throw the baby out with the bath water!

The material in this Perspective may be reprinted if accompanied by the following acknowledgment: "Giorgio Sacerdoti, 'Is the party-appointed arbitrator a "pernicious institution"?' A reply to Professor. Hans Smit' Columbia FDI Perspectives, No. 35, April 15, 2011. Reprinted with permission from the Vale Columbia Center on Sustainable International Investment (www.vcc.columbia.edu)."

A copy should kindly be sent to the Vale Columbia Center at vcc@law.columbia.edu.

For further information please contact: Vale Columbia Center on Sustainable International Investment, Ken Davies, kendavies@yahoo.com.

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.

Most recent Columbia FDI Perspectives

- No. 34, Harry G. Broadman, "The backstory of China and India's growing investment and trade with Africa: Separating the wheat from the chaff," February 17, 2011.
- No. 33, Hans Smit, "The pernicious institution of the party-appointed arbitrator," December 14, 2010.
- No. 32, Michael D. Nolan and Frédéric G. Sourgens, "State-controlled entities as claimants in international investment arbitration: an early assessment," December 2, 2010.
- No. 31, Jason Yackee, "How much do U.S. corporations know (and care) about bilateral investment treaties? Some hints from new survey evidence," November 23, 2010.
- No. 30, Karl P. Sauvant and Ken Davies, "What will an appreciation of China's currency do to inward and outward FDI?" October 18, 2010.
- No. 29, Alexandre de Gramont, "Mining for facts: PacRim Cayman LLC v. El Salvador," September 8, 2010.

All previous FDI Perspectives are available at <http://www.vcc.columbia.edu/content/fdi-perspectives>