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## **ARBITRATION, DEMOCRACY AND THE RULE OF LAW: A CONSTITUTIONAL LANDSCAPE**

### INTRODUCTION

In this paper, I intend to address some questions regarding the role of arbitration within a democratic system that is based on the rule of law. My aim is to discuss arbitration from a very general perspective. The specific topics I have selected are important, I think, to help us appreciate and discuss some of the key features of the institution. My claims are extremely tentative –they are just the starting point for a future project. Actually, I have more questions than answers to offer.

#### I. THE GENERAL CASE FOR ARBITRATION

Arbitration is an important institution in our legal world. Individuals often choose to resolve their disputes through arbitrators, instead of using regular courts. Sometimes arbitration is *ad hoc*: the parties themselves design the decision-making procedure. More often, however, arbitration is *institutional*: the parties refer to the rules established by a given arbitration house. In any event, there is an explosion of arbitration, both domestically and internationally. It is no surprise that scholars coming from the field of constitutional law are increasingly interested in this legal phenomenon.

Arbitration, of course, is an old institution. We find it in ancient times. Forms of arbitration probably existed before courts were set up. After all, it takes a relatively developed state to create courts. What is remarkable is how widespread arbitration has become, after a long historical period where the law in many countries treated it with a certain degree of hostility. For a long time, indeed, arbitration agreements were not specifically enforceable. In many jurisdictions, courts were not empowered to stay judicial proceedings and refer the case to arbitration, when one of the parties invoked an arbitration agreement. The kinds of controversies to which arbitration could apply, moreover, were extremely limited. At present, in contrast, the laws in most

advanced nations promote arbitration. They facilitate the judicial enforcement of arbitration agreements and arbitral awards, and they espouse an expansive conception of the matters that are susceptible to arbitral decision-making.

There is a strong liberal case in favor of allowing individuals to use arbitration. The supportive theory can be based on the following considerations.

First, in a liberal polity private individuals should be free to choose the best way to resolve the disputes they find themselves in. Their fundamental right to pursue their interests as they see fit includes their right to elect the method to settle controversies that affect their interests. Private individuals cannot, of course, decide how controversies are to be resolved that affect third parties, or that have an impact on the public good. But as far as their own interests are concerned, they should be free to agree on a particular way to bring a dispute to an end. Actually, if private individuals are permitted to negotiate a settlement, without the help of a third party, it would seem incoherent not to let them choose an arbitrator to decide their dispute. It is not surprising, therefore, that some liberal Constitutions have explicitly recognized a fundamental “right to arbitration” (see chapter 5, article 5, of the French Constitution of 1791, and articles 280-281 of the Spanish Constitution of 1812. Some Constitutions in Latin America also grant explicit protection to the right to arbitration).

Second, there are good reasons why individuals may prefer arbitration over the judicial process in various contexts. Among those reasons, three are especially important: a) arbitrators can be experts in a particular field, whereas judges have a more generalist legal training; b) the arbitral process is more flexible than the judicial process; this may, perhaps, make the dispute more tractable; c) the arbitral process will normally settle the dispute more quickly, since there is no possibility to appeal against the arbitral award –there are some grounds under which a court can annul the award, but they tend to be extremely limited.

These reasons, of course, may apply in some cases, while not in others. Thus, it may be advisable to have specialized experts, but sometimes a generalist judge is better equipped to come up with reasonable outcomes. Experts in a narrow technical field may be prey to “cognitive loafing”: they may be unwilling to think critically about their practices, in light of more general principles. Administrative agencies, for example, have been said to suffer from this bias. The same might be true of some experts that are hired as arbitrators. Similarly, procedural flexibility and the absence of a system of appeals may be fine, but in very complex and important cases parties may feel more comfortable with the formality and the additional checks that the judicial process incorporates.

In any event, the important point is that private individuals should have the right to resort to arbitration, not only out of respect for their general liberty to pursue their interests as they deem appropriate, but also because in many instances there are indeed good grounds for them to prefer arbitration over litigation.

Third, when private parties elect to resolve their disputes through arbitration, they do not undermine the capacity of regular courts to produce the relevant case law that will clarify the meaning of the applicable law. Courts will still have to handle a sufficiently large number of cases that will serve as the basis for the gradual construction of the pertinent jurisprudence.

There is an important contrast here that needs to be noted. Generally speaking, arbitrators confine themselves to the resolution of the specific controversy that has been brought to them. They do not try to lay down a jurisprudential rule that will serve future decision-makers. Courts, in contrast, have a dual function to perform. They are to decide the concrete controversy, as arbitrators do, but, in addition to that, they are expected to generate a case law that will help clarify the meaning of the applicable legal rules. This dual function is particularly salient when it comes to supreme courts.

Several factors account for this key distinction between arbitrators and courts. To begin with, most awards are not published, while judicial opinions are. Arbitrators, moreover, don't have strong incentives to lay down rules for future cases. They have been paid by the parties to decide the specific case, not to think deeply about the rule that should apply to other individuals in the future. Actually, arbitrators may fear that a very clear holding will make them less likely to be hired as arbitrators in future disputes, if that holding disfavors a class of people that may be potential clients. Even if the rules they formulated were "balanced" ones, their effect would be to reduce future litigation. But arbitrators are not particularly interested in that, of course: they want more, not less, arbitration business.

So we cannot expect arbitrators to produce much in terms of precedents, which are technically a "public good". (A precedent creates positive externalities for people who have contributed nothing to the process through which the precedent has been generated). The political community, however, should not be anxious about the under-production of jurisprudential rules by arbitrators. Regular courts are still there, intensely occupied with many cases that pose all sorts of legal issues. Courts have enough material to produce precedents from.

It bears emphasizing that this division of labor between arbitrators and judges is basically the same, whether the disputes to be resolved are purely domestic, or whether they are connected to an international transaction. Indeed, international commercial arbitration is "international" only in the sense that the underlying transaction (or the enforcement of the agreement to arbitrate, or of

the arbitral award) is connected to two or more countries. But this type of arbitration is still anchored in a particular domestic legal system. This is so both from a procedural and a substantive perspective.

From a procedural point of view, international commercial arbitration is located within the legal system of a particular country. It does not freely float in an international sphere. The arbitral process is always “seated” somewhere: it develops under the law enacted by the country that has been chosen as the seat.

From a substantive point of view, moreover, parties to a contract usually select the law of a particular country to govern the contract. This is largely done to protect legal certainty. It is generally too risky to subject the contract to vague principles of international *lex mercatoria*. The more developed and mature body of law that states have produced offers better protection to the parties. As a result, arbitrators that deal with international transactions are normally asked to apply the set of laws enacted by a given political community –they are not to invent or create the law that applies to the case. That set of laws, in turn, has been interpreted by the relevant state courts, which have laid down precedential rules. So the division of labor between arbitrators and courts is basically the same: arbitrators in the international commercial arena have the rather limited role of applying the relevant body of national law to the specific controversies. They can do so with flexibility, of course, given the international nature of the transaction. But this is not categorically different from what happens in domestic cases: arbitrators can also act with some measure of flexibility there.

## II. A MORE SPECIFIC CASE: INTERNATIONAL COMMERCIAL ARBITRATION

In addition to the general argument in favor of letting private parties resort to arbitration, there is a more specific argument that applies to international commercial arbitration. The argument, as we will see, has force. But it rests on certain features of the existing legal framework that we may be critical of. If that framework were reformed, the special argument would no longer apply, and we would then be left with the general argument.

The specific case points to the fact that, in the field of international commercial transactions, arbitration has two important advantages over litigation. The two advantages are interrelated.

## **Neutrality of the Forum**

First, arbitration offers parties that are nationals (or residents) of different countries a neutral forum to resolve their disputes. Suppose a French company enters into a contract with an English company. When the parties think about controversies that may arise in the future in connection with the contract, they fear that national judges will be biased. The French company is reluctant to have English courts decide the case, while the English company has similar doubts about French courts. If, instead, the parties to the contract choose arbitration, they can select persons who are neutral, in the sense that they are not institutionally attached to the state one of the parties is a national of. The arbitral process, as was already noted, will certainly develop within the legal framework of a particular country –the country that the parties have chosen as the seat. But the decision-makers will be appointed by the parties, and they can be as distant from one party as from the other. Typically, if a single arbitrator is hired, both parties have to agree. Each can thus exercise a veto power over candidates that are too close to the other party. If a tripartite arbitral body is instead set up, each party usually appoints an arbitrator unilaterally, and the presiding arbitrator is then selected by common agreement of the parties (or by the arbitrators). The presiding arbitrator is then the key figure to guarantee neutrality.

Now, neutrality could also be achieved in a different way: instead of taking the arbitration route, the parties might select the courts of a “neutral” country. In our example, the French and the English companies could attach a choice-of-forum clause in their contract to the effect that any controversy that arises in the future will be decided by Swiss courts, let’s say. This strategy may work. The risk exists, however, that the courts of the country that has been chosen as the neutral forum will say that they lack jurisdiction, if they believe that there is not a sufficient link between the case and that country. This risk is absent in the case of arbitration: arbitrators cannot say they have no jurisdiction for lack of link, since they are not the organs of any state. More importantly, the existing international regime treats arbitration agreements better than choice-of-forum clauses. But this brings us to the second reason.

## **The enforcement of arbitration agreements and arbitral awards: the New York Convention of 1958**

The second reason is that arbitration enjoys great protection under the New York Convention of 1958 on the Recognition and Enforcement of Foreign

Arbitral Awards. This international instrument, which has been ratified by most countries in the world, requires courts to honor the arbitration agreements signed by the parties to a controversy. There is a similar instrument that requires courts to honor choice-of-forum agreements: the Hague Convention of 2005 on Choice of Court Agreements. But it has not entered into force (almost no country has ratified it). Individuals that enter international transactions are thus not really “free” to choose between arbitration and litigation. If they seek a neutral forum, the existing regime pushes them to prefer arbitration over litigation: while an arbitration agreement will be enforced with the extraordinary help of the New York Convention, the agreement to select the courts of a specific country is more fragile.

A similar asymmetry in treatment emerges when the decision reached by the decision-maker needs to be enforced in a foreign country. The New York Convention facilitates the enforcement of arbitral awards. When it comes to court judgments, the Hague Convention of 1971 on the Recognition and Enforcement of Judicial Judgments in Civil and Commercial Matters plays a similar role. But this treaty, which entered into force in 1979, has attracted only a few ratifications.

So, yes, arbitration has some specific advantages in the international commercial sphere, but they are a result of a legal regime that does not put litigation and arbitration on an equal footing.

It is interesting to note that the neutrality argument could be the basis for a more ambitious critique of the current structures. If, indeed, national courts are likely to be biased in favor of locals, this suggests that the level of civilization we have reached in legal matters is not very high. To make some progress, we should think about the possibility of creating “international courts” to decide private law matters. Much in the same way that, in the United States, federal courts have jurisdiction to decide controversies between citizens of different states, a new set of international courts may be needed to decide controversies that confront individuals of different nationalities.

It is important to emphasize that, if local courts are to be distrusted, then arbitration is only a fragmentary solution to the neutrality problem. For, in practice, arbitration only covers contractual disputes. Arbitration does not extend to many other controversies (torts, crimes...) involving citizens of diverse nationalities. If, for example, a local pedestrian suffers injuries caused by a foreign driver, the action for damages will be decided by local courts. Should we be worried about bias?

It is worthy of note that, until the XIXth century, “mixed juries” (made up of natives and aliens) were used in Great Britain to try cases involving a national and a foreigner. The institution of the mixed jury was finally abolished in 1870, on the theory, among others, that there was no reason to distrust the

capacity of British citizens and judges to decide cases impartially when one of the litigants came from another country. But if the local judiciary deserves no criticism as far as neutrality goes, why should the picture change when international commercial transactions are at issue?

It would be fruitful to place the neutrality argument in a broader context. We should compare different institutional strategies to react to the problem of bias in various fields. Within the framework of the European Union, for example, the prejudice against foreigners is in part counter-acted by European Union law, which protects the principle of no discrimination on grounds of nationality (as part of the market freedoms, and as part of European citizenship). The principle of no discrimination is enforced by local courts, but there is a more “neutral” tribunal, the ECJ in Luxembourg, that has some capacity to guide such courts into an objective legal outcome. This is only an imperfect solution to the danger that local judges will rest on a “we/they distinction” when they apply the law. Would a stronger European integration help reduce the force of the neutrality argument in favor of arbitration, when the parties affected are nationals of EU member states? This is an interesting question to pursue.

### III. THE RELIABILITY OF ARBITRATION AS A PROCEDURE FOR THE CORRECT APPLICATION OF THE LAW

A problem I want to address, next, concerns the extent to which arbitration is a reliable procedure as far as the correct interpretation and application of the law is concerned. The fact that we do not expect arbitrators to play any significant role in the production of precedents does not necessarily mean that we should not be worried about the accuracy with which they apply the relevant law to the disputes they have to handle. Sure, the harm they can cause, if they apply the law in the wrong way, is confined to the parties to the dispute: arbitrators do not extend the ensuing harm to future litigants, given their lack of authority to generate precedents. But even if the negative effects of arbitral mistakes are limited to the parties to the controversy, there may still be room for concern -in the name of the rule of law. It is not obvious, however, that the state should care about arbitral mistakes.

#### **A Tension in the Law**

At the heart of modern arbitration laws we find this basic principle: parties are allowed to arbitrate their disputes, to the extent they are free to dispose of

the rights and interests that are at stake. Given this principle, why should it matter whether arbitration is a reliable process to reach the right legal outcome? If parties are allowed to settle a dispute through negotiation, and the deal they strike is to be respected, no matter how distant it is from the decision a court would have made on the basis of the law, it would seem that they are also entitled to ask an arbitrator to resolve their dispute, and the arbitral award should be allowed to stand, no matter how much it deviates from the decision a court would have handed down.

Actually, in most legal systems the parties can choose two types of arbitration: they can ask the arbitrators to decide the case under the law, but they can also ask arbitrators to decide the case *ex aequo et bono*. If the latter form of arbitration is employed, then the decision is based on general principles of justice and fairness, which may be different from the particular rules that the state has adopted through legislation.

Yet, most countries in the world impose constraints on the arbitral process, and the parties are not allowed to contract around them. To a large extent, such constraints are established in order to guarantee the integrity of the arbitral process and its reliability as a method to apply the law to disputes. We can classify these constraints as “internal” and “external”.

The internal constraints include, for example, the requirement that arbitrators be impartial. Arbitration may differ from adjudication in various respects, but it must be similar to it in this crucial feature. If the arbitrator (for personal, financial, professional or other reasons) is biased in favor of one of the parties, he is to be removed. If he is not, the award may be invalidated by courts. Of course, if the party that is harmed by the arbitrator elects not to challenge the award, the state will not intervene. But the law makes the neutrality of arbitrators a principle that, *ex ante*, parties cannot contract out of.

It should be noted, parenthetically, that there has been some debate as to whether the current arbitral practices are consistent with the ideal of impartiality. Typically, when a tripartite arbitral body is selected, each party chooses one arbitrator unilaterally, while the third arbitrator (the presiding arbitrator) is jointly appointed by the parties, or by the two co-arbitrators. Although the three arbitrators are normally under the legal duty to be impartial, some critics contend that the arbitrators that are unilaterally selected are actually biased in favor of the respective parties. Only the presiding arbitrator can promise some degree of genuine neutrality. In order to justify the current practices, a distinction is sometimes drawn between partiality and sympathy: the co-arbitrators, it is argued, must not be “partial” to the appointing party, but they are authorized to be “sympathetic” to the interests of that party. Whether this subtle distinction is tenable is an open question. Some critics have suggested that the arbitral practices should be reformed: no arbitrator should be

appointed unilaterally; all of them should be agreed upon by the parties. An alternative strategy to ensure impartiality would be to design a system under which the arbitrators would not know which party appointed them.

In any event, whether or not arbitration falls short of the impartiality principle, the point is that the law does impose that principle on the normative level. Freedom of contract does not protect an arbitration agreement that violates it.

Other examples of internal constraints that the law establishes relate to the procedural guarantees: Arbitrators must conduct the proceedings in a fair manner. They must hear the arguments made by the parties, and they must admit and assess the relevant evidence. The arbitration proceedings may be much more flexible than judicial proceedings, but they must honor basic principles of fairness. In addition, arbitrators are usually required to give reasons to justify their decisions. They have to make explicit the legal and factual arguments that support the outcome they have come up with. In part, these and other requirements are in the service of legal accuracy: arbitrators are more likely to apply the law correctly if they observe those requirements.

The “external constraints” on arbitration, in turn, come from courts. They are necessary to enforce the internal constraints. The law typically gives judges the authority to quash arbitral awards in some circumstances. There is a tendency in most countries to limit the legal grounds on the basis of which arbitral decisions may be challenged. Normally, only procedural flaws can be invoked. Only rarely are judges empowered to overturn arbitral awards for substantive errors. Even if the scope of judicial review is limited, however, the fact that the state cares about the awards, and asks courts to supervise them under some circumstances, shows that arbitration is a process that is thought to affect the political community in some relevant way. The state seems to have an interest in making sure that this method to resolve disputes has certain features that make it resemble adjudication. Only a form of arbitration that is similar enough to adjudication is acceptable. But why should this be so?

It is sometimes argued that arbitration gets lots of protection from the state and that, in exchange for this privileged protection, arbitration should observe certain rules and principles. But this argument is not convincing. It is true that arbitration agreements are enforced by the state, through the courts, but this is true of contracts in general. It is also true that there is a specific form of enforcing arbitration agreements: courts must stay the judicial proceedings and order arbitration, if one of the parties invokes the arbitration agreement. But this type of judicial intervention is, in practice, the only way to force a recalcitrant party to honor the agreement he signed. Given the nature of a contractual agreement to arbitrate a dispute, the state must enforce it in this specific manner. If the only remedy for breach of the arbitral agreement were

granting damages to the party that wanted the case to be arbitrated, the agreement would have scarcely any legal bite.

It is true that the state helps arbitration in other ways: courts can be resorted to at various stages to ensure the success of the arbitral process. Typically, it is possible to request judges to appoint arbitrators (if the parties fail to agree), to issue interim measures, or to order the production of evidence. The judicial machinery is thus used to help arbitration. This is not necessarily a “privilege”, however: it is the kind of help we need from the state, in order to guarantee that the agreement that the parties have reached (to arbitrate a dispute) is fully enforced. But even if we consider that the institutional contribution by the state is so large that arbitration agreements get more protection than ordinary contracts do, it is still an open question why the state is entitled to impose certain constraints: what is the connection between that “privilege” and these constraints? Why, for example, should the state require arbitrators to state their reasons in their awards? What is the story that links this requirement with the fact that the state is helping the parties with their arbitration?

Another theory argues that the reason why the state imposes constraints on arbitration is that courts have to maintain their integrity when they enforce arbitration agreements and awards. Adjudication, it is claimed, has some features that need to be preserved. If courts are asked to lend their support to an arbitration process that is too different from adjudication, then the very integrity of adjudication is called into question. Courts, for example, must hear both sides, must assess evidence, and must render an impartial decision that is based on explicit reasons. If courts are asked to enforce arbitral awards that are the result of a process that does not have these basic features of adjudication, judicial integrity is affected. When judges are required to support such arbitral awards, they are indirectly giving their green light to a kind of procedure that is at odds with the fundamental principles that guide the judicial process.

It is doubtful, however, that judicial integrity is really in danger if courts are asked to implement forms of arbitration that deviate from the principles of adjudication. If a clear distinction is drawn between arbitration and adjudication, the political community should have nothing to fear if judges are asked to enforce arbitration agreements and arbitral awards. The public should understand that arbitration is a creature of contract, and that the parties may design forms of arbitration that are very different from adjudication. The fact that courts are needed to enforce those forms of arbitration does not mean that the distinctive features of adjudication get blurred. Courts, after all, are often required to enforce the deals struck by the parties to settle a dispute, and there is obviously no similarity between a negotiated settlement and the judicial process.

One is thus authorized to conclude that the law exhibits some tensions. On the one hand, the parties enjoy ample room to design the arbitral process as they prefer. It is a dispute involving their interests that needs to be resolved. On the other hand, the law imposes some constraints on the parties: arbitration must exhibit certain features that make it resemble adjudication. We should construct a more satisfactory theoretical account of the foundations of arbitration, so that we can put these two pieces together in a harmonic way.

### **When Mandatory Law is at Stake**

In the previous section, we have assumed that arbitration is used to resolve a dispute that affects the rights or interests the parties are free to dispose of. What happens, however, when the law includes rules that are “mandatory”, and that seek to protect public interests? There has been an interesting evolution in this regard. The trend in many countries in the last decades has been to expand the scope of matters that are arbitrable. So, if a dispute that affects the parties is governed by mandatory law, it can still be covered by an arbitration agreement. Anti-trust laws, for example, may be relevant to determine the validity of a contract between two companies. If arbitrators are asked to decide the controversy between them, they will have to apply those laws, which are of a mandatory character. The state, of course, has a strong interest, then, in making sure that arbitrators interpret and apply that piece of mandatory law correctly. In such type of case, it makes perfect sense for the state to establish internal constraints and external checks on the arbitral process, in order to enhance its reliability in terms of the legal accuracy of the outcomes.

An interesting question that arises in this context concerns the use by arbitrators of some of the mechanisms that judges have at their disposal to help them apply certain types of mandatory norms correctly. A first example concerns constitutional questions sent to the Constitutional Court to rule upon the validity of a statute. May arbitrators use this mechanism? Different answers have been given in different countries. The Italian Constitutional Court, for instance, has said yes, while the Spanish Constitutional Court has said no. A second example concerns the preliminary reference procedure to request a supranational court to clarify the meaning of the relevant law. The Court of Justice of the European Union has ruled that arbitrators cannot employ this procedure, while the Court of Justice the Andean Community has held that they can.

This question deserves a more detailed discussion than can be offered here. Of course, the answer depends, first of all, on the existing rules. But it is

necessary to pose the question from a normative perspective. Should we have a system that allows arbitrators to avail themselves of these types of mechanisms? All things considered, I think so. If we don't permit arbitrators to use these mechanisms, then we have to rely on external checks: the arbitral awards must be fully open to challenge on the merits, so that judges can then resort to those procedures. This unduly delays the final resolution of the case, in a way that runs counter to one of the rationales of arbitration. It is better to allow arbitrators themselves to employ such procedures, which can help them decide in the right manner, thus enhancing the reliability of the arbitral process.

#### IV. WHEN THE REGULATORY STATE IS A PARTY TO THE DISPUTE: INVESTMENT ARBITRATION

There is a specific form of arbitration that has generated great controversy: investment arbitration. In order to understand the challenges that it poses, we should first understand what is special about it.

##### **Investment Arbitration: Basic Features**

When a foreign company or individual makes an investment in a particular country, the risk exists that the state authorities of that country will exercise their governmental powers in ways that reduce or eliminate the value of the investment in an unjustified manner. A response to this problem has been found in international law, both at the substantive level and at the procedural level.

From a substantive perspective, public international law has developed some customs that protect foreign citizens in general, and foreign investors in particular. States, for example, are under the duty to provide foreigners with full protection and security, they must offer them fair and equitable treatment, and they cannot take their property without paying compensation. In addition to customary law, states have entered into international treaties of various kinds, to further specify and extend these standards. Two states, for example, may subscribe a bilateral investment treaty (BIT) that grants citizens and companies that are nationals of those states a collection of rights as foreign investors. Or two states may agree upon a broader treaty on free trade that includes a chapter on investments. These instruments may also be multilateral (as is the case with NAFTA, MERCOSUR, and the Energy Charter, for example). As a result of these international treaties, investors have a legal weapon in their

hands to attack any national law that the host government invokes to justify its actions. Thus, if the national parliament makes a new statute that negatively affects an investment in an unacceptable manner, the executive branch cannot simply rely on it. If the legislative reform is against the principles and rules established under the relevant treaty or customary norm, the investor can object to it.

From a procedural perspective, public international law helps investors through the creation of a forum where their disputes with host governments can be resolved: investment arbitration. What has pushed developments in this direction is, to a large extent, the distrust of local courts. In this field, distrust of the local judiciary does not merely come from the fact that one of the parties to the dispute (the investor) is a foreigner. It also derives from the fact that the other party is the government (not a private party). The fear is that the government will press the local courts to rule in its favor. Because the private and public interests at stake in these controversies are usually very large, the risk of bias is especially pronounced. Hence the need to construct a neutral forum, through arbitration.

An alternative solution, of course, would be the creation of international courts, specialized in investment law. The disputes between investors and governments could be brought to such courts. But public international law has not gone that far yet.

There are actually different arbitration forums where investment controversies may be brought. The most important one is ICSID (the International Center for Settlement of Investment Disputes), which was created by the Washington Convention of 1966, under the auspices of the World Bank. An investor can bring a complaint against a state before the arbitral bodies that are set up under the ICSID framework. (A state can also bring a claim against an investor, but this is very rare in practice). This arbitration house is open to states that have ratified the ICSID Convention. Both the host state and the home state (the state the investor is a national of) must be a party to the ICSID Convention. If only one of them is a party, but not the other, there is then the possibility of using the ICSID Additional Facility Rules, which are of a different nature, as we will see.

Now, for a state to be brought to an ICSID arbitration tribunal, it is necessary, of course, that both parties agree to arbitrate. As is true of arbitration in general, the parties to the dispute must have consented to use arbitration to settle the controversy. The investor can easily consent by simply filing the complaint before the arbitral institution. The state's consent, in turn, is normally expressed before the dispute arises. Sometimes, the contract between the government and the investor includes the pertinent arbitration clause. Other times, the national law (whether a statute or the Constitution) provides that the

state agrees to arbitrate particular classes of disputes with foreign investors. Most frequently, however, consent on the part of the state is to be found in an international treaty (a BIT, for example) that the state signed with the other state (the home state) the investor comes from. It is important to bear in mind that the fact that a state has ratified the ICSID Convention simply means that this arbitration house is available, but it does not mean that the state is thereby giving its consent to arbitrate. The source of consent has to be found elsewhere.

What makes ICSID arbitration remarkable is that the award issued by the arbitrators can only be reviewed by a committee within ICSID. No national court is afterwards authorized to review the award. National courts, moreover, cannot refuse to enforce it –the New York Convention of 1958, which enumerates some grounds for denying enforcement under national law, does not apply here. The reason is that the ICSID arbitral process is not anchored in any domestic legal system. It is instead a process that takes place in the sphere of public international law. The decision it generates is thus immune from national checks. (If the ICSID Additional Facility Rules are instead employed, things are different. The arbitration process is then located within a domestic legal system, and the courts of the seat that has been chosen have the authority to review the award, in light of the national arbitration laws. The enforcement of the award can also be denied, on the legal grounds mentioned in the New York Convention).

ICSID arbitration is an important illustration of the gradual empowerment of private individuals under public international law. In the domain of human rights, we have witnessed the emergence of legal regimes that entitle private individuals to sue a state before an international tribunal. The European Court of Human Rights is the most prominent example in this regard. Similarly, the ICSID Convention has opened a forum where private individuals, in their capacity as foreign investors, can bring a claim against a state. The international tribunal in this area, however, is of an arbitral nature.

Let us now focus on some controversies that surround investment treaty arbitration under ICSID.

## **Investment Arbitration and Impartiality**

One of the most important themes that underlie the criticisms that have been made against the ICSID system concerns arbitral bias in favor of investors. The objection is often advanced that arbitrators are interpreting and applying the abstract principles that protect investors in ways that are too

generous to the latter. As a result, democratic governments are harmed: they are losing their capacity to regulate matters in the public interest (to protect the environment, for example). To support the objection, some scholars have pointed out that the generous doctrines espoused by arbitrators are the upshot of an institutional structure that is biased in favor of investors. Arbitrators, it is contended, are interested in making ICSID an attractive arbitration forum. The more cases that are brought to it, the more business for arbitrators there will be. Since, in practice, investors are the ones that bring the cases, they must be treated well by arbitrators. In contrast, judges whose future salaries do not depend on who wins a case, are more likely to be balanced in their interpretation of the law.

This is an interesting criticism, but there are reasons to cast some doubt on it. First, it is true that arbitrators have an incentive to make arbitration attractive to investors. But they have a counter-incentive not to make states upset about the system, which is relatively fragile. States are still powerful actors in the international regime. Second, as a general rule, only one of the arbitrators is appointed by the investor. The other is chosen by the state that is a party to the dispute, while the third arbitrator has to be agreed upon. Arbitrators cannot be very hostile to state interests, if they want to maintain or enhance their likelihood of being hired in the future. Third, some studies actually suggest that the arbitral awards are not favorable to investors to such a degree that there is reason to suspect bias. Investors do lose cases, and the amount of damages they obtain when they win is often much lower than they had originally claimed.

Another line of criticism is that arbitrators, in contrast to judges, are not subject to the intellectual discipline of consistency. This makes it less likely that their decisions will be correct. Whereas courts are expected to apply the precedents they generate in the future, no such thing is true of arbitrators. The latter are not part of a structure that is well equipped to produce a consistent jurisprudence. Arbitrators form a decentralized network of decision-makers that are free to decide each case as they think reasonable, without the powerful constraint that it would mean for them to be bound collectively to a set of precedential rules. This lack of discipline is especially worrisome in the field of investment law, given the very open-ended character of the principles that are to be interpreted and applied. When the substantive law gives so much discretion to the decision-makers, the need for a system of precedents should be more strongly felt, in order to reduce that discretion.

There is truth to this objection, but we should not exaggerate the difference between courts and arbitrators in the particular field of investment law. An underdeveloped system of precedents has already emerged. Most of the awards in this domain are published, and are regularly taken into account by arbitrators. It is true, however, that the style of reasoning of arbitrators tends to

be rather casuistic. Arbitrators are less likely than courts to produce categorical rules. But, as some scholars have argued, states actually prefer to have a system that is relatively casuistic in this field, rather than one that generates clear and stable rules that may work against their regulatory interests. The way arbitrators are appointed, together with the abstract nature of the law to be applied, facilitate a case-by-case type of decision-making process. States can thus diversify their risks.

## **Investment Arbitration and Interpretive Dialogue**

The last question I want to address concerns the dialogue between political institutions and arbitrators. In order to put this issue in a broader context, we should recall that, at the domestic level, there is a complex set of interactions between the political organs and the judiciary. Typically, the laws that are adopted through the democratic process are interpreted by courts. The legal interpretations fixed by courts can be overridden by the political institutions through a legislative reform. Similarly, when the Constitution is interpreted by the judiciary, it is often possible for the political branches to counteract the relevant doctrines through a constitutional amendment. There is thus a public dialogue about the norms the political community should have.

As a general rule, arbitration does not undermine this dialogue. As we saw before, arbitration does not make a significant contribution to the interpretation of the law. The awards are normally secret. Even if made public, the awards are not taken to create any case law that other decision-makers are expected to follow. So the public dialogue can center on courts –what arbitrators decide is not very important from a general perspective.

Investor-state arbitration, however, is different. The role of arbitrators in charge of deciding disputes between governments and foreign investors is not limited to the resolution of the case. Those arbitrators are also expected to contribute to the generation of doctrines that specify the relatively abstract standards that govern the field of investment. There is no democratic parliament regularly producing the more specific rules that arbitrators should apply.

Now, what are the forms of the dialogue in the investment domain? In what ways may states contribute to the process through which the relevant international treaties are interpreted? And how can they react against arbitral interpretations they disagree with?

There are basically five ways for states to channel their interpretive inputs. First, as a party to an investment dispute, the government of state can argue its case and offer its interpretation of the relevant law. Second,

sometimes states are allowed to intervene in arbitral proceedings, even if they are not a party to the controversy, in order to express their views on the interpretation of the relevant treaty they have signed. Third, some treaties provide for the establishment of a commission, made up of representatives of the states that have ratified it, with the power to issue interpretive notes on the treaty. These notes are binding on arbitrators. Fourth, under some treaties, a state may bring an arbitration process against another state, to obtain an abstract ruling on the interpretation of a particular clause that has given rise to controversy. The decision made in this state-to-state arbitration process is binding on arbitrators handling specific disputes under the treaty. Finally, it is possible for the states to agree to amend the treaty, if they want to override the interpretation reached by arbitrators.

These are the principal moves that states can make to influence the interpretive process. But there are some differences between this dialogue and the one that takes place at the domestic level.

First, because it is hard to expect arbitrators to produce a body of relatively categorical rules through a system of precedents, the dialogue is more difficult to channel. States have to react to specific decisions, rather than to a more general jurisprudential doctrine.

Second, one of the advantages of investment arbitration is that the dispute between the investor and the host state need not harm the relationships between the host state and the home state. Investment arbitration depoliticizes the underlying conflict: the home state is not expected to get into the picture to support the investor. (Under the ICSID Convention, the investor actually waives his right to diplomatic protection. Only if the arbitral award is not honored by the host state may the home state exercise that protection). In light of this philosophy, it is harder for states to make use of the possibilities that are formally open to them to contribute to the interpretive process. Thus, if a state that is not a party to the dispute intervenes in the arbitral proceedings, there is a danger that the conflict will get politicized. Similarly, if interpretive notes are issued by the states, or if state-to-state arbitration is resorted to, politics enters the scene again.

The more natural form of intervention by the states is through the amendment process. But, of course, it is not easy for states to agree to change a treaty, especially if this is to be done to respond to the interpretations established by the arbitrators.

What is easier, however, is for states to express their views in new treaties they write. There has been an interesting development in this regard. In the past, powerful capital-exporting nations tended to press weaker capital-importing countries to ratify international treaties that were very protective of investors. At present, however, the contrast between the two groups of states is

less stark. More often than in the past, states can find themselves in a dual position: they are both exporters and importers of capital. While they are interested in protecting their nationals when the latter invest abroad, they are also interested in safeguarding their governmental capacity to regulate matters in the public interest when they receive investments from foreigners. This has led to a more balanced regulation of investment guarantees in the new treaties. (The evolution in the United States, concerning its Model BIT, is very revealing. The 2004 and 2012 Models are more nuanced than the earlier 1987 Model).

So while states cannot easily change the existing treaties, they can make new ones, and gradually replace the old ones when they expire.

Whether this is a sufficient strategy to cabin the interpretive powers of arbitrators is an open question, however. There is ample room for improvements and reforms in this area. But how exactly should we design alternative forms of democratic dialogue? This is not an easy question.