

PROPOSED U.S. ARBITRATION REFORM AND THE THREAT TO INTERNATIONAL ARBITRATION: WHY THE STAKES ARE SO HIGH

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*International arbitration is no more a ‘type’ of arbitration than a sea elephant is a type of elephant. True, one reminds us of the other. Yet the essential difference of their nature is so great that their similarities are largely illusory.*²

Introduction

A number of “arbitration reform” bills have recently been introduced in the United States Congress. Their purpose is to address perceived unfairness in certain areas of *domestic* arbitration. But this legislation, if enacted in its current form, would have the apparently unintended consequence of severely limiting – if not eliminating – *international* arbitration in the United States.

International arbitration has become the norm for resolving international commercial disputes. Indeed, unlike domestic arbitration – which is seen as an *alternative* to domestic courts – international arbitration usually provides the *only* neutral, viable forum for the resolution of international business disputes. Needless to say, almost every U.S. company of any meaningful

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² Jan Paulsson, “International Arbitration Is Not Arbitration,” John E.C. Brierly Memorial Lecture, McGill University, May 28, 2008 at 1 (hereafter, “Paulsson”).

size is now doing at least some business internationally. It is therefore not an overstatement that the proposed legislation could have a devastating impact on international arbitration and, consequently, on international commerce. Yet the drafters of the proposed legislation seem entirely unaware of the severe “collateral damage” their bills could cause, perhaps in part because of their failure to understand or consider the critical differences between domestic arbitration on the one hand, and international arbitration on the other. Nor does there appear to be any recognition or consideration of the critical role that international arbitration plays in international business.

The purpose of this short paper (and accompanying presentation) is to explain why (1) domestic arbitration and international arbitration are (to continue Jan Paulsson’s metaphor above) two very different animals; and (2) given its importance to international business, international arbitration must be placed beyond the reach of the pending legislation in Congress – lest severe consequences be visited on the ability to resolve international disputes involving U.S. parties.

Before turning to the differences between domestic and international arbitration, it is helpful first to review their similarities and agree on a general definition of “arbitration” (as opposed to, say, litigation or mediation) that applies in both contexts. The laws governing arbitration may vary slightly from one jurisdiction to another. But arbitration has several defining characteristics in both the domestic and international contexts. As one commentator states:

First, arbitration is generally *consensual* – in most cases, the parties must agree to arbitrate their differences. Second, arbitrations are resolved by *non-governmental decision-makers* – arbitrators do not act as state judges or government agents, but are private persons ordinarily selected by the parties. Third, arbitration produces a *binding award*, which is capable of

enforcement through national courts – not a mediator’s or conciliator’s non-binding recommendation. Finally, arbitration is comparatively *flexible*, as contrasted to most court procedures.³

Thus, unlike mediation or conciliation, arbitration is binding. Litigation may be commenced in court with the consent of only one of the parties; once commenced, it requires the participation of the other party whether it consents to the proceeding or not. Arbitration requires the consent of both parties. Such consent may be given at the time the dispute arises, but more typically is given before the dispute arises, often in the form of a contractual arbitration clause. And, unlike litigation, arbitration is resolved by non-governmental decision-makers (typically a sole arbitrator or a panel of three arbitrators), in an institution and/or under procedures that have been chosen by the parties.⁴

But that is generally where the similarities between domestic arbitration and international arbitration begin and end.

A Bit of History and Context: Domestic Arbitration

Domestic arbitration – that is, arbitration between parties of the same nationality as an alternative to resolving disputes in domestic courts – is hardly a new concept. As one

³ Gary B. Born, *INTERNATIONAL COMMERCIAL ARBITRATION* 1 (2d ed. 2001) (hereafter “Born”) (emphasis in original).

⁴ There are numerous arbitration institutions throughout the United States and around the world that the parties can choose to conduct their arbitration. For example, the American Arbitration Association (“AAA”) and JAMS are two-well known arbitral institutions in the United States that administer domestic arbitrations and also have their own procedural rules for the conduct of arbitration. These rules generally provide considerable room for the parties to deviate from them and/or fashion their own rules. In addition, parties can choose *ad hoc* arbitration – that is, arbitration that is not administered by any arbitral institution, but that may be held according to institutional rules (*e.g.*, the JAMS rules) or whatever other rules the parties can agree on.

commentator puts it, “private dispute resolution among commercial men is as old as commerce itself.”⁵

Domestic arbitration dates back at least to Ancient Rome, where “arbitration was developed solely within the domain of contract; it was entirely independent of the law of procedure and of legal actions.”⁶ Domestic arbitration was also prevalent in parts of Europe during the Middle Ages:

Burghs created after the 12th century, merchants in the fairs, and corporations were generally empowered by their Charters, be they royal or granted by feudal lords, to organize and administer their own justice. Numerous Courts were thus established, which were frequently regarded as arbitral Courts because parties were given certain leeway to choose their judges and because the judge thus appointed was expected to apply rules other than those embodied in local custom.⁷

In England, the first arbitration act dates to 1698, formalizing a practice of informal arbitration by members of trade guilds, who found common law courts inefficient and inexpert in applying mercantile law.⁸ Domestic arbitration became especially popular in France following the French Revolution, when arbitration “appeared as an institution of ‘droit naturel’ to be viewed with the utmost favour.”⁹ It then became unpopular in France in the mid-nineteenth century, when domestic arbitration “was no longer regarded as proceeding from the expression of a natural right

⁵ W. Laurence Craig, “Some Trends and Developments in the Laws and Practice of International Commercial Arbitration.” 30 TEXAS INT’L LAW J. 1, 5 (1995) (hereafter, “Craig”).

⁶ René David, ARBITRATION IN INTERNATIONAL TRADE 85 (1985) (hereafter, “David”).

⁷ *Id.* at 85-86 (footnote omitted).

⁸ Craig, *supra* note 5, at 6 (citing Geoffrey R.Y. Radcliffe & Geoffrey Cross, THE ENGLISH LEGAL SYSTEM 246 (6th ed. 1977)).

⁹ David, *supra* note 6, at 89-90.

and of a civil liberty; rather it was considered as an eviction of the jurisdiction of the courts, which offended a healthy conception of justice.”¹⁰

Although domestic arbitration has fallen in and out favor in different countries over the centuries, it has generally been looked on favorably in most Western countries since the period following World War I¹¹ – though, of course, it has never been without its critics.¹²

But the purpose of domestic arbitration – certainly today, and apparently over the centuries – has been to provide parties of the same nationality with an *alternative* to adjudicating their disputes in their local courts. In particular, advocates of domestic arbitration in the United States argue that it provides an alternative to a U.S. litigation process that has become unduly expensive, protracted, and unpredictable – with damages awards (in particular, punitive damages awards) bearing no reasonable connection to the actual harm suffered. They argue further that domestic arbitration allows decision-makers with special expertise relevant to the particular dispute at hand to decide complex issues – issues with which judges and/or juries may have little or no familiarity. Still another advantage of domestic arbitration is that it allows the parties to “agree upon procedural rules that are tailor-made for their individual needs.”¹³

¹⁰ *Id.* at 91. “Domestic arbitration” in these early contexts may have occasionally involved parties of different nationalities. But the point is that its purpose was to provide an alternative to local courts, rather than a neutral forum for deciding commercial disputes between parties of different nationalities.

¹¹ *Id.* at 88-130.

¹² See Paulsson, *supra* note 2, at 11 (describing the views of Professor Heinrich Kronstein of Georgetown Law School, who, in a 1944 article in the *Yale Law Journal* described “[o]rganized arbitration” as “an instrument of cartels and monopolistic trade associations” that would “pervert . . . the balance imposed by law”) (citing Heinrich Kronstein, “Business Arbitration – Instrument of Private Government,” 54 *YALE L.J.* 36, 36-39 (1944)).

¹³ Born, *supra* note 3, at 2.

Generally, critics who seek to limit the use of domestic arbitration through legislation focus their criticism of domestic arbitration to several relatively limited contexts – such as consumer, employment, franchise, and similar disputes, in which parties to the contract or transaction providing for arbitration are perceived to be parties of unequal bargaining power. These critics are concerned that, where the parties have unequal bargaining power, the weaker party will have no choice but to sign away his or her access to domestic courts, along with many of the rights afforded by those courts (including, for example, the right to trial by jury and the right to appeal). It is this category of critics who are largely behind the proposed legislation designed to limit arbitration. There is another category of critics who believe that even for parties of equal bargaining power, domestic arbitration has become just as expensive, cumbersome, and protracted as domestic litigation. Of course, for this latter category of critics, the solution is simply to avoid entering arbitration agreements rather than to seek legislation to limit or prohibit arbitration.

But the bottom line is that domestic arbitration exists as an additional option to domestic courts. Parties who consent to domestic arbitration may do so in part because they believe it is preferable to local courts. Parties who eschew domestic arbitration may do so in part because they believe that local courts provide a better forum in which to adjudicate their disputes. Either way, the domestic courts remain open to hear and impartially decide the disputes of domestic parties, as well as to enforce the resolution of those disputes. That will be the case whether domestic arbitration is expanded, limited, or done away with altogether.

A Bit of History and Context: International Arbitration

While domestic arbitration provides an *alternative* to domestic courts, the role of international arbitration is far more crucial. For parties of different nationalities, who may speak

different languages and come from dramatically different legal systems and cultures, international arbitration typically provides the *only* neutral and impartial forum in which to have their disputes decided. For such parties, the question of whether international arbitration is faster, or less expensive, or more streamlined than taking their disputes to the local courts of the other party, is relatively insignificant. To these parties, the critical imperative is finding a neutral forum to resolve their dispute.

There is near unanimity on this fundamental difference between domestic arbitration (as an alternative to local courts) and international arbitration (as the sole neutral forum for international disputes involving private parties). To quote again Jan Paulsson:

[T]he debate about the supposed advantages of arbitration, whether they are accepted or denied, must stop at the border if it is to remain at all coherent. Is it quicker? Is it less expensive? Is it less disruptive because it is confidential and informal? Does one get better decisions from persons selected for their relevant expertise? All these questions may be debated endlessly. Depending on the country you're in, and the industry you're concerned with, the alternative is endlessly variable – from the admirable to the intolerable.

In international arbitration, all of these elements fade into relative insignificance when contrasted with a criterion which is dominant here although it is by definition irrelevant in the national context. That unique criterion is *neutrality*.¹⁴

Similarly, Gary Born, another prominent practitioner and commentator, observes that

“international arbitration has several characteristics that distinguish it from domestic arbitration”:

Most importantly, international arbitration is designed and accepted particularly to assure parties from different jurisdictions that their disputes will be resolved neutrally. Among other things, the parties usually seek an independent decision-maker, detached from the courts, governmental institutions, and cultural biases of

¹⁴ Paulsson, *supra* note 2, at 2 (emphasis in original).

either party. They also ordinarily contemplate the arbitrator's application of internationally-neutral procedural rules, rather than a particular national legal regime.¹⁵

And Nicholas Katzenbach, a former Attorney General of the United States and a former General Counsel of IBM, has stated:

While we have experienced commercial arbitration in domestic trade for many years and this has been successful and helpful in a variety of ways, I suggest that arbitration in international commerce is really of a wholly different order of importance. Here to get effective and reasonably predictable and fair resolutions arbitration has become *essential* in a way it never has been in domestic matters.¹⁶

There are, of course, exceptions to the rule. A U.S. company, for example, may be less suspicious of adjudicating its dispute with an English company in a court in London, where the language and legal culture are highly similar to that of the United States. But would a U.S. company confidently expect to find a neutral and impartial forum in the local courts of the other 190-plus countries of the world? The top thirty trade partners of the United States (measured by U.S. exports) include, for example, Mexico, China, Korea, Taiwan, Brazil, Malaysia, the United Arab Emirates, Venezuela, Colombia, Thailand, Chile, the Philippines, and Russia.¹⁷ A U.S. company would probably not expect to receive neutral and impartial treatment in the courts of all of these countries (and, in candor, the U.S. company would be justified in lacking that expectation with respect to many of them). Nor would companies from many of these countries

¹⁵ Born, *supra* note 3, at 2.

¹⁶ Nicholas de B. Katzenbach, "Business Executives and Lawyers in International Trade," in *SIXTY YEARS OF ICC ARBITRATION: A LOOK AT THE FUTURE* 67, 67-68 (ICC Int'l Court of Arbitration ed., 1984), *quoted in* Craig, *supra* note 5, at 3-4.

¹⁷ U.S. Department of Commerce, Census Bureau, Foreign Trade Division, "Top U.S. Trade Partners Ranked by 2007 U.S. Total Export Value."

expect to receive neutral and impartial treatment in the courts of the United States (and, in candor, many of these companies would also be justified in lacking that expectation).

Just as important, throughout most of the world, it is far easier to enforce an international arbitral award than it is to enforce a domestic court judgment against a foreign company. This is because of the U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which was signed in New York in 1958 (the “New York Convention”). The success of the New York Convention has been remarkable, with nearly 150 nations – *i.e.*, about three-quarters of the existing states in the world – having ratified it. Nearly all of the major trading nations of the world are signatories.¹⁸ By contrast, there are very few signatories to the handful of international conventions for the recognition and enforcement of foreign judgments – and the United States is not a party to any of them. Thus, not only does international arbitration provide the only neutral and impartial forum for disputes between parties of different nationalities. It also provides the only such forum that is accompanied by anything resembling a global enforcement process.

The history of international arbitration is just as long as if not longer than that of domestic arbitration. But unlike domestic arbitration, which has almost always been seen as an alternative for domestic businesses to resolve their disputes outside domestic courts, international

¹⁸ Alan Redfern, Martin Hunter, Nigel Blackaby, and Constantine Partasides, *LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* 11 (4th ed. 2004) (hereafter, “Redfern & Hunter”). Since the publication of the fourth edition of Redfern & Hunter in 2004, there have been a number of additional countries that have ratified the New York Convention, including, for example, Afghanistan (2005); the Bahamas (2006); Gabon (2006); Liberia (2005); the Marshall Islands (2006); Montenegro (2006); Rwanda (2008); and the United Arab Emirates (2006). Among the 40 or so nations that have not signed, only Iraq and Libya can be considered as “major trading nations.”

arbitration has for most of its history been seen as *an alternative to war*. Indeed, the history of international arbitration was until recently dominated by disputes between states rather than private parties.

According to one historian, international arbitration dates back to the ancient Greeks in the middle of the seventh century BC. He writes:

By that time the great migrations had come to an end and separate states had been organized. A certain equilibrium obtained among the Greek states of this epoch, and it was perhaps due to this balance of power that the growth of arbitration was favored. The states were beginning to emerge from their isolation and come into economic relations, thus paving the way for disputes. On the other hand, no state was yet sufficiently strong to defy its neighbors, and consequently arbitration was called into play.¹⁹

International arbitration between states continued through Roman times, when the “Romans took over the policy of the Hellenistic princes of employing arbitration to adjudicate differences between states that lay within the growing sphere of Roman influence.”²⁰

In the Middle Ages and on through the Renaissance, the European states were more inclined toward war than alternative dispute resolution, yet there were still instances of disputes between states being resolved through arbitration instead of armed conflict. Writing in the early sixteenth century, no less a voice than that of Desiderius Erasmus called out for international arbitration to be used more frequently as an instrument of peace:

The world has so many grave and learned bishops, so many venerable abbots, so many grey-haired grandees wise by long experience, so many councils, so many senates instituted not in

¹⁹ Henry S. Fraser, “A Sketch of the History of International Arbitration,” 11 CORNELL L.Q. 179, 186 (1925-1926:2) (hereafter, “Fraser”) (citing A. Raeder, L’ARBITRAGE INTERNATIONAL CHEZ LES HELLÈNES, 144-47 (1912)).

²⁰ *Id.* at 187-88.

vain by our ancestors. Why should not the childish quarrels of princes be settled through the arbitration of these learned men?²¹

Other great intellectuals – such as Hugo Grotius, William Penn, Jean-Jacques Rousseau, Jeremy Bentham, and William Penn, to name a few – voiced similar sentiments.²²

International arbitration between states became increasingly prevalent in the nineteenth century, with arbitrations held to address such matters as (by way of a few examples) a sulphur monopoly in Naples, the Sardinian salt trade, various fisheries disputes, the seizure of ships and other goods, and disputes concerning the Suez Canal.²³ A number of wars concluded with treaties containing arbitration clauses, including the Mexican-American War in 1848. The resulting Treaty of Guadalupe Hidalgo included what some have described as the first permanent arbitration clause in recent history.²⁴ At the end of the nineteenth century, the first Peace Conference was convened in The Hague, which established the Permanent Court of Arbitration

²¹ Desiderius Erasmus, ADAGIA, Chil. IV, Centur. I. Prov. I, *quoted in* Fraser, *supra* note 19, at 180.

²² *See* Fraser, *supra* note 19, at 180-84.

²³ *Id.* at 199.

²⁴ *Id.* at 199-200. The clause provided that in the event of future differences, which could not be settled by the two governments:

a resort shall not, on this account, be had to reprisals, aggression, or hostility of any kind, by the one republic against the other, until the government of that which deems itself aggrieved shall have maturely considered, in the spirit of peace and good neighborhood, whether it would not be better that such difference should be settled by the arbitration of commissioners appointed on each side, or by that of a friendly nation. And should such course be proposed by either party, it shall be acceded to by the other, unless deemed by it altogether incompatible with the nature of the difference, or the circumstances of the case.

Id. at 200 (quoting THE STATUTES AT LARGE AND TREATIES OF THE UNITED STATES OF AMERICA, Vol. IX, 938-39).

(“PCA”). But again, through the end of the nineteenth and into the early twentieth century, international arbitration meant primarily arbitration between states.

The rise of international arbitration for non-state parties came largely in the wake of World War I. After the savagery of the war, “people of good will sought urgently for ways to prevent its recurrence.”²⁵ Increasing international trade was of course an important way to bring people of the world together and to make them more interdependent. At the same time, the increased interaction between people of different nations also meant the increased likelihood of disputes between such people – hence the need for a neutral, impartial means of resolving such disputes, in order to preserve and promote international peace. As Paulsson has explained:

Peace, it was reasonably thought, would be buttressed if peoples and their governments had mutually reinforcing stakes in systems of cooperation. Trade was an obvious thing to be promoted; it would not make sense to attack a golden goose. Of course commercial transactions lead to disputes in some inevitable proportion of cases, as reality intrudes on expectations and as parties then take different views of imperfect contractual provisions. It is therefore essential that such disputes be resolved fairly and efficiently lest the unreliability of bargains become an impediment to trade. So the idea of international [commercial] arbitration as a tool of peace emerged.²⁶

The Court of Arbitration of the International Chamber of Commerce (“ICC”) was founded in Paris in 1923, and has been at the forefront of international commercial arbitration ever since.²⁷ The ICC recognized that “one of the barriers to the development of trade had been

²⁵ Paulsson, *supra* note 2, at 5.

²⁶ *Id.*

²⁷ Redfern & Hunter, *supra* note 18, at 5. Another of the world’s still-leading international arbitration institutions, the Committee for the Settlement of Disputes in Commerce, Industry and Shipping of the Swedish Chamber of Commerce (“SCC”), had been founded several years earlier in 1917. *Id.*

the complexity and variety of national legal systems”; the ICC “therefore endeavored to aid businessmen in their efforts to find means of settling their disputes quickly, simply and privately.”²⁸

In the United States, the New York Arbitration Statute was enacted in 1920, which made arbitration agreements enforceable in New York courts.²⁹ The New York statute provided a model for what became the federal statute dealing with arbitration, the United States Arbitration Act of 1925, which later became known as the Federal Arbitration Act (“FAA”). In 1958, the United Nations Conference on International Arbitration was held in New York. It produced the New York Convention (discussed above) the same year. Among other things, the New York Convention requires member states to recognize and enforce arbitral awards and also requires that national litigation be stayed in favor of arbitration.³⁰

By the mid-1980s, it had become recognized that international arbitration represented the *norm* for the resolution of international commercial disputes.³¹ In the past twenty-five years, the prevalence of international arbitration for the resolution of international business disputes has grown even further. There is no question that the rapid growth of international business has made the world a smaller place, bringing together large numbers of people from different parts of the world – and from entirely different business and legal cultures – in ways that were

²⁸ Conference on International Commercial Arbitration, September 12, 1958, *Summary Records of the Third Meeting*, U.N. Doc. E/CONF.26/SR.3, 4, available at <http://www.uncitral.org/pdf/english/travaux/arbitration/NY-conv/e-conf-26-sr/3-N5814242.pdf>.

²⁹ N.Y. Arbitration Law, L. 1920, c. 275, Consol. c. 72.

³⁰ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2815, 330 U.N.T.S. 38.

³¹ Craig, *supra* note 5, at 2 (citing numerous sources).

unimaginable less than a generation ago. But again, as international commerce grows, so too do international business disputes. The need for a neutral and impartial means of resolving such disputes has never been more important.

International arbitration has been successful in providing those means. According to one recent study, 81% of international arbitration cases result in either settlement or voluntary compliance with the arbitral award.³² Among the cases that have resulted in an award, most parties are able to enforce the award within one year and usually recover more than 75% of the value of the award.³³ Of the corporate counsel participating in the study, 86% said they were satisfied with international arbitration.³⁴ Given the substantial and increasing number of disputes – and the increasing diversity of contracts, transactions, and nationalities involved in such disputes, with participation from nearly every corner of the globe – those statistics are remarkable.

The Rise and Importance of International Investor-State Arbitration

There is another extremely important type of international arbitration that has gained prevalence only in the past ten years or so: investor-state arbitration. As described above, most of the history of international arbitration has involved disputes between states. The advent of international commercial arbitration between private parties came only after World War I. Throughout most of Western legal history, a private party could not assert a claim against the state, due to principles of sovereign immunity. If a private party had a dispute with a foreign

³² PriceWaterhouseCoopers, INTERNATIONAL ARBITRATION: CORPORATE ATTITUDES AND PRACTICES 6 (2008).

³³ *Id.* at 12.

³⁴ *Id.* at 5.

state, the best that party could hope for was to persuade its own government to exercise “diplomatic protection” and intervene on its national’s behalf. As the International Court of Justice remarked in the famous *Barcelona Traction* case:

The Court would here observe that . . . a State may exercise diplomatic protection by whatever means and to whatever extent it thinks fit, for it is its own right that the State is asserting. *Should the natural or legal persons on whose behalf it is acting consider that their own rights are not adequately protected, they have no remedy in international law.*³⁵

But to encourage and promote foreign direct investment into their countries, an increasing number of states – particularly in the developing world – have given their consent for investors to assert claims against them in international arbitration. That consent has been given through arbitration clauses in several different types of legal instruments, including:

- investment agreements (*e.g.*, concession agreements between the “host” state and the foreign investor);
- domestic investment laws, enacted by the host state to attract foreign investment by affording it certain protections; and
- bilateral investment treaties (“BITs”), multilateral investment treaties (such as the North American Free Trade Agreement and the Energy Charter Treaty), and free trade agreements (“FTAs”).

In this last category (*i.e.*, BITs, multilateral treaties, and FTAs), the signatory states give their consent for investors of the other signatory states to assert claims in international arbitration if

³⁵ *Case Concerning the Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain)*, 1970 ICJ Reports, 3 ¶ 78 (emphasis added).

any of several enumerated protections are violated.³⁶ Thus, the investor can bring claims in arbitration against the government of the host state even in the absence of privity between the investor and the host state.³⁷

In 1998, about a dozen or so known investor-state arbitration cases had been filed. As of 2008, there were over 300 known cases. Most of the cases are brought at the International Centre for Settlement of Investor Disputes (“ICSID”) under the auspices of the World Bank. A number of investor-state cases have also been brought at the ICC, the SCC, the London Court of International Arbitration (“LCIA”), or as *ad hoc* arbitrations under the Arbitration Rules of the United Nations Commission on International Trade Law (“UNCITRAL”).

The cases have been brought by major global companies (*e.g.*, AES, Archer Daniels Midland, Chevron, Duke Energy, France Telecom, IBM, Nomura, Occidental, Shell Oil, Siemens, and Vivendi), as well as by smaller companies and even individuals. At least 48 different countries have been named as respondents. These countries range from the wealthy (*e.g.*, Canada, Spain, the United States) to the extremely poor (*e.g.*, Bangladesh, Burkina Faso, Bolivia, Kenya, Kyrgyzstan), and include many others that fall somewhere between those

³⁶ The enumerated protections typically include, for example, freedom from expropriation without compensation; freedom from discrimination; a guarantee of “fair and equitable” treatment; a guarantee of “full protection and security”; a guarantee of treatment no less favorable than that provided by the host state to its own nationals, or that provided to other foreign investors, or that required by international law; and a guarantee that the state will honor all of its legal obligations to the investor. *See, e.g.*, Arif H. Ali and Alexandre de Gramont, “ICSID Arbitration in the Americas,” in *Global Arbitration Review: The Arbitration Review of the Americas* 7 (2008).

³⁷ *See* Jan Paulsson, “Arbitration Without Privity,” 10(2) ICSID REV – FOREIGN INVESTMENT LAW JOURNAL 232 (1995).

extremes (*e.g.*, Argentina, Bulgaria, Chile, Croatia, Hungary, Mexico, Pakistan, Romania, Russia, Turkey, Ukraine).

The vast majority of these cases have been brought under BITs. Ten years ago, there were only several hundred BITs in existence. As of June 2008, there were over 2600 BITs in place – with 179 countries parties to BITs.³⁸ There is some empirical evidence that the existence of BITs increases investment flows to developing countries.³⁹ Moreover, a recent study prepared by *The Economist* and the Columbia Program on International Investment found that nearly 70% of companies responded that the existence of an international investment agreement (with its accompanying substantive protections and arbitration provisions) influenced their decision to invest in a particular market.⁴⁰ Especially in economically uncertain times, it is difficult to dispute that the existence of protections for foreign investors – and the ability to enforce those protections in a neutral international arbitration forum – constitute important factors for companies considering investments in countries where the political risk is perceived to be high.

Thus, investor-state arbitration provides incentives for foreign companies to invest in developing countries; provides protections to small and large investors abroad; and is typically the only way to hold governments accountable for adverse actions against, or the failure to protect, foreign investors. It is an increasingly important part of international arbitration and an

³⁸ United Nations Trade Conference on Trade and Development, “The Development Dimension of International Investment Treaties” 2 (Dec. 2, 2008).

³⁹ *See, e.g.*, Eric Neumayer and Laura Spess, “Do Bilateral Investment Treaties Increase Foreign Direct Investment To Developing Countries?”, 33(10) *WORLD DEVELOPMENT* 1567 (2005).

⁴⁰ *The Economist* and the Columbia Program on International Investment, “World Investment Prospects to 2011: Foreign Direct Investment and the Challenge of Political Risk” 96 (2007).

increasingly important factor in promoting international investment – and hence, in growing the global economy. It too is threatened by the proposed U.S. legislation designed to reform limited types of *domestic* arbitration.

The Proposed Legislation: A Brief Overview

The precise details of the various bills that have been introduced in Congress – and the precise manner in which they would impact international arbitration – will be addressed at greater length by others in this program. My purpose is simply to provide a brief overview in order put the rest of this paper in context. It seems quite extraordinary that the critically important system of international arbitration – developed over centuries as a means to promote international trade, international peace, and the rule of law – could be severely crippled by the arguably laudable (but comparatively narrow) goal of limiting domestic arbitration in the context of consumer, employment, and franchise disputes. But that is precisely what the proposed legislation threatens to do.

Although over thirty arbitration bills have been introduced in Congress, two proposed bills introduced by prominent Senators from both political parties illustrate some of the essential problems with the pending legislation: the Arbitration Fairness Act of 2007, introduced by Senator Russell Feingold, a Democrat from Wisconsin, and the similarly named Fair Arbitration Act of 2007, introduced by Senator Jeff Sessions, a Republican from Alabama.⁴¹

Senator Feingold’s proposed bill provides, among other things, that “[n]o predispute arbitration agreement shall be valid or enforceable if it requires arbitration of”:

⁴¹ See Mark Kantor, “Legislative Proposals Could Significantly Alter Arbitration in the United States,” 74 ARBITRATION 444 (2008) (hereafter, “Kantor”).

- (1) an employment, consumer, or franchise dispute; or
- (2) a dispute arising under any statute intended to protect civil rights or to regulate contracts or transactions between parties of unequal bargaining power.⁴²

It also provides:

An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than by the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.⁴³

Practitioners of international arbitration will immediately see two fundamental problems with these provisions. First of all, the legislation provides no definition or enumeration of “statute[s] intended . . . to regulate contracts or transactions between parties of unequal bargaining rights.” Does it include securities laws, antitrust laws, unfair trade practices laws? There are numerous statutes, federal and state, that could be construed as “regulating contracts or transactions between parties of unequal bargaining rights.” Second, it is a long-established principle that arbitrators rule on challenges to their authority to decide a case – not the courts. Requiring foreign parties to resolve such issues in U.S. courts, under U.S. federal law, would

⁴² S. 1782, 110th Cong. § VII (2007) (emphasis added).

⁴³ *Ibid.*

eviscerate the entire purpose of international arbitration: providing the parties with a neutral forum to decide their disputes.⁴⁴

Senator Sessions' bill is even worse.⁴⁵ Among other things, it would ban *ad hoc* arbitration, which – under the UNCITRAL and other rules – has come to play an enormously important role in the context of international arbitration. It would ban the institutional appointment of arbitrators, another critically important aspect of international arbitration (especially in selecting the presiding arbitrator, when the two party-selected arbitrators are unable to do so). It would require that, unless the parties agree otherwise, the arbitrator must be a member of the bar of the court in the U.S. State where the hearing is conducted – dramatically limiting the pool of available international arbitrators to hear disputes, while potentially striking a blow to the neutrality of the decision-maker(s). Senator Sessions' bill would also require the dispute to be decided under the same substantive law as would apply under conflict-of-laws principles applicable in the State in which the non-drafting party to the contract resides. That choice-of-law rule is entirely at odds with the principle that parties in international arbitration choose the law that governs their disputes (and that, in the absence of such a choice, the choice of law is based on well-established principles such as the “most significant relationship” test or

⁴⁴ One can also easily envision problems arising from the language prohibiting arbitration of employment and franchise disputes in the international context. Imagine, for example, an employment contract between a U.S. company and a German CEO, providing for arbitration in the event of a dispute. That arbitration clause would be void and unenforceable. Either the U.S. company or the German CEO could force the other into U.S. court. Similarly, imagine a Chinese franchisee and a U.S. restaurant company that agreed to arbitrate any disputes they had in a neutral arbitration forum. That arbitration provision would also be rendered unenforceable.

⁴⁵ See S. 1135, 110th Cong. (2007) (hereafter, the “Sessions Bill”); see also Kantor, *supra* note 41, at 447-48 (enumerating the problems posed by the Sessions Bill as discussed in this paragraph).

the “closest connection” test). It also provides that “consistent with the expedited nature of arbitration, relevant and necessary prehearing depositions shall be available to each party at the direction of the arbitrator,” and requires the parties to “grant access to all information reasonably relevant to the dispute to the other parties, subject to any applicable privilege or other limitation on discovery under applicable State law.”⁴⁶ But depositions and many other aspects of U.S. style discovery are unheard of in many jurisdictions around the world; they are perceived as giving the U.S. party significant advantages over the non-U.S. party. The methods of obtaining information through “discovery” or similar vehicles are typically quite limited in international arbitration.

Again, this is not the place to review the entire inventory of serious harms that would be caused to international arbitration if legislation were passed in anything resembling the form of the two bills discussed above. Nor is it the place to debate the merits of the proposed legislative reform with respect to *domestic* arbitration in the limited context of consumer, employment, and franchise disputes. Putting those issues to the side, it seems entirely clear, particularly reviewing the provisions of the proposed bills set forth above, that they were not intended to apply to international arbitration. Indeed, it seems extremely unlikely that the drafters of this legislation even thought about international arbitration in preparing these proposed bills.

Although the potential harm to international arbitration posed by the draft bills is staggering, the “fix” is relatively easy. The laws of many jurisdictions distinguish between domestic and international arbitration. In France, for example, domestic arbitration and international arbitration are treated under separate laws, which differ from one another in significant respects. Under the French law governing domestic arbitration, for example, an

⁴⁶ Sessions Bill, *supra* note 45, § 2.

agreement to arbitrate a dispute in the future is valid *only* if both parties have the status of merchants.⁴⁷ That restriction, as well as several others applicable to domestic arbitration, do not apply to international arbitration under French law.⁴⁸

There is no reason why similar lines cannot be drawn in the proposed reform legislation pending in the U.S. Congress. If Congress determines that domestic arbitration should be curtailed in such areas as consumer, employment, and franchise disputes, so be it. But given that the intent behind such proposed legislation does not remotely appear to involve international arbitration – and given the serious harm that the proposed legislation could cause to international arbitration and, therefore, to international business – there is every reason for international arbitration to be carved out of such legislation. There is no reason for it to be included.

Numerous consumer rights, civil rights, and employee rights advocates groups have combined with plaintiffs’ lawyers, securities law groups, and franchisees to lobby hard for *domestic* arbitration reform.⁴⁹ Particularly following the sweeping electoral gains for Democrats (who are most likely to be sympathetic to these constituencies), these advocacy groups have reason to be hopeful that they can achieve some measure of legislative reform. But there is nothing to suggest that international arbitration is or should be anywhere within their sights.

Again, it would be easy to draft legislation that would carve out international arbitration (and, for that matter, domestic arbitration that does not involve parties of unequal bargaining

⁴⁷ CODE CIVIL art. 2061 (Fr.).

⁴⁸ See Paulsson, *supra* note 2, at 20; Jean-François Poudret, Sébastien Besson, Stephen Berti & Annette Ponti, *COMPARATIVE LAW OF INTERNATIONAL ARBITRATION* 43 (2007) (the “contrast between the restrictive provisions of domestic law and the liberal principles applying in international arbitration is one of the characteristic features of French arbitration law”).

⁴⁹ See Kantor, *supra* note 41, at 444.

powers) and achieve the reforms that these groups appear to be seeking. The challenge is to make sure that international arbitration is not simply forgotten in the debate – to make sure that Congress knows exactly what is at stake.