Kluwer Arbitration Blog

Is International Arbitration in a Race to the Top?

Catherine A. Rogers (Arbitrator Intelligence) · Thursday, March 15th, 2018 · Arbitrator Intelligence

Before answering the titular question, let's start with the more basic question: What is a race to the top? The phrase seems self-explanatory. It is a compelling and vivid metaphor that has by now entered to the public lexicon. But the phrase "race to the top" originated as a counterpart to the more ominous phrase: "race to the bottom."

The concept of a race down to bottom is often credited to two 1930s US corporate law scholars, Adolf Bearle and Gardiner Means. They used the phrase to describe a potential negative consequence when individual states in the United States compete to attract businesses to incorporate or reincorporate in their states.

Berle and Means hypothesized that, to increase their revenue by attracting more corporations, states would relax their corporate laws, including those that regulate corporate governance, disclosure obligations, minimum capitalization requirements, and the like. Corporations, the theory goes, would be drawn to those jurisdictions with the most appealing (TRANSLATE: most lax) corporate law, leading to a systematic decline in corporate governance standards as states raced downward to outdo each other.

By the 1970s, corporate law scholars developed a competing hypothesis about the effect of US corporate regulatory competition. Instead of a race to the bottom, they argued, regulatory competition would produce a race to the top. States would compete not (or not only) to develop more lax corporate law rules. They would compete to develop rules that accommodate corporate efficiency and promote more effective corporate governance. In racing to the top, these scholars point to development of specialized commercial courts, of protections against hostile takeovers, of efficiencies that reduce the cost of capital, and the like.

All these years later, scholars are still hotly debating whether regulatory competition in US corporate law is leading to a race to the top or a race to the bottom. While interesting, we now will leave the debate about corporate law to the corporate law scholars, and instead turn back to what these concepts might mean in international arbitration. The first question is whether and to what extent regulatory competition exists in international arbitration.

The most obvious parallel to US states competing to be chosen as the seat for

corporations is nation States competing to be chosen as the seat for arbitrations.[1)] Back in the 1980s, Rusty Park identified a "scramble among Western European nations" to compete for international arbitration business.[2)] Today, that scramble is not only in Western Europe, but also in Asia, Latin America, the Middle East, and Africa. States compete by signing on to the New York Convention, by enacting new international arbitration laws (most typically some version of the Model Law), by (in some instances) funding new arbitration facilities or judicial training, and by removing legal obstacles to foreign attorneys appearing in locally seated international arbitrations. Meanwhile, national court decisions on arbitration are systematically reported in industry publications and subject to global scrutiny. Decisions that support the efficacy of international arbitration are lauded, while those decisions that unduly favor local interests or misapply New York Convention or the Model Law are derided.

The result of all this regulatory competition among States appears to be a race to the top, where the summit is effective and predictable enforcement of arbitration agreements and awards, and reduced judicial and State interference with arbitral proceedings. But States are not the only entities competing in international arbitration.

Apart from States, arbitrators compete for appointments, attorneys compete for clients, institutions compete to administer proceedings, experts compete to provide opinions, various arbitration organizations and academics compete to influence developments in the field, third-party funders compete to finance cases, and the parties compete to prevail in the substantive disputes. Does some or all of this competition involve some form of "regulatory competition?"

The answer to that question turns on the definition of "regulation." While the term is often used in common parlance to refer to government imposed rules, competition in international arbitration is not limited to conventional forms of States-sponsored regulation. Given States' intentionally limited role, other sources order most aspects of international arbitration. And, for the purposes of this discussion, many of those sources would constitute "regulation," at least as that term is understood under broad definitions. For example, Professor Julie Black defines "regulation" as "the sustained and focused attempt to alter the behaviour of others according to defined standards or purposes with the intention of producing a broadly identified outcome or outcomes…."[3)] In addition to reforms by States, rules promulgated by arbitral institutions would easily fit within this definition. Arguably, so would sources of soft law, such as Guidelines promulgated by entities like the IBA, and potentially certain decisions by arbitrators.

To take stock of where we are, competition exists in international arbitration not only among States, but among other sources generate different forms of regulation. Before considering whether this regulatory competition will lead to a race to the top or a race to the bottom, let's consider what the bottom would look like.

The bottom is where parties can use international arbitration to launder money and enforce illegal contracts. The bottom is where arbitrators can fail to disclose known conflicts of interest confident that "pro-arbitration" courts will nevertheless enforce

the award, and where arbitrators can take years to render an award reassured that complicit institutions will look the other way and the opacity of the system will hide these indiscretions from public glare. The bottom is where attorneys can engage in any form of guerilla tactics, including knowingly presenting false evidence to the tribunal, without any objection from the arbitrators who want to preserve their potential future appointments from those attorneys. And finally, the bottom where third-party funders recruit leading arbitrators, tout their affiliation, but then adamantly deny even the possibility of a conflict of interest and the need for disclosure.

While the bottom certainly looks bleak and dismal, it does not seem to be where we are headed. To illustrate that, instead, international arbitration appears to be racing uphill, let's examine, first, competition among arbitral institutions and, second, sources that regulate arbitrator conduct.

Just as more States are joining the completion to host arbitrations, more institutions are competing to be selected to administer those arbitrations. This competition among institutions has both prompted and been pushed by greater transparency so that the relative strengths of institutions can be assessed by parties and attorneys. For example, we see institutions not only publicizing rule changes, but also more detailed statistics about costs, duration, and diversity and other variables about arbitrators. This transparency has made competition among institutions more possible and obvious, prompting in turn a rather fantastic and break-neck pace of reforms to make arbitral proceedings more effective and efficient.

For example, 10 years ago, the availability of interim relief in international arbitration was uncertain, the concept of an emergency arbitrator was virtually unheard of, and the notion of consolidation was pretty much unthinkable. But the need for these innovations, and the perceived advantage of enacting new rules to respond to these needs, has fueled a race among institutions to produce new rules facilitating these practices.

Now let's turn to competition with respect to regulation of arbitrator conduct. Variables that affect this race are parties' interest in winning, arbitrators' interest in lots of appointments (with as little work, as much discretion, and as little oversight as possible), and national courts' interest in demonstrating that they are "arbitrator friendly" by enforcing awards. Add to these features the fact that historically arbitrators not only lead but were more directly involved in the daily management of institutions. In that context, we might imagine an incentive to accommodate fellow arbitrators and help them (and the institution) avoid embarrassing challenges. Moreover, historically arbitrator disclosure obligations were governed by vague standards such as "justifiable doubts" about independence and impartiality. Under these standards, arbitrators enjoyed broad discretion in deciding whether to disclose or consider themselves disqualified. Under these standards, parties were in a precarious position in deciding whether to raise a challenge because they could not know the likelihood of that challenge's potential success. In the absence of countervailing forces against these factors, the race downhill would be on. Instead, arbitral institutions put the brakes on.

Arbitral institutions generally manage arbitrator challenge and disqualification processes—it might be reasonable to estimate that as a practical matter institutions are the final word on 90% or more of challenges. In fulfilling this function, institutions have introduced some important regulatory innovations. Most notably, institutions competitively (lead by the LCIA) began publishing results of disqualification decisions under their rules. Publication of such information was not only a means of increasing transparency, which is a prerequisite for healthy regulatory competition, but also in itself a form of regulation—parties and arbitrators could look to these rulings to assess future conflicts.

Another important innovation was introduction of the IBA Guidelines on Conflicts of Interest in International Arbitration, which were first enacted in 2004 and later revised in 2014. The IBA Guidelines both expanded the bases for disclosure and transformed vague, value-laden qualitative terms into fact-based quantitative terms. Clearer, fact-based criteria reduced arbitrator discretion in determining what constitutes a disclosable conflict. For example, an arbitrator has much more discretion in deciding whether repeated appointments by a party raise justifiable doubts about the arbitrator's impartiality than in determining whether the arbitrator has had three appointments in the past two years under Guideline 3.1.3. This reduction of arbitrator discretion limits the potential for less scrupulous arbitrators to exercise discretion unwisely, to benefit their own interest (to get or retain an appointment) instead of the parties' interest in having a conflict-free tribunal.

I do not have space here to develop fully a thesis about regulatory competition in international commercial arbitration. From the examples above, however, the preconditions that seem essential to produce a race to the top may be summarized as follows:

1) The market is dynamic and sufficiently transparent;

2) Stakeholders in the market enjoy a shared sense of their collective, long-term self-interest;[4] **and**

3) Regulation effectively recalibrates the balance when stakeholder incentives undermine the shared collective self-interest.

In a future publication, I hope to explore in more detail the function of these preconditions and the effect they have on various sources and forms of regulatory competition in international commercial arbitration.

This discussion was originally presented, in a slightly different form, as the keynote address for the 2018 Cambridge Arbitration Day. For this reason, it is fitting to close by identifying one last area of competition that is not among regulators, but is nevertheless important: competition among law school sponsored arbitration days. Over the years, I have been fortunate enough to participate in many such events at Harvard, Columbia, University of Pennsylvania, Penn State, Georgetown (which has now expanded to an arbitration month!), as well as Oxford and most recently Cambridge. Law school arbitration days bring a unique energy, eagerness, and curiosity to the otherwise constant drumbeat of international arbitration events. They

bring fresh perspectives and an optimism about new opportunities as young aspirants seek not only to learn, but to imagine what might be possible in their professional futures. The enthusiasm and thoughtfulness of these young practitioners will undoubtedly fuel international arbitration in its continued race to the top.

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References

↑1 In the United States, unlike many civil law jurisdictions, a corporation can be incorporated or have its legal "seat" in one state but have its principal operations in another. Although apparently coincidence, both corporate law and international arbitration use the term "seat" to describe the juridical home, which can be separate from a company's operations in corporate law, or the location of hearings for an international arbitration.

↑2 William W. Park, 'National Law and Commercial Justice: Safeguarding Procedural Integrity in International Arbitration', 63 Tul. L. Rev. 647, 680 (1989)

↑3 Julia Black, Critical Reflections on Regulation, 27 Austl. J. Legal Phil. 1, 26 (2002)

↑4 It is beyond the scope of this blog to consider whether international investment arbitration is similarly in a race to the top, and certainly some critics would seem to suggest it is instead on a race to the bottom. In examining why two similar processes could have different vertical trajectories, the absence of a shared sense of collective self-interest in investment arbitration is an important consideration.

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