Private Justice in a Global Economy: From Litigation to Arbitration

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The study of private settlement of cross-border trade and investment disputes through international commercial arbitration or other mechanisms has been much neglected by scholars of international political economy and international institutions. This oversight is attributable in part to the traditional focus of international relations on intergovernmental international organizations and the lack of attention to private international institutional arrangements.[1] A further reason for the oversight is that arbitration is resolutely private, making information exceedingly difficult to obtain. Two distinguished international arbitrators, Alan Redfern and Martin Hunter, recently observed that the study of the practice of international commercial arbitration is like peering into the dark. Few arbitral awards are published and even fewer procedural decisions of arbitral tribunals come to light.[2]

Despite this difficulty, private forums for international commercial dispute resolution, of which international arbitration is an increasingly popular type, deserve much closer attention by scholars of international relations. After virtually disap-

I am grateful to Ken Abbott, Beth Yarbrough, Barbara Koremenos, Charles Lipson, Ronald Mitchell, Antonio Ortiz, and Duncan Snidal for excellent comments on earlier drafts. I also thank Debbie Davenport, Miles Kahler, Robert Keohane, Lisa Martin, Jeffrey Stacey, and the participants of the Rational Design project, the Program on International Politics, Economics, and Security (PIPES) at the University of Chicago, and a seminar at Harvard University Business School for helpful suggestions. Special thanks to Dominique Hascher, General Counsel and Deputy Secretary General of the International Court of Arbitration of the International Chamber of Commerce in Paris, for inviting me to do an internship at the court in 1998, and to Anne-Marie Whitesell for welcoming me to her legal team at the court. I benefited greatly from discussions on international commercial arbitration with Adrian Winstanley of the London Court of International Arbitration, Eva Müller of the Arbitration Institute of the Stockholm Chamber of Commerce, as well as Gerald Aksen, Lucienne Carasso Bulow, Alessandra Casella, Yves Dezalay, Bryant Garth, Thomas Heller, Christian Joerges, William Park, Susan Rose-Ackerman, Martin Shapiro, Anne-Marie Slaughter, Hans Smit, Francis Snyder, Job Taylor, and Raymund Werle.

1. Two notable exceptions are Lipson 1985; and Cutler 1995.

2. Redfern and Hunter 1991, xv. Information mainly comes from tapping the experience of the principal arbitral institutions or by looking at individual cases that come before the courts, either as a result of enforcement proceedings or because an arbitral award is challenged by the losing party.

International Organization 55, 4, Autumn 2001, pp. 919–947
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https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

pearing during the age of nation-state ideology in the nineteenth century, international commercial arbitration has been staging a formidable comeback in the past twenty years. Today's scene calls to memory the flourishing era of arbitration practices and institutions associated with the international trade fairs of medieval Europe. The number of arbitration forums has grown from a dozen or so in the 1970s to more than one hundred in the 1990s, and the caseload of major arbitral institutions has more than doubled during the same period.[3] Lawyers and judges agree that "there is [now] clear evidence of something of a world movement . . . towards international arbitration."[4] The *Economist* recently called arbitration "the Big Idea set to dominate legal-reform agendas into the next century."[5]

Even though the focus of this study is on various arbitration options, it also reflects more broadly on the market of institutions for international commercial dispute resolution for private parties. It addresses the question of why different forums for dispute resolution are selected.

In the domestic context parties who seek a binding method of resolving disputes through third-party intervention have the choice between a national public court and private arbitration. In the international context such a choice does not exist because there are no international public courts that handle international commercial disputes involving only private parties.[6] Therefore, the choice for international private parties is between recourse to a national court (that is, litigation) and recourse to private international dispute resolution, namely international commercial arbitration or so-called alternative dispute resolution (ADR) techniques, such as conciliation and mediation.[7]

Arbitration is a binding, nonjudicial, and private means of settling disputes based on an explicit agreement by the parties involved in a transaction. Such an agreement is typically embodied in the terms of a contract between the parties. Alternatively, if the contract is silent about the dispute-resolution method, the parties can select the method when the dispute arises.[8] Arbitration entrusts the settlement of a question to one or more persons who derive their powers from the private agreement.[9] Unlike judges in public courts, who must follow fixed rules of procedure and apply the laws of the land, arbitrators can dispense with legal formalities and may apply whatever procedural rules and substantive law best fit a case.

3. Brown 1993.

4. Kerr, Lord Justice of England, preface to Craig, Park, and Paulsson, 1990, xii.

5. *The Economist*, 18–24 July 1992, 17, survey on the legal profession. See also Wetter 1995.

6. The only exception is the European Court of Justice, which may deal with certain disputes between private parties under European Community law. Redfern and Hunter 1991, 25; Burley and Mattli 1993; Mattli and Slaughter 1995 and 1998a,b.

7. The term *jurisdiction clause* in an international contract is generally used to describe a forum selection that designates a public court to hear a case, while an *arbitration clause* refers to private international dispute resolution.

8. Even if the parties have contractually agreed to use one method, they may switch to another if they feel that the latter is more appropriate for a given dispute.

9. Mustill and Boyd 1989, 38–50.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

Arbitration becomes international when the parties to a dispute reside or conduct their main business in different countries. The term *commercial* in international commercial arbitration is broadly conceived and covers activities such as sale of goods, distribution agreements, commercial representation of agency, leasing, consulting, transportation, construction work, joint ventures, and other forms of industrial or business cooperation.[10]

International commercial arbitration can be conducted in two ways, as ad hoc arbitration or as institutional arbitration. Ad hoc arbitration does not rely on the supervision or formal administration of an arbitration center. Institutional arbitration, in contrast, is done under the aegis of an arbitral center, usually according to the institution's own rules of arbitration.[11] The most established of these institutions are the International Court of Arbitration (ICA) of the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), and the Arbitration Institute of the Stockholm Chamber of Commerce (SCC Institute).[12] Many more arbitral institutions have been set up in the past decade, notably in Asia, the Middle East, and North America.[13]

I argue that the various forums of dispute resolution can be understood as indirect products of rational selection where actors select those institutions that are most effective and appropriate for given disputes. In the United States, for example, the legal counsels of major corporations have spearheaded the recent trend away from sometimes cumbersome and lengthy court proceedings toward faster and less expensive methods, such as ADR. Similarly, the surge in popularity of arbitration as a means of international commercial dispute resolution can be attributed to features of arbitration that the international business community values for a growing number of disputes, notably in the areas of technology transfer, intellectual property, engineering, and construction. These features include flexibility, technical expertise, privacy, confidentiality, and speed. In short I describe a market of dispute-resolution methods where different "suppliers" offer different venues from which the firms on the demand side can select based on their design problems. This creates an accelerated evolutionary process of forum formation (that is, accelerated by rational

10. This definition is suggested in the United Nations Commission for International Trade Law (UNCITRAL) Model Law, Art. 1 (1), fn.

11. Institutional arbitration is also referred to in the literature as "administered" or "supervised" arbitration. On institutional arbitration, see Slate 1996; Hoellering 1994; Vigrass 1993; Graving 1989; and Lowenfeld 1993.

12. Another major institution is the American Arbitration Association. Its focus is primarily on domestic arbitration; for this reason, it is omitted from the discussion in this study. (Yearly, it handles about forty thousand domestic and two hundred international arbitration cases.)

13. Due to limited space, I focus primarily on international commercial arbitration and not the more specialized arbitration as offered, for example, by the Society of Maritime Arbitration (New York), the Grain and Feed Trade Association (London), and various stock and commodity exchanges. Nevertheless, I would argue that the framework used here does shed light on some key institutional features of commodity trade and maritime arbitration. See also Mentschikoff 1961; Harris, Summerskill, and Cockerill 1993; Summerskill 1993; Covo 1993; and Johnson 1991 and 1993.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

anticipation of what will sell and what will work), and the result will be very much the same as a direct rational-design effort.[14]

The key institutional dimensions along which the various methods of international dispute resolution vary are (1) procedural and adaptive flexibility, and (2) centralization of procedural safeguards and information collection. For example, flexibility is typically much lower in public court proceedings than in institutional arbitration, ad hoc arbitration, or ADR; and centralization is present in institutional arbitration but not in ad hoc arbitration or ADR.

Drawing on the analytical framework developed by Barbara Koremenos, Charles Lipson, and Duncan Snidal, I elaborate on several of the Rational Design conjectures, linking the institutional features of dispute-resolution methods to the needs or demands of private parties.[15] These conjectures can be summarized as follows: Centralization of forums to which private international parties resort to resolve their disputes increases with uncertainty about the parties' preferences or behavior (conjecture C1, CENTRALIZATION increases with UNCERTAINTY ABOUT BEHAVIOR). Such uncertainty may be low, for example, if the parties are locked in a mutually beneficial, ongoing commercial relationship; in this case, the parties' institutional demands for resolving disputes will be markedly lower than those of firms with few interactions and little knowledge of each other.

However, full information and adequate knowledge are not always sufficient to ensure compliance; enforcement problems may remain severe if the payoff from unilateral defection is significantly greater than that from mutual cooperation at the dispute-resolution stage. In this case, strong centralized procedural safeguards will be necessary to foil defection. This argument is summarized in conjecture C4, CENTRALIZATION increases with ENFORCEMENT problems.

Centralization is also likely to increase with the parties' uncertainty about the state of the world (conjecture C2, CENTRALIZATION increases with UNCERTAINTY ABOUT THE STATE OF THE WORLD)—that is, with the parties' relative lack of information, for example, about the legal environment (the laws and integrity of judges) in which arbitration takes place and about the conditions for enforceability of arbitral awards. More generally, traders with little experience in international exchange or traders from very different cultural and linguistic regions may rely more heavily on centralized support and expertise for resolving their disputes than veteran traders operating in a relatively homogenous region.

Finally, uncertainty about the state of the world may also result from the susceptibility of an issue-area to new developments or unanticipated shocks that may leave parties in uncharted legal territory. In such situations institutional flexibility may be required to resolve disputes effectively. For example, firms operating at the forefront of new production and exchange methods are likely to

14. As illustrated later, the distinction between suppliers and demanders is useful analytically, but in practice it is often blurred because methods for resolving private disputes are provided mostly by private organizations run and funded by firms themselves.

15. Koremenos, Lipson, and Snidal, this volume.

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prefer a flexible form of dispute resolution that allows them to tailor rules regarding procedure, evidence, and even the substance of the case to their evolving needs. This relationship is captured by conjecture F1, FLEXIBILITY increases with UNCERTAINTY ABOUT THE STATE OF THE WORLD.

The study is organized as follows. In the first section I briefly review and critique themes in the institutional literature in international relations and economics that are relevant to this study. In the second section I discuss the key institutional differences among the various methods of international commercial dispute resolution and introduce the principal international arbitral forums. After laying this groundwork I seek to explain within the Rational Design framework why private parties select the dispute-resolution forums they do. I conclude with a discussion of ways to broaden the study.

Private Dispute Resolution and the Institutional Literature

Political scientists and economists have developed two theoretical schools, regime theory and new institutional economics (NIE), respectively, that seek to explain institutional arrangements. Unfortunately, the two schools have based their theories in part on assumptions that move the theories' reach away from the types of institutional arrangements discussed in this study.

"International regimes" are defined broadly as sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors' expectations converge in a given area of international relations.[16] In a world of rapidly growing interdependence regimes are said to help states correct "market failures" stemming from asymmetric information, moral hazard, risk, and uncertainty.[17] Regime theorists have shed important light on the nature of interstate relations, but they have overlooked the importance of nonstate actors in international relations. In particular they have failed to examine the extent to which international market players themselves can remedy "market failures" by creating private institutional arrangements. This omission has deprived the theory of the comparative institutional perspective necessary to assess the desirability of intergovernmental regimes. Only a comparative institutional analysis that weighs the costs and benefits of both private and public institutional remedies of "market failures" can provide a framework to address questions of efficiency, effectiveness, and optimal institutional design.[18] I am not implying that regime theory is flawed but rather suggesting that the theory could be strengthened by extending its focus beyond state behavior. For example, there is nothing that keeps the ICC from being viewed as a regime for its members, as I show later.

16. Krasner 1983, 2.
17. Keohane 1984, 93.
18. A related point is made in Demsetz 1969.

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NIE is a rapidly growing field that has developed from the pioneering work of Oliver Williamson. It offers a rigorous conceptual framework for comparative institutional analysis.[19] NIE seeks to explain varying types of industrial organization, from straightforward market exchange to vertically integrated exchange, based on differences in transaction costs. The principal dimensions within which transactions differ are asset specificity, uncertainty, and frequency. The first is the most important; it represents the degree to which durable investments are made to support particular transactions.

NIE postulates that transaction costs are economized by assigning transactions (which differ in their attributes) to governance structures (which differ in their adaptive capacities and associated costs) in a discriminating way. Governance structures are the organizational frameworks within which the integrity of a contractual relation is decided and maintained. In particular, the higher the asset specificity, the greater the institutional complexity needed to promote efficient exchange. Examples of governance structures are economic hostages, vertical integration, unitization, and multinationalism.[20]

Nevertheless, Williamson's framework is not without shortcomings. For example, none of Williamson's governance structures would be needed if courts could resolve disputes swiftly and inexpensively. But Williamson argues that court ordering or legal centralism is inefficient. "Most studies of exchange assume that efficacious rules of law regarding contract disputes are in place and are applied by the courts in an informed, sophisticated, and low-cost way. . . . The facts, however, disclose otherwise. Most disputes, including many that under current rules could be brought to a court, are resolved by avoidance, self-help, and the like. . . . [And] because the efficacy of court ordering is problematic, contract execution falls heavily on [governance structures]."[21] This proposition is problematic. First, courts are institutions, too. A comparative institutional analysis that sets aside a large universe of institutions on the grounds of their alleged inefficiency risks being internally inconsistent. Within Williamson's framework, it is incomprehensible why inefficient institutions come into being or survive. Second, even if it established analytically (by way of ad hoc assumptions) that public courts and public law are inefficient, there remains the question of why NIE does not consider their next best substitutes, namely private courts and private law.

In short, NIE provides a sophisticated analytical framework for studying varying forms of governance. However, by overlooking the importance particularly of private courts and law, NIE may be accused of truncating the full range of variation on the dependent variable (governance forms) and thus suffering from selection bias. Williamson recognized that "a place for law [should] properly [be] provided in

19. Williamson 1975 and 1985.

20. Yarbrough and Yarbrough have recently added to this list various forms of trade liberalization. Their analysis provides a good example of how NIE can enrich the study of international institutional arrangements. See Yarbrough and Yarbrough 1992.

21. Williamson 1985, 20, 32.

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any comprehensive study of contract."[22] Beth Yarbrough and Robert Yarbrough have responded to this invitation and are presently extending Williamson's framework to incorporate law and public courts in a way that is consonant with the analysis offered in this study. Courts, they argue, are not generically inefficient; rather they are not very efficacious for certain types of transactions. One type is those transactions in which asset specificity makes the historical context of a relationship critical to resolving disputes. A second type is those in which the confrontational nature of court proceedings risks damaging future relations (hence courts' historical reluctance, until recently, to become involved in many family matters). In such cases, Yarbrough and Yarbrough predict noncourt means of dispute settlement.[23]

Institutional Features of International Commercial Dispute-resolution Methods

The range of methods for resolving international commercial disputes is wide. It includes litigation in public courts, several arbitration options, and so-called ADR techniques. In this section I highlight the institutional characteristics of the various methods.

Flexibility in Dispute Resolution

A key feature of arbitration is its high degree of procedural flexibility. Arbitration provides the parties with full control over the arbitral process. The parties may decide the number of arbitrators comprising the arbitral tribunal, the appointment procedure of the arbitrators, the place of arbitration, the powers of the tribunal, and the applicable law in the dispute. In contrast, a trial before a national court must be conducted in accordance with the rules of that court. Further, public court proceedings are typically open to the public, and court decisions are published and readily available. Arbitral proceedings, however, are held in private; details about the cases, including the arbitral awards, are confidential.[24] Privacy may help firms to hide a number of facts from competitors and the public in general, such as trade secrets and know-how not guaranteed by patents or financial difficulties and other problems. Nevertheless, the parties may choose to publicize arbitral decisions either to create precedents or to provide authoritative interpretations of standard contract terms.[25]

22. Ibid., 168.

23. Beth Yarbrough, pers. comm. with the author.

24. René David, a leading French expert of international arbitration, notes that "secrecy, which is one of the reasons why arbitration is resorted to by the parties, is easily extended . . . to everything concerning arbitration." See David 1985, 31.

25. Cost is a factor, unrelated to flexibility, that is frequently said to distinguish litigation from arbitration. Arbitration centers, for example, claim that litigation is much more expensive than arbitration. This need not necessarily be true, however. First, although litigants do not pay the salary of a judge,

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Flexibility characterizes not only arbitral procedures but also the actual institutions of arbitration, such as the ICA, the LCIA, and the SCC Institute. These forums can respond much more quickly to demands for new dispute-resolution rules and services than public courts. The reason is evident: Private courts are demand driven. The very same market actors who request new rules also control these courts. As noted by Alessandra Casella, these forums are shaped from the "bottom," that is, by the firms that voluntarily finance and share the "club goods" they need.[26] Thus the demanders are also the suppliers; they possess full information on how new business practices or changing market conditions affect their dispute-resolution needs. They are capable of quickly responding to new needs by creating new services and by rewriting the charters of their courts. The frequent revisions of the rules of major arbitral institutions attest to the high degree of institutional flexibility of these forums.

Many of today's arbitration practices evoke medieval Europe's private courts and the Law Merchant, a body of private commercial rules and principles that were distinct from the ordinary law of the land. The merchant courts sat in fairs, markets, seaport towns, and most other large centers of commercial activity. Merchant courts chose as judges merchants who possessed intimate knowledge of particular commercial practices and techniques. W. Mitchell, a historian of the Law Merchant, writes, "The summary nature of its jurisdiction . . . characterized the Lex Mercatoria. Its justice was prompt . . . [and] the time within which disputes [had to] be finally settled was narrowly limited."[27] Sea merchants, for example, demanded that disputes be settled "from tide to tide according to the ancient law marine and ancient customs of the sea . . . without mixing the law civil with the law maritime."[28] Another reason for using guild courts was that "under severest penalties, [the guilds] forbade members to appeal, in cases where they alone were concerned, to any court save that of the guild."[29] Merchant courts relied on sanctions such as ostracism and boycott of all future trade to ensure that traders would be held to the resolution dictated by the arbiters.[30]

Besides arbitration and litigation, there are ADR techniques. The most widely known forms of these are conciliation and mediation. Like arbitration, conciliation and mediation offer the parties great procedural flexibility. The parties pick

parties involved in arbitration must pay the fees and expenses of the arbitrators. Second, litigants are not charged for using the public facilities of the courts of law, but the parties in arbitration pay the administrative fees and expenses of an arbitral institution and these can be substantial, particularly when they are assessed by reference to the amount in dispute. In short, arbitration may or may not be less expensive than litigation; much depends on the specifics of the case and the attitudes of the parties to a dispute. Consequently, in the analytical part of the study I do not consider cost as an institutional dimension.

26. Casella 1996; see also Dezalay and Garth 1996.

27. Mitchell 1904, 12–13.

28. Ibid., 20.

29. Ibid., 42.

30. Benson 1989. See also Milgrom, North, and Weingast 1990; Greif, Milgrom, and Weingast 1994; and Cutler 1995.

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conciliators or arbitrators of their choice and design procedures that best fit their cases. Typically, a mediator seeks to reduce the distance between the parties' positions and make the parties understand each other's point of view, in order that they may achieve a compromise solution. A conciliator performs a different function. After consulting all sides and evaluating the evidence, the conciliator draws up the terms of a solution that is hopefully acceptable to all parties involved in the dispute. Conciliation and mediation differ in one important respect from arbitration: they do not result in a binding or enforceable award. A mediator cannot compel the parties to reach a settlement, and a conciliator has no power to impose a compromise solution on the parties.[31]

Centralization of Forums for Resolving Disputes

International commercial arbitration can be conducted in two ways, as institutional arbitration or ad hoc arbitration. Ad hoc arbitration differs from institutional arbitration in that it does not rely on the supervision or formal administration of an arbitration center. In this sense it is the least institutional form of arbitration. In ad hoc arbitration, the parties are "on their own"; they are not bound by time limits set by arbitral institutions, and their proceedings are not monitored by any central body. The parties can leave the issuance of arbitration procedures to their arbitrators or develop their own rules and design their own arbitral management either in the initial contract or after a dispute has arisen. Alternatively, the parties may simply adopt or adapt the rules of one of the major arbitration centers but, again, without entrusting the administration of the arbitration to such centers.[32] Another increasingly popular option is to use the arbitration rules of the UN Commission on International Trade Law of 1976 (UNCITRAL arbitration rules). Reference in the parties' contract to the UNCITRAL rules will immediately incorporate a full-blown set of procedures designed specially for ad hoc arbitration.[33]

Ad hoc arbitration to resolve international commercial disputes is similar to ADR in that neither the mediator nor the conciliator is monitored by any central institution. Like the mediator and conciliator, the arbitrator in an ad hoc case depends entirely on the good will of the parties for a smooth process of dispute resolution. Ad hoc arbitration and ADR contrast sharply with institutional arbitration as offered, for example, by the ICA, where the provision of procedural safeguards and information is highly centralized. They also differ from arbitration as conducted by the LCIA, and the SCC Institute. These three institutions are

31. For this reason, ADR is sometimes combined with an adjudicatory process as a fall-back solution. For example, a contract may provide for a specific time limit to start some form of mediation or negotiation after which arbitration becomes the only method available. Park 1997b.

32. In ad hoc arbitration, parties may rely nevertheless on an "appointing authority" (for example, a court, an arbitral institution, or the chairman of a trade association) to appoint arbitrators.

33. On ad hoc arbitration, see Aksen 1991; and Arkin 1987.

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TABLE 1. *Institutional dimensions of methods for resolving international commercial disputes*

	Litigation (public courts)	*Institutional arbitration (ICA, LCIA, SCC)*	*Ad hoc arbitration and ADR*
Flexibility	Low (typically)	High	High
Centralization			
Centralized information gathering	N.A.	High to medium	None
Centralized monitoring and other safeguards	N.A.	High to medium	None

considered in order.[34] Table 1 summarizes the key institutional dimensions along which the various methods of international commercial dispute resolution vary.

Illustration of Institutional Arbitration: Three Private Forums

International Chamber of Commerce Arbitration. The ICC is a business organization offering a wide range of services to firms engaged in international trade and investment, including commercial dispute resolution. Founded in 1919, it counts today as members over 7,000 enterprises and commercial organizations in 114 countries. Its organizational structure includes a general secretariat in Paris, employing some eighty-five persons and a secretary-general. The supreme organ is the council, which meets twice a year. Members of the council are appointed by the national committees of the ICC. Each committee may select one to three members according to its contribution to the ICC budget. The council's president is elected for a two-year term. The ICC has established several commissions and special committees to address major issues relating to international commerce, such as intellectual property, competition law, taxation, transportation, telecommunications, the environment, and bribery. Annual conferences are supplemented every three years by an ICC Congress, attended on average by some one thousand participants.[35]

A major organization within the ICC is the ICA, established in 1923.[36] The idea of such a court was conceived after World War I by businessmen wrestling with the practical difficulties of designing a dispute-resolution process acceptable to mer-

34. Most of the information about these forums comes from interviews I conducted during an internship at the ICA and visits to the LCIA and the SCC in March and April 1998.

35. Craig, Park, and Paulsson 1990, 25–27.

36. Before 15 June 1989, the court's name was Court of Arbitration of the International Chamber of Commerce.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

chants of different national backgrounds.[37] It is composed of a chair, eight vice-chairs, and fifty-seven members selected by the ICC national committees and professional organizations. The members are professors, former judges, barristers, and lawyers with expertise in international commercial law and arbitration. They represent a wide range of legal traditions, including civil law, common law, and Islamic law. The ICA meets four times a month, once in plenary session and three times as comité restraint. The ICA is assisted by a secretariat located at ICC headquarters in Paris. The secretariat has a staff of thirty-eight people, including six teams of lawyers from various countries. It assumes responsibility for the day-to-day administration of ICA cases and keeps copies of all written communications and pleadings exchanged in the arbitration proceedings. It also provides assistance and information to parties, counsel, and arbitrators. The provision of centralized information is a particularly valuable service because in an international arbitration case many different national systems of law may need to be consulted, depending on where the arbitration takes place and what issues are involved. National arbitration laws may determine questions of the capacity of the parties to agree to arbitration, the validity of the arbitration agreement, the "arbitrability" of the subject matter of the dispute, and the recognition and enforcement of arbitral awards.[38]

ICC arbitration is characterized not only by a high degree of centralized information gathering but also by the extensive monitoring offered by the ICA. Arbitration proceeds in five steps:

1. The claimant submits a request for arbitration to the secretariat, and the secretariat transmits the request to the defendant, who must respond within thirty days.

2. The court appoints arbitrators and when the parties do not make their own selection chooses the place of arbitration.[39] In selecting the arbitrators, the court relies in part on recommendations from the ICC national committees. The court also fixes the arbitrators' fees and estimates the overall arbitration costs based on the amount in dispute. After receiving half of the advance on arbitration costs, the secretariat transmits the file to the arbitral tribunal. The fixing of fees by the court is intended to prevent the parties from being placed in the uncomfortable position of having to negotiate issues of remuneration with those who will be responsible for deciding their case or otherwise to avoid challenges to an arbitrator's independence.

37. Craig, Park, and Paulsson 1990, xxi. The ICA is supplemented by four other ICC bodies dealing with the settlement of international commercial disputes. They are the Commission on International Arbitration, which advises on the development of ICC Rules of Conciliation and Arbitration; the International Maritime Arbitration Organization; the International Center for Technical Expertise; and the Standing Committee on Regulation of Contractual Relations, which gives parties the possibility of referring to a neutral outsider to adjust contracts whose performance is threatened by fundamentally changed circumstances. See Craig, Park, and Paulsson 1990, 27–28.

38. Redfern and Hunter 1991, xvi. See also Gentinetta 1973.

39. ICC arbitral tribunals are composed of one or three arbitrators.

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3. Within two months of receiving the file, the tribunal submits a document called the "Terms of Reference to the Court." This procedure for arriving at the terms can be compared to a prehearing conference, where the arbitrators get to know each other and become familiar with the specifics of the case. The document summarizes the parties' respective claims, states the applicable law and the place of arbitration, and specifies the procedural rules (for evidence, witness statements, and so on) The court checks the Terms of Reference for conformity with ICC rules.
4. As soon as the second half of the advance is paid, the arbitral tribunal proceeds with the case. Within six months (which the court may extend), the tribunal submits a draft award to the court.
5. The court scrutinizes the arbitral award. The court may draw the arbitrators' attention to points of substance or may suggest modifications to the form of the award.[40] Once the court is satisfied, it approves the award, and the secretariat notifies the parties.

The docket of the ICA reflects the growing popularity of ICC arbitration. The first three thousand requests for arbitration were filed between 1923 and 1977. The next three thousand were lodged between 1977 and 1987. In 1991 alone, 333 cases were filed; the yearly number of cases kept growing steadily, reaching 450 in 1997.[41] About 54 percent of the 5,666 parties involved in ICC arbitration are from Western Europe. The most frequently represented nationalities are, in order, France, United States, West Germany, Italy, United Kingdom, Switzerland, Yugoslavia, Netherlands, Belgium, Egypt, Spain, Austria, Rumania, Sweden, and Greece. A recent development is the upsurge of ICC arbitration involving parties from Eastern Europe, Latin America, and South East Asia (7.9, 11.5, and 9.5 percent, respectively, of all parties in 1996).[42]

The London Court of International Arbitration. The LCIA, another long-established arbitration institution, was inaugurated in 1892 as the London Chamber of Arbitration on the initiative of the Corporation of the City of London and the London Chamber of Commerce and Industry. In 1903 the tribunal's name was changed to the London Court of Arbitration. A joint committee, comprising representatives from the Corporation of the City of London and the London Chamber of Commerce, was formed to administer the activities of the court. In 1975 the Institute of Arbitrators (later to become the Chartered Institute of Arbitrators) joined the other two administering bodies. In 1981 the name was changed to the London Court of International Arbitration to reflect the nature of its work, which

40. The ICA returns roughly 15–20 percent of the awards to the arbitrators for revision. See Dezalay and Garth 1996, 47–48; and Smit 1994, especially 68–72.

41. See Craig, Park, and Paulsson 1990; and *The ICC International Court of Arbitration Bulletin*, various issues.

42. *The ICC International Court of Arbitration Bulletin*, various issues.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

was moving steadily from domestic to international arbitration. In 1986 the LCIA was incorporated as a limited company under the control of a board of directors. It is composed of a president, who is also the chairman of the board of directors, four vice-presidents, and about twenty other members, all of whom are international arbitrators from major trading countries. The number of members drawn from the United Kingdom is restricted to no more than one quarter of the total. The court is assisted by a small London-based secretariat of about five people.

The LCIA is somewhat less involved in arbitration proceedings than the ICA. Its main function is to select arbitrators or to confirm party-nominated arbitrators. Like the ICA, the LCIA has the right to reject party-nominated arbitrators if it judges that they are not independent or that they are otherwise unsuitable. The LCIA fixes the arbitrators' fees and ensures that the arbitrators comply with the procedural timetable and respect all other rules of LCIA arbitration. Unlike the ICA, the LCIA does not require arbitrators to draft terms of reference, nor does it scrutinize arbitral awards.

Despite recent efforts to further internationalize its services, notably through the creation of four so-called users councils for Europe, North America, Asia-Pacific, and Africa, the LCIA remains an institution with a British bent.[43] This is reflected, for example, in the fact that all LCIA presidents until 1993 were British, and that 60 percent of court-selected arbitrators and 65 percent of party-nominated arbitrators are nationals from the United Kingdom. The parties most frequently involved in cases being considered by the LCIA come from the United Kingdom, United States, Australia, Canada, India, and Hong Kong.

The Arbitration Institute of the Stockholm Chamber of Commerce. A frequently named third major international arbitration institution is the SCC Institute, established in 1917 as an independent entity within the SCC. The SCC Institute is composed of a board of three members (and three deputies). The chairman of the board has to be a judge with expertise in commercial and industrial matters. Of the two other members, one has to be a practicing lawyer, the other "a person who enjoys the confidence of the business community."[44] The board is assisted by a small secretariat.

Similar to the LCIA, the SCC Institute's main role is to act as an authority to appoint arbitral tribunals. Challenges against arbitrators are handled directly by the board. The rules of the SCC Institute require that a tribunal deal with a case in an "impartial, practical, and speedy fashion," give all parties "sufficient opportunity to present [their cases]," and reach a decision "no later than one year after the case has been referred to the arbitral tribunal."[45]

43. "Users' councils" have been set up to keep the international business community apprised of the arbitration services offered by the LCIA and to identify the changing needs of business to be able to respond quickly to these needs. Membership in these councils is by invitation; members include lawyers, arbitrators, and multinational industrial, commercial, and trading organizations.

44. SCC 1988, para. 2.

45. Ibid., para. 16, 26.

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The development of the SCC Institute into a major center of international commercial arbitration dates from the 1970s when the United States and the Soviet Union agreed that trade contracts between the two countries should contain a clause providing for arbitration according to the rules of the SCC Institute. The caseload of the institute grew to a yearly average of about thirty-five in the 1980s and one hundred in the 1990s. In 1997, eighty-two international cases and twenty-nine domestic cases were registered with the secretariat. The most frequently represented nationalities in recent years have been Russian, Ukrainian, and American.

Explaining Forum Selection and Institutional Variety

In this section I seek to explain why actors engaged in international trade and investment select different methods of international commercial dispute resolution. I argue that these methods respond to the varying institutional needs of different types of disputes and disputants. Such needs can be explained in terms of the uncertainty about the preferences or behavior of contractual partners, the severity of the enforcement problem, and the uncertainty about the state of the world. The empirical evidence discussed offers strong support for several Rational Design conjectures.

Uncertainty, Enforcement, and Centralization

Uncertainty about preferences and behavior varies with the relative intimacy of the relationship between parties involved in international exchange. Intimacy or closeness of a relationship, in turn, depends on the parties' homogeneity, their frequency of interaction, and their distance from each other. Robert Cooter and Janet Landa, for example, have documented how traders belonging to ethnically homogeneous commercial groups, such as the East Indians in East Africa, the Syrians in West Africa, and the Chinese in Southeast Asia, experience considerably lower levels of behavioral uncertainty when dealing with one another than when dealing with outsiders.[46] One reason is that such trading groups serve as repositories of trust, which reduces the probability of a breach of contract between insiders.

Disputes may occasionally erupt even among insiders, but they are likely to be resolved more cooperatively than conflicts among strangers.[47] Marc Galanter, a leading exponent of the law and society movement, has argued that "in order to understand the distribution of [domestic] litigation, we must go beyond the characteristics of individual parties to consider the relations between them. Are the parties strangers or intimates? Is their relationship episodic or enduring? Is it

46. See, for example, Cooter and Landa 1984; and Landa 1981. See also Greif 1992; and Curtin 1984.
47. For examples, see Auerbach 1983. See also Ellickson 1991.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

single-stranded or multiplex?"[48] He finds that, generally, the more inclusive and enduring a relationship between a set of parties, the less likely disputes will be taken to official forums (public courts); instead, such parties will seek to resolve their differences in so-called embedded forums, that is, forums that are part of the social setting within which a dispute arose.[49] A classic illustration of embedded commercial interactions and dispute resolution is Stuart Macaulay's study of local business practices among firms in Wisconsin. Macaulay finds that uncertainty about contract performance is reduced by widely accepted local norms (for example, "commitments are to be honored in almost all situations—one does not welsh on a deal," and "one ought to produce a good product and stand behind it") and by close personal relationships across the boundaries of local business organizations. He notes that "salesmen often know purchasing agents well. The same two individuals occupying these roles may have dealt with each other . . . [for up to] 25 years. Each has something to give the other. . . . [T]op executives may [also] know each other. They may sit together on government or trade committees. They may know each other socially and even belong to the same country club."[50] Disputes in this business community are frequently settled without reference to the contract or potential or actual legal sanctions. "If something comes up, you get the other man on the telephone and deal with the problem. . . . One doesn't run to lawyers if [one] wants to stay in business."[51]

These examples shed light on the varying degrees of centralization of forums for resolving international commercial disputes, suggesting the following conjecture: Centralization of forums to which private international parties resort to resolve their disputes increases with the uncertainty about the parties' preferences or behavior. This conjecture is in line with Rational Design conjecture C1, CENTRALIZATION increases with UNCERTAINTY ABOUT BEHAVIOR.[52] Centralization implies a high degree of central provision of procedural safeguards and information. Such provision is characteristic of institutional arbitration; it is absent, however, in ad hoc arbitration or ADR (see Table 1).

Parties involved in an ongoing mutually beneficial relationship (possibly with dealings along many different fronts) are less likely to rely on highly institutionalized forms of dispute resolution than parties with no anticipated future relationship, that is, parties that are not repeat players or do not belong to some close-knit trading

48. Galanter 1993, 24.

49. See also Galanter 1981. For examples of embedded forums, see Doo 1973; *Columbia Journal of Law and Social Problems* 1970; Bernstein 1992; and Maitland 1936.

50. Macaulay 1963, 63.

51. Ibid., 61.

52. Note that I am interested in knowing not which dispute-resolution clause the parties write into a contract but which method they ultimately use. The contractual provision may differ from the actual method used. For example, parties that write an ICC arbitration clause into their contract may decide to use ad hoc arbitration when a dispute erupts. Similarly, parties may choose some form of arbitration rather than complying with a jurisdiction clause. Some contracts have no provision for resolving disputes; in these cases the parties will choose the appropriate forms when disputes erupt, provided the parties have an interest in settling their disputes. Coe 1997, 56, 161.

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community. There are two reasons. First, parties in a continuing relationship can more easily control each other because the expected future gains can serve as hostage.[53] They are locked in a "win-win" situation; thus each other's behavior is quite predictable, for the parties have little to gain (but potentially much to lose) from using dilatory tactics or adopting other forms of noncooperation. They are anxious to maintain good relations and are therefore likely to be interested in reaching a quick and amicable settlement. Second, parties in a continuing relationship typically have good information about each other's past behavior, past problems, and past solutions. This knowledge may be usefully brought to bear in a new instance of conflict.

International arbitrators and lawyers whom I have interviewed have confirmed the importance of the nature of a business relationship in determining how a dispute is likely to be resolved. Typically, parties in long-term relationships have a strong preference for settling disputes through ADR or ad hoc arbitration. This finding is also supported in several writings. Bertie Vigrass, former registrar of the LCIA, summarizes the evidence as follows: "In the traditional fields of arbitration, such as maritime, construction, insurance, and commodity, it is usual for the majority of arbitrations to be 'ad hoc' in nature. This is probably because there is an on-going relationship between parties, their legal representatives, and arbitrators."[54] Four leading international arbitrators—Martin Hunter, Jan Paulsson, Nigel Rawding, and Alan Redfern—have similarly noted that "ADR provides an effective means of resolving disputes between parties who have an interest in maintaining an on-going business relationship. The parties approach the process in a spirit of negotiation and compromise, instead of adopting the adversarial positions associated with litigation."[55]

The extent of centralization of a dispute-resolution method, however, is not solely determined by the relative uncertainty about the parties' preferences or behavior. Enforcement problems may persist even in the presence of good information and knowledge about the parties if the payoff from unilateral defection is significantly greater than the payoff from mutual cooperation at the dispute-resolution stage. This implies that the more severe the enforcement problem, the greater the need for centralization (Rational Design conjecture C4, CENTRALIZATION increases with ENFORCEMENT problems).

Such enforcement problems are typical, for example, when contracts are about to expire. No long-term relationship will last forever. Construction, licensing, distributorship, joint venture, and other long-term contracts will eventually terminate, and relationships will come to an end. Logically, such changes will also affect the ways in which disputes that arise after a business relationship has ended will be resolved. Consider, for example, the case of a complex, long-term construction contract as

53. On the role of hostages in economic exchange, see Williamson 1983; and Kronman 1985.
54. Vigrass 1993, 469. See also Graving 1989, 368.
55. Hunter et al. 1993, 73. See also Perlman and Nelson 1983, 232; Coe 1997, 44–49; and Park 1997b.

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described by James Myers, head of a major international construction group:[56] At the onset, the contractor, employer, and engineer are all anxious to maintain harmonious working relationships with one another. They realize that the ability of one party to perform over an extended period of time rests on the cooperation of the others. Disputes, when they arise, will be resolved swiftly, fairly, and in a friendly fashion. ADR and ad hoc arbitration are the preferred methods of resolving disputes in such settings. Parties may sometimes even refrain from presenting claims, lest the relationship be strained. Once the project is completed, however, the parties' attitudes are likely to change. A contractor who has no further business with the employer may now feel no compunction about demanding payment for additional costs accumulated during the course of the construction, and the employer will have no hesitation in dismissing such claims as baseless. Myers notes that "proceedings which occur after the completion of an [international construction] contract . . . are resolved in a distinctly adversarial atmosphere in which large sums of money are sought, with little or no 'commercial downside'—meaning that the commercial relationship has normally expired and the parties have nothing to lose by refusing to accommodate each other for the sake of continuous harmonious commercial relations."[57]

It is apparent from this example that good will, the prerequisite for successful use of ADR or ad hoc arbitration, can no longer be taken for granted after a contractual relationship has ended. In such a situation, ADR and ad hoc arbitration are doomed to failure, but institutional arbitration is in its element. Unsurprisingly, the vast majority of disputes submitted to institutional arbitration arise shortly before or after a commercial relationship has ended. The following example, a typical institutional arbitration case, explains why and illustrates how procedural safeguards and monitoring provided by arbitral institutions help to overcome the difficulties posed by defection strategies.[58]

In 1987 a large German company (the claimant) entered into an agreement with a firm in Colombia (the defendant) granting the Columbian firm the exclusive license to manufacture and distribute certain pharmaceutical and biological products in Colombia for four years. In 1991 the German company decided not to renew the license agreement, and one year later it initiated arbitration proceedings claiming that the defendant had breached certain of its surviving obligations, such as reporting inventory and sales of the licensed products and refusing to pay substantial sums. The Colombian firm refused to respond to these claims.

In this case the conflict erupted after one party decided to end a business relationship. For the Colombian firm, the termination of the contract seems to

56. Myers 1991. See also Schwartz 1995; Stipanowich 1996; and Vagts 1987.

57. Myers 1991, 316.

58. The example is based on an actual ICC arbitration case. The names of the parties have been omitted. The case captures many of the features typical of institutional arbitration, notably in licensing, distributorship, construction, and sale of goods. About 70 percent of ICC arbitration cases fall into these categories.

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have triggered a change in its view about the necessity of acting cooperatively. Defection from "surviving obligations" may be seen as an attractive strategy because it brings immediate gains without imposing an obvious long-term cost. Such an uncooperative disposition typically also pervades the dispute-resolution process in this type of case. For example, the defendant could try to evade the contractual obligation to arbitrate the dispute, arguing that the matter falls under its national jurisdiction and can only be decided in a national court according to national law and procedural rules. This is precisely the strategy that the Colombian party took; it wanted the case to be tried in Colombian courts under Colombian law. If this fails, the defendant may seek to derail the arbitral proceedings by disagreeing on the choice of arbitrator(s), procedural rules, place and language of arbitration, and applicable law. It could also try to delay the proceedings by failing to appear on dates selected for hearings or by raising questions over procedural matters. If none of these dilatory tactics succeeds, the defendant still has the option of challenging the arbitral award before a national court, on the basis that the arbitral tribunal exceeded its jurisdiction or that there was a substantial miscarriage of justice in the course of the proceedings. Finally, the party may simply choose not to honor the arbitral award.

Ad hoc arbitration demands little more than simple coordination among the arbitrators, procedural rules, applicable law, and place of arbitration. The institutional demands on cases like the German-Colombian one are much more complex. Extensive monitoring and strong institutional safeguards are necessary to deprive potential bad faith and other forms of "defection" of their effects in such cases.

The ICA is an example of an organization well equipped to handle such "difficult" cases. Its rules and institutional apparatus effectively override obstacles that a noncooperative disposition by one of the parties may pose. For instance, if one of the parties refuses to participate in the arbitral proceedings, the ICA is entitled to appoint the arbitrator(s) and constitute a tribunal. The notice and summons procedure is performed by the ICC secretariat and is supervised by the court, assuring the arbitrators that the defaulting party had notice of the arbitration.[59] If one party fails to sign the Terms of Reference, the ICA may approve them and the proceedings continue. After the Terms of Reference are approved, the opportunity for a party to engage in dilatory tactics by presenting additional claims and counterclaims is minimized because such claims can only be heard on the agreement of all parties.[60]

The court closely monitors the arbitral proceedings, ensuring that time limits and due process principles are respected.[61] It replaces arbitrators who do not fulfill their functions or are behind in their work. At the end of the process, it scrutinizes the award in relation to jurisdiction and applicable law. This monitoring and checking

59. Aksen 1991, 12.
60. Ibid., 13.
61. Principles of due process include transparency of the arbitral process, the right of the parties to be called and heard, and equal treatment of the parties in the exchange of pleadings, in evidentiary matters, in resort to expertise proceedings, and in the holding of hearings.

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increases the quality of the arbitral award and, in turn, reduces the chance that the losing party will challenge the award in a national court. As noted by an experienced international arbitrator, "most final awards rendered under ICC auspices are carried out voluntarily by the parties, because [of their high] quality. . . . A company that fails to carry out an [ICC award] is almost certain to lose subsequent[ly][62] and in addition runs the risk of jeopardizing its reputation in international circles."[63] Indeed, only about 6 percent of all ICC awards have been challenged by the losing party, and a minute 0.5 percent of awards rendered under the aegis of the ICC have been set aside by a national court.[64]

It is easy to see why ad hoc arbitration and ADR are ill-suited for situations represented by the German-Colombian case. If at any stage of the proceedings in ad hoc arbitration or ADR matters go unexpectedly awry and one of the parties starts acting in bad faith, there is no international supervisory institution to coerce compliance with procedural rules.[65] Furthermore, if the losing party in an ad hoc arbitration case challenges the award in a national court, the winning party will find it considerably more difficult to prove to the national court that due process rules were respected and the tribunal was impartial and objective. Not surprisingly, national courts are much more comfortable confirming commercial awards that result from a monitored arbitration process than those produced by ad hoc proceedings.[66]

Uncertainty about the state of the world and centralization. Uncertainty about the state of the world is a third variable that is useful in understanding the selection of different arbitration options. It refers to the extent to which actors involved in international exchange are knowledgeable about international commercial arbitration and possess information about the legal environment (the laws and the integrity of local judges) in which arbitration takes place and the conditions for enforceability of arbitral awards. Good information on the legal environment and enforceability is a prerequisite of successful resolution of commercial disputes. The conjecture here is straightforward: The greater the uncertainty about the present state of the world, the greater the need for centralized information on international commercial arbitration and domestic arbitration laws and practices (Rational Design conjecture C2, CENTRALIZATION increases with UNCERTAINTY ABOUT THE STATE OF THE WORLD). Such information may be particularly important in cases involving traders with little

62. In other words, when the winning party applies to a national court for recognition and enforcement of the award.

63. Aksen 1991, 22. See also David 1985, 45; and Hunter et al. 1993, 10.

64. See Craig, Park, and Paulsson 1990, 32–33; and David 1985, 50.

65. The type of problem that can arise in ad hoc arbitration is illustrated in a recent case (*Intercarbon Bermuda v. Caltex Trading and Transport*), where one party refused to proceed with an arbitration pursuant to an arbitration clause that provided for no institution to set the arbitration in motion. The claimant was forced to spend seven years in litigation before obtaining a federal court order compelling arbitration. Park 1995, 70. See also Coulson 1993; Aksen 1991, 8–9; and Paulsson 1993, 438.

66. David 1985, 11.

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experience in international exchange or traders from very different cultural and linguistic regions. Major arbitral institutions help to provide the necessary information and procedural guidelines to enable inexperienced parties to resolve their commercial disputes in an efficient and timely fashion.

"Legal environment" encompasses domestic legislation on arbitration and court interpretations of it. The law in the location where arbitration will occur is of great importance because it may determine questions of the capacity of the parties to agree to arbitration, the validity of the arbitration agreement, the "arbitrability" of the subject matter of the dispute, and the recognition and enforcement of arbitral awards. Thus parties seeking to maximize procedural certainty may benefit from relying on centralized information on domestic arbitration laws and practices; such information will help them choose an arbitral situs where annulment of awards is not likely to be facilitated by a bribe to a local judge, where the range of nonarbitral legal questions is narrow and well defined, where the integrity of the arbitration process is ensured and any judicial meddling with an arbitrator's substantive decision is minimized, and where arbitration decisions are enforceable—if necessary, through execution against the assets of the losing party by proceedings in national courts of any state in which these assets are located.

Some countries have clear arbitration legislation, but their courts may misapply the law, for example, by adopting overelastic interpretations of "violations of public policy" as grounds for setting aside awards. Other countries may have national laws containing mandatory provisions that override explicit contractual stipulations. Two examples serve to illustrate how arbitrary and fickle domestic legal decisions regarding international arbitration may be, thus underlining the importance of centralized information on developments in national arbitration laws and practices:[67]

The Indian Supreme Court held in May 1992 that if Indian law applied to an arbitration clause, an application to set aside an award could be heard in India, even if the place of arbitration were outside India, and the Indian courts could enjoin the enforcement of the award anywhere. In other words, an acceptance of Indian law in a contract with an Indian party would ultimately lead to the Indian courts irrespective of the choice of a neutral venue.

In Singapore, in a 1988 decision, the High Court affirmed restrictions on foreign arbitration parties imposed by local practice rules. This was followed by a new Singapore Legal Profession Act, which stipulates that foreign lawyers can only appear in arbitration proceedings when the law applicable to a dispute is not Singaporean law. When Singaporean law does apply, foreign lawyers may only appear jointly with lawyers who are Singaporean nationals.

The second issue of central importance is the enforceability of arbitral awards. An award rendered in a given country may not automatically be enforceable in other countries where the losing party's assets may lie. Thus, a key function of major

67. The examples are drawn from Hunter et al. 1993. See also Park 1997a.

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arbitral institutions is to collect and continuously update information on the conditions of enforceability of awards in various parts of the world. For example, by 1997 over one hundred states had acceded to the 1958 New York Convention on the Recognition and Enforcement of Arbitral Awards.[68] The majority of these states adopted the so-called reciprocity reservation. That means that their courts will enforce an award under the New York Convention only if the award has been rendered within the territory of another state that has also adhered to the New York Convention.[69] A court in a signatory country may refuse recognition and enforcement of awards only on procedural grounds, including invalidity of the arbitral agreement, denial of an opportunity to be heard, arbitrator excess of jurisdiction, arbitral procedure contrary to the parties' agreement, and annulment of the award in the country where rendered.[70] However, the interpretation by national courts of these grounds for denying enforcement of arbitral awards may vary from country to country. Therefore, major arbitral institutions also keep information on the various national interpretations.

In sum, private firms and their lawyers may often lack sufficient information about the legal state of the world to avoid expensive delays and other negative surprises. This is particularly true if the parties are inexperienced in international trade and investment or if they deal with firms from distant regions.[71] Uncertainty about the legal environment and enforceability can be reduced, at least in part, by relying on information provided by major arbitral institutions, such as the ICA or the LCIA. Such forums have the institutional capacity to monitor and record changes in domestic arbitration laws and practices around the world, especially if their memberships have a broad geographic base.

An examination of the docket of the ICA offers supporting evidence for the conjecture that firms from different regions rely more heavily on centralized support and expertise for the resolution of their disputes than firms operating in relatively homogenous regions. Table 2 lists the origin of the parties in all ICA cases since 1974. Strikingly, Western Europeans have been involved in well over half of all cases. The key finding, however, emerges from Table 3. Despite the well-known fact that Europeans (and North Americans) trade much more intraregionally than with other regions, it appears that considerably more interregional commercial

68. See UN Doc E/Conf. 26/SR., 1–25. The standard work on this treaty is Berg 1981. Besides the New York Convention, there are at least two other international enforcement conventions, the 1975 Inter-American Arbitration Convention (also called the Panama Convention) and the 1961 European Convention on International Commercial Arbitration. In addition to these conventions, many bilateral commercial and investment treaties contain enforcement provisions. For a brief historical account of the development of the various enforcement conventions, see Redfern and Hunter 1991, 60–64; see also Sanders 1996, 41–42; and Jackson 1991.

69. Hunter et al. 1993, 19. Art. III of the New York Convention provides that convention states shall recognize foreign awards as "binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon," subject to no conditions more onerous than those imposed on domestic awards.

70. Park 1995, 55–56.

71. Aksen 1991, 14.

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TABLE 2. *Origin of parties in ICC arbitration cases (average per period)*

Region	*1974–85*	*1986–90*	*1991–95*	*1996–97*
Western Europe	59.2%	56.9%	59.7%	49.5%
Central and Eastern Europe	3.8%	3.2%	6.1%	7.1%
Middle East	8%	5.2%	4.1%	3.2%
Africa	9.2%	8.9%	5.3%	5.7%
North America (United States and Canada)	13.3%	13.8%	11.8%	13.5%
Latin America and the Caribbean	3.4%	3.6%	4.8%	11.5%
Asia	3.1%	8.4%	8.2%	9.5%

Source: ICC International Court of Arbitration Bulletin, various issues; and author's notes taken during internship at ICC International Court of Arbitration, Paris, 1998.

disputes are submitted to the ICA than disputes arising among firms from the same region, that is, Europe, North America, or any other region listed in Table 2. On average, approximately three out of four disputes brought to the ICA involve parties from different regions. This statistic contrasts sharply with the finding about the geographic distribution of ad hoc cases. According to international arbitrators interviewed in Paris, Stockholm, and New York, ad hoc cases seem to be more common among parties from relatively homogenous regions and communities.[72] However, since no institution keeps track of ad hoc arbitration cases and full information therefore does not exist, the finding about ad hoc cases must be considered tentative.

Uncertainty about the state of the world and flexibility. Uncertainty about the state of the world can also refer to the susceptibility of an issue-area to new developments or unanticipated shocks that may leave parties in uncharted legal territory. The conjecture, in this case, is as follows: The more uncertain the state of the world, the greater the desirability of a flexible method for resolving disputes (Rational Design conjecture F1, FLEXIBILITY increases with UNCERTAINTY ABOUT THE STATE OF THE WORLD), thus implying a preference of arbitration and ADR over litigation in public courts.[73]

The flexibility offered in arbitration and ADR may be valued, for example, because it gives firms operating at the forefront of new production and exchange methods the possibility of appointing experts who have the necessary technical knowledge to evaluate complex, new situations and understand the facts; an ordinary judge cannot be expected to have this specialized knowledge. Complex

72. Based on interviews at the ICA (April 1998), the SCC Institute (April 1998), and law firms in New York (October 1998).

73. On institutional flexibility and its relationship to uncertainty, see also the studies in this volume by Oatley, Richards, and Rosendorff and Milner.

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TABLE 3. *Regional distribution of ICC arbitration cases (average per period based on available samples)*

	1974–85 (37 cases)	*1986–90 (36 cases)*	*1991–95 (19 cases)*	*1996–97 (140 cases)*
Intraregional disputes	30%	11%	26%	32%
Interregional disputes	70%	89%	74%	68%

Source: Author's computation based on case collections in Jarvin and Derains 1990; Jarvin, Derains, and Arnaldez 1994; Arnaldez, Derains, and Hascher 1997; and author's notes taken during internship at ICC International Court of Arbitration, Paris, 1998.

technical issues may arise in cases dealing with transfer of technology, industrial property, trademarks, technical know-how, and financial products. Brian Neill, Justice of the Court of Appeals of England and Wales, observes that "cases arise from time to time which involve questions which lie at or near the frontiers of current scientific knowledge. Can they be tried satisfactorily in the ordinary courts? There must be doubt."[74]

Flexibility also permits the expert to disregard, to some extent, the technicalities of the law in favor of a solution that accords with new business practices. An arbitral tribunal, for example, may be given powers of so-called amiable composition or, as it is sometimes put, the right to decide *ex aequo et bono* (in equity and good conscience); that is, the tribunal may reach a decision without applying strict legal principles, provided the decision is fair. More generally, flexibility allows the parties to tailor the rules—regarding procedure, evidence, or even the substance of the case—to their specific needs.[75]

The advantages of flexibility in dispute resolution can be illustrated with the help of a major arbitration case that involved IBM and Fujitsu, two of the world's largest computer companies. The dispute erupted over intellectual property rights to operating system software. In the early 1970s Fujitsu decided to develop and market IBM-compatible operating system software for mainframe computers.[76] A decade later, IBM confronted Fujitsu with allegations that Fujitsu's operating system programs violated IBM's intellectual property rights. After lengthy negotiations, the two companies signed two agreements in 1983; one agreement granted Fujitsu immunity and waiver of IBM claims with respect to past and future distribution of Fujitsu's programs in exchange for payments from Fujitsu to IBM; the other agreement required each party to provide the other with information relevant to

74. Neill 1988, 235. For confirming evidence of the importance of this point, see recent survey results in Bühring-Uhle 1996, 136–37.

75. Redfern and Hunter 1991, 24; see also Jones 1958, 464; and Kerr 1987.

76. This account draws on Mnookin 1994.

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compatibility. These agreements, however, quickly broke down, and in 1985 IBM filed a demand for arbitration accusing Fujitsu of copying its software in violation of copyright law and IBM's rights under the 1983 agreements. Fujitsu denied violating IBM's rights and accused IBM of failing to live up to its obligations under the agreements.

The case turned out to be highly complex because of enormous legal and factual uncertainties. IBM and Fujitsu were developing software in a world of rapidly changing technology. However, no clear understanding existed of what the law of copyright was and how it applied to computer software and the particular subject matter of the dispute. One of the arbitrators involved in the case, Robert Mnookin, noted that "this was not a dispute where there was a clear and agreed understanding of the underlying law and where it was only necessary to apply clear law to particular facts. . . . There were no [prior] . . . judicial decisions. No one knew the precise scope of copyright protection."[77] Legal uncertainties were compounded by factual uncertainties. Indeed, the disputed programs involved hundreds of thousands (in some cases millions) of lines of codes, rendering fact finding exceedingly difficult.

The arbitrators overcame some of these difficulties by themselves creating the law that would bind the two parties vis-à-vis each other. First, they probed the interests of the parties to identify areas of convergence.[78] They then proceeded to develop, in close consultation with the parties' technical representatives, detailed rules to define what would and would not be permitted in compatible software development. As a result of the arbitration effort, IBM and Fujitsu agreed to set aside the 1983 agreements and execute a new agreement in 1987 that provided a successful framework for resolving all issues in dispute.

In short, arbitration enabled the parties to take a flexible approach and tailor the rules to their particular problem and underlying interests. Rather than framing the strategies in terms of penalties or exoneration for past conduct, the parties took a forward-looking strategy and actively participated in the rule-making process that eventually established clear rights and obligations between them.

Far from being an isolated case, the IBM-Fujitsu dispute is representative of a rapidly growing body of international arbitration cases dealing with intellectual property rights. This growth has been fueled by the speedy reduction of trade barriers, the proliferation of digital means of communication, and the increase of commerce via the internet. Unsurprisingly, such disputes are the fastest growing

77. Robert Mnookin at Geneva Global Arbitration Forum (21 October 1993); see Mnookin, Méan, and Robine 1994, 141–42.

78. It became clear that Fujitsu's paramount interest was to develop IBM-compatible software, but it demanded access only to external interface information, not information about internal design of IBM programs. IBM in turn was interested in ensuring that Fujitsu did not copy internal design information and that it received adequate compensation for external interface information contained in IBM programs extracted by Fujitsu.

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category of cases submitted to the ICA, increasing from 8.6 percent in 1982 to an average of almost 20 percent in the past four years.[79]

The institutional characteristics, such as flexibility, that render arbitration appealing in a growing number of areas, may not, however, be necessary or even desirable in other commercial contexts, and thus the requisite dispute-resolution methods will vary. Consider, for example, the case of international loan agreements between private parties. Big companies may take out large syndicated loans to finance trade, exploit natural resources, assist take-over bids, provide working capital, construct new plants, drill rigs, buy ships, and so on. When writing international loan agreements, the lending banks will take great care in covering all contingencies that may result in losses to the banks and in seeking the best possible protection against such events. The banks will also spell out as clearly as possible what sums of money are to be paid at any particular time, how they are to be paid, and by whom.[80]

Loan agreements also contain a governing-law or choice-of-law clause that sets forth the law that determines the validity of the contractual provisions that have been inserted in the loan agreement and the effect and scope of the contractual rights and obligations expressed in the agreement.[81] As Richard Slater explains, "A bank wants to be sure that if certain events of default, which it has taken the trouble to write into its loan agreement, occur, then it is entitled to accelerate the loan[82] without having to worry about whether the event is material, whether the borrower was to blame for its occurrence, whether it was fair, or whether it was in accordance with normal practice. A bank wants as little scope as possible for debate about the meaning of the provisions in its loan agreement."[83]

It is now easy to see why bankers shun arbitration clauses and, instead, insert in almost all international loan agreements jurisdiction clauses, selecting either New York courts or the London High Court as forums (depending on whether the contract is governed by New York or British substantive law).[84] Unlike in construction, engineering, and intellectual property cases, which tend to go to arbitration, the question in international loan cases is generally quite simple: has the debt fallen due and been left unpaid, and, if so, how much is it? In most cases, establishing this fact is simple. Thus disputes under a loan agreement will

79. Based on interviews at the ICA, Paris (April 1998). One area that several interviewees identified as likely to generate heavy arbitration activity is telecommunications, the fastest growing sector of most industrialized economies. Privatization of government-owned network operators, deregulation, and the introduction of cross-border competition are fundamentally changing the industry; and many telecommunication disputes are expected to involve intellectual property issues. Interviews at the Commission of the European Union, Brussels (March 1998), and the LCIA, London (April 1998).

80. Slater 1982, 177–78.

81. Gruson 1982, 17. The vast majority of loan agreements select British or New York law, in part because of these laws' strict approach to the concepts of breach of contract and sanctity of contract.

82. "To accelerate the loan" means to terminate a lending relationship and declare all amounts outstanding under the loan agreement immediately due and payable.

83. Slater 1982, 195–96.

84. Cates and Isern-Feliu 1983, 28–29, 34.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

typically relate not to matters of fact but law.[85] However, legal uncertainties or intricacies are also rare in loan cases. Legal matters under loan agreements are well covered by case precedents and statutes; thus the courts in New York and the United Kingdom possess, in most cases, the requisite information to deal expeditiously with default cases.[86] For these reasons, litigation seems a more appropriate method than arbitration for the resolution of disputes arising from international loan agreements.

Conclusion

International commercial arbitration has emerged over the past two decades as the method of choice for settling a growing number of trade and investment disputes involving private parties. Its surge in popularity can be attributed in part to the institutional attributes of arbitration, which include flexibility, technical expertise, privacy, and confidentiality. These attributes match the needs of disputants in areas such as intellectual property, transfer of technology, engineering, and construction. Arbitration options, however, are not the only methods available to private parties. The market for dispute-resolution mechanisms also includes recourse to public courts and several alternative-dispute resolution techniques.

I have argued that firms on the demand side select methods for dispute resolution according to their design problems. In other words, the various methods respond to the varying institutional needs of different types of disputes and disputants, and these needs can be explained in terms of the severity of the enforcement problem, uncertainty about the preferences or behavior of contractual partners, and uncertainty about the state of the world. More specifically, the findings are that (1) centralization of forums to which private international parties resort to resolve their disputes increases with the severity of the enforcement problem (Rational Design conjecture C4, CENTRALIZATION increases with ENFORCEMENT PROBLEMS); (2) centralization also increases with uncertainty about the parties' preferences or behavior (conjecture C1, CENTRALIZATION increases with UNCERTAINTY ABOUT BEHAVIOR); (3) the need for centralized information on international commercial arbitration and domestic arbitration laws and practices grows with greater uncertainty about the legal environment in which arbitration takes place and the conditions for enforceability of arbitral awards (conjecture C2, CENTRALIZATION increases with UNCERTAINTY ABOUT THE STATE OF THE WORLD); and (4) the desirability of a flexible method for resolving disputes increases with the susceptibility of an issue-area to new developments or unanticipated shocks that may leave the parties in uncharted legal territory (conjecture F1, FLEXIBILITY increases with UNCERTAINTY ABOUT THE STATE OF THE WORLD).

85. Wood 1980, 71–73; see also Slater 1982, 197; and Cates and Isern-Feliu 1983, 28–36.
86. Ryan 1982, 89–132.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

This study thus illustrates that Koremenos, Lipson, and Snidal's analytical framework not only sheds light on institutional arrangements among states[87] but can also account for varying forms of international governance established by private parties.

My analysis, however, has only scratched the surface of a complex but fascinating area of research for scholars of international relations and other social scientists. Several issues evoked in passing merit fuller analysis. One is the study of specialized arbitration, for example, as conducted in maritime affairs or as offered by various stock and commodity exchanges. Such arbitration is typically conducted within commercial groups with strong national roots. For example, the British Coffee Trade Federation numbers over one hundred firms as members, including the leading roasters, merchants, brokers, and wharfingers in the United Kingdom. Notwithstanding its national base, the federation is linked to a wide network of transnational commodity organizations such as the Committee of European Coffee Associations, the European Federation of Coffee Roasters Associations, and the Federation of Commodity Associations. This raises the question of how this "institutional embeddedness" is likely to shape the arbitral institutions and practices of national federations.

Another question that emerges from the study of arbitration is why states have traditionally been reluctant to resort to international arbitration. Indeed, while the number of arbitration cases involving private parties has grown exponentially, instances of interstate arbitration are few. For example, after a modest beginning, recourse to the Permanent Court of Arbitration at the Hague became infrequent in the extreme. Of the twenty-five cases considered by the court, twenty-two cases were disposed of by 1935; the other three were heard in 1940, 1956, and 1970, respectively.[88]

Another example are disputes submitted to the arbitration mechanism of the International Center for the Settlement of Investment Disputes (ICSID). ICSID was created in 1966 by the so-called Washington Convention as part of the World Bank organization. ICSID's authority is limited to investment disputes where one of the parties is the host state. By 1995, only thirty investment disputes had been brought to the ICSID for arbitration, resulting in what Stephen Toope calls a "highly limited case load";[89] and Aron Broches notes similarly that "advance acceptance of [ICSID's] jurisdiction has not resulted in a large number of cases."[90]

The specific reasons for the paucity of arbitration cases involving states are varied and complex. However, one theme runs throughout history, namely the deep concern of states with maintaining sovereignty and independence combined with a perception that national autonomy and international arbitration practices are not easily compatible. Consider the following examples: In 1903 France concluded an

87. Koremenos, Lipson, and Snidal, this volume.
88. Butler 1992, 44.
89. Toope 1990, 255.
90. Broches 1979, 374; see also Gray and Kingsbury 1992.

https://doi.org/10.1162/002081801317193646 Published online by Cambridge University Press

agreement with the United Kingdom that provided for the settlement by arbitration of certain disputes that may arise between the two countries. Reference would be made to the Permanent Court of Arbitration. Tellingly, however, the signatories added a clause to the agreement stating that only those differences would qualify for submission to arbitration "that . . . do not affect the vital interests, the independence, or the honor of the two contracting states."[91] Similar provisions were inserted in other arbitration treaties of the period. Needless to say, the malleability and subjective nature of these exceptions considerably weakened the legal obligation to arbitrate disputes.[92]

Some countries considered even such watered-down arbitration clauses as too intrusive. Latin American countries, for example, rejected arbitration and insisted on so-called Calvo clauses that required foreign parties to agree to adjudication within the host state of any dispute arising out of an investment contract.[93] More recently, oil-exporting nations have manifested similar hostility to arbitration, demanding that "disputes arising between a government and operator shall fall exclusively within the jurisdiction of competent national courts."[94]

States' concern with safeguarding sovereignty is also reflected in principles of international law. One example is the distinction made between immunity from *jurisdiction*, also called *immunity from suit*, and *immunity from execution*, which means immunity from measures sought against the property of a state for the enforcement of an arbitral award. A waiver of immunity from jurisdiction, which follows from entering into a valid agreement to arbitrate, does not automatically entail a waiver of immunity from execution. This principle is enshrined, for example, in the ICSID Convention, which stipulates that "nothing . . . [in the ICSID Convention] shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or any foreign State from execution."[95] Similarly, the draft Convention of State Immunity that the International Law Commission published in 1991, after thirteen years of work, states that "no measures of constraint such as attachment, arrest, and execution against property of a State may be taken in connection with a proceeding before the court of another state. . . . Immunity from execution may be viewed, therefore, as the last fortress, the last bastion of state immunity."[96] Today most states have accepted doctrines of restricted immunity and waiver of immunity with respect to jurisdiction; but they continue to apply absolute immunity when it comes to actual execution.

91. Art. 1 of the agreement is quoted in Carter and Trimble 1991, 332–33.

92. On sovereignty costs in the context of regional and international legalization, see Abbott and Snidal 2000; Mattli 1999; and Mattli 2000.

93. Shea 1955.

94. 1967 OPEC resolution quoted in Craig, Park, Paulsson 1990, 647.

95. Art. 55 of Washington Convention.

96. Art. 18 of the Draft Convention of State Immunity by the International Law Commission, and Commentary on Article 18 in the Report of the International Law Commission; quoted in Sanders 1996, 73.

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In practice, the shocking result can be that a party, after having put every effort into an arbitration against a state and having obtained a judgment for enforcement in its favor, finds itself unable to collect the money to which it is entitled under the award.[97] One remedy, agreeing to a waiver of immunity from execution when entering into a contract, is rarely used.[98]

In sum, traditional aversion of states to compromising over issues of national control and autonomy, as well as practical problems in enforcement that stem from the age-old principle that with sovereignty comes immunity, may take us a long way toward explaining why arbitration cases involving states have been relatively few.

97. Carter and Trimble 1991, 366.
98. Sanders 1996, 81.

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