European Court of Justice vs. Arbitral Tribunals: The Role of Preliminary Ruling When European “Public Policy” is at Stake

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Abstract

In this theoretical paper we use a functional approach of law and economics to analytically test how the case-law of the European Court of Justice (hereinafter ECJ) affects individual's ex-ante incentives to include arbitration clauses in their contracts. The ECJ denied arbitral tribunals' jurisdiction to refer cases for a preliminary ruling, under Article 267 of the Treaty on the Functioning of the European Union (hereinafter TFEU). This implies that, even if competition law is a matter of public policy and its arbitrability is undisputed in the European legal system, when a contractual party claims a EU competition law infringement, arbitrators have no power to prevent a national court of a Member State from setting the arbitral decision aside. Such shadow of uncertainty risks to impair the very essence of arbitration, at least as a mechanism of private enforcement of EU competition law. We adapt two of the existing law and economics models on litigation (i.e. Priest and Klein's model on the selection of disputes for litigation and Dari-Mattiacci and Parisi's model on dissipation of value and lost treasure in rent-seeking games, the latter inspired by Gordon Tullock's paradox) with the intent to study the merits of alternative procedural rules that affect parties ex-ante incentives to arbitrate disputes involving an issue of public policy. Our results provides an analytical argument for reverting the current ECJ's interpretation of Article 267 TFEU. The purpose is to enhance the effectiveness of arbitration as a means of private enforcement of competition law, increasing legal certainty and procedural simplification.

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Introduction

It is widely acknowledged that private enforcement of both EU and national competition law has been extremely limited in Europe. Competition law is mostly enforced by competition agencies and subject to the review of courts. The European Union have not provided yet the proper procedural incentives necessary to achieve the optimum level of private enforcement.¹

The recent European debate on how to enhance private enforcement is focused mainly on class actions. However in the United States, where private enforcement and class actions are much more developed, consumers are not the majority of claimants in private enforcement proceedings. One third of the plaintiffs are defendants' competitors, more than one third are dealers or distributors and less than 20 percent are consumers.² This means that the majority of competition lawsuits revolves around business-to-business contracts between perpetrator and victim of an anticompetitive conduct. In fact, every vertical agreement, R&D agreement, price agreement, JV agreement, merger agreement and many others, potentially include an issue of private enforcement of EU competition law.

All the aforementioned contractual relationships, in Europe and more generally in a globalized economy, are very likely to involve massive transfers of goods, services and capitals between different legal systems. It is worth noting that during the last 10 to 15 years, arbitration almost gained the title of exclusive jurisdiction for international contractual transactions. If two companies do not have their headquarters in the same country, it is most likely that every dispute that may arise upon the performance of a contractual obligation falls within the scope of an arbitration clause.

Unless otherwise expressed, contractual arbitration clauses include also claims based on EU competition law. Indeed, arbitration seems to have all the characteristics necessary to provide an efficient competition law enforcement: it is cheaper than litigation, it is faster, it can lower collateral business risks, has flexible procedural rules, it is conducted by professional arbitrators highly specialized in the subject matter of the dispute.

Theoretically arbitration has the potential to play a leading role in the European private enforcement framework. This paper is part of a wider project that uses the economic analysis of law to solve a set of issues arising from the application of competition law in alternative dispute resolution proceedings, provided that there is no legislative body addressing this matter. The final goal of this wider project is to compare the merits of alternative procedural rules that affect individual incentives to arbitrate, with the intent to strengthen the private enforcement of international contractual transactions.

The inspiration for this paper came from two articles, the first by Eisenberg and Miller published in 2007 entitled “The flight from arbitration: an empirical study of ex ante arbitration clauses in the contracts of publicly held companies”. The second article is by Drahozal and Wittrock publishing in 2008 with the title “Is there a flight from arbitration?”. Both articles are empirical studies that examine whether and how the use of contractual arbitration clauses has changed over time in the United States. Their goal is to empirically test the impression among practitioners of a growing dissatisfaction with arbitration, at least in the United States. Drahozal and Wittrock found that: “in aggregate, there has been little change in the use of arbitration clauses” but we were more interested in another remark present in their article. Most exclusions of arbitral jurisdiction and changes to the terms of the arbitration clauses studied by the authors were parties’ response to arbitral invalidation or disadvantageous proceedings caused by national courts’ case-law.

The European legal order is characterized by a legislative vacuum on how EU competition law applies in international arbitration, especially on how it aspires to apply and how practically to deal with it. The European Court of Justice’s case-law provides the few existing rules on the application of EU competition law in arbitration proceedings, and it leads to the research question that this article tries to answer: does the case-law of European Court of Justice have the potential to cause a shift of parties’ preference towards arbitration clauses that exclude arbitral jurisdiction on disputes involving an issue of public policy and consequently does this case-law have the effect of depriving business parties of an useful private enforcement tool and leading them into traditional litigation?

6 Ibid.
A hint at the importance of this issue comes from the presently shared opinion in the arbitration community that, due to the degree of uncertainty of this subject matter, arbitrators or parties’ counsels facing a competition law issue tent to disregard it, as being in front of a “veil of Maya”, even if it could serve the party's interest by retroactively freeing her from a burdensome contractual provision.

A more precise appreciation of the intersection of EU competition law and international arbitration revolve around the principle that for the EU legal order competition law needs to be treated as a set of mandatory norms.\(^7\) Arbitrability of competition law is undisputed, both in case law and literature.\(^8\) It is widely accepted that competition law material issues are an arbitrable matter. And arbitrability was not opposed by ECJ and by the US Supreme Court on the assumption that the public policy interests embodied in competition law can be safeguarded by national courts during the award review. However this assumption has proved largely illusory in practice. The legal system is facing a trade-off between, on one hand, the principle that arbitral awards cannot be subject to a review on the merit of the dispute. Because a review on the merit will practically throw away the result of the arbitration proceeding and start the dispute all over again resembling a second instance court. But, on the other hand is the principle that competition law is a public policy regulation, the application of which needs to be somehow guaranteed by the legal system. The matter is how to strike the balance between these two principles in the second-look by national courts.

In this theoretical paper we adapt the Priest-Klein’s model\(^6\) on the selection of disputes for litigation and integrate it within Dari Mattiacci-Parisi’s model on dissipation of value and lost treasure in rent-seeking games.\(^10\) The purpose is to analytically test how the case-law of the European Court of Justice (hereinafter ECJ) on a specific procedural rule affects individual’s ex-ante incentives to exclude competition law form a contractual arbitration clause. The rule under examination is the ECJ interpretation of Article 267 of the Treaty on the Functioning of the European Union. Denying arbitral tribunals jurisdiction to refer cases for a preliminary ruling, under Article 267, risks to deprive of effectiveness an arbitral awards based on provisions declared by the ECJ as EU public policy rules.


The paper is divided in three parts: the first one is a (I) legal and historical overview of the problem, which sets the preliminary remarks necessary to understand both the problem and also the general assumptions of the economic analysis; the second part is the (II) participation constraint analysis, a fundamental building block for describing how the legal rule stated in ECJ’s case-law on Article 267 TFEU affects plaintiff's expected utility function when he has to decide whether to file or not to file an arbitration proceeding that potentially involves European “public policy” issues; and the third part is (III) the parties’ effort analysis, testing how parties’ level of effort in winning a dispute is affected by the ECJ’s case-law on Article 267 TFEU. The intent is to find whether, the rule created by the ECJ’s case-law can cause an increase in lost treasure in comparison with the opposite interpretation of Article 267 TFEU supported by legal scholars. The existence of a potential higher lost treasure in arbitration could provide parties with the incentive to run away from arbitration and back to traditional litigation, losing all the advantages of arbitration and sinking into a dispute resolution mechanism that proved itself unsatisfactory for the private enforcement of competition law.

(I) Legal and historical overview
There are three preliminary remarks we need to address to justify our economic analysis. The first (a) is the functioning of Article 267 TFEU in the light of ECJ's interpretation; the second (b) regards the limitations to the recognition and enforcement of an arbitral award by a national court and the third (c) describes why denying arbitral tribunal authority to request preliminary ruling may impair the effectiveness of arbitration when European competition law is involved.

(a) The functioning of Article 267 TFEU
Under Article 19 of the Treaty on European Union the function of the European Court of Justice is to “ensure that in the interpretation and application of the Treaties the law is observed” and in doing so the ECJ shall “give preliminary rulings, at the request of courts or tribunals of the Member States, on the interpretation of Union law”. The procedure for requesting a preliminary ruling is described by Article 267 TFEU: “The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning: (a) the interpretation of the Treaties; (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union; Where such a question is raised before any court

11 See Article 19 of the Treaty on European Union.
or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgement, request the Court to give a ruling thereon. Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court.”

According to these provisions the ECJ is the exclusive judicial authority with the power to provide a legally binding interpretation of the European Union law through its preliminary ruling. However such power can be exercised only when a court or tribunal of a Member State decides that a preliminary ruling is necessary to give its judgement. Moreover the ECJ has no power to affect this decision nor to act as an appellate court assessing the merit of the dispute. It just provides the correct interpretation of the Union law in the case at stake. Using the words of the ECJ: “The objective of the reference procedure is to retain the independence of the national courts, while at the same time preventing a body of national case law not in accord with the rules of [the European Union] law from coming into existence in any Member State” guaranteeing an uniform application of EU law throughout the Union. It is worth noting that the preliminary ruling procedure accounts for over 50% of all cases heard by the ECJ, making Article 267 TFEU a key feature in the development and enforcement of the European Union law.

After this description of Article 267 TFEU our attention can shift on ECJ’s case-law on Article 267 TFEU. More specifically, how this provision works, according to the ECJ, when private arbitral tribunals are handling a dispute that requires a preliminary ruling on articles 101 and 102 of the TFEU. Namely, whether an arbitral tribunal can be considered “court or tribunal of a Member State” in the meaning of Article 267 TFEU and if it is not the case how arbitration proceedings are supposed to act in such circumstances to solve the dispute.

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12 Actually the ECJ ruling is legally binding only for the court that made the request of preliminary ruling. However the whole European legal system takes under deep consideration ECJ’s case-law.

13 As correctly argued in Hartley, T., ‘The Foundations of European Community Law’ (2010) Oxford 7th edn., 287: “There are two major differences between an appeal and a reference. First, in the case of an appeal the initiative lies with the parties: the party who is dissatisfied with the court’s judgment decides whether to appeal and then take the necessary procedural steps. The court a quo normally has no further say in the matter and cannot prevent the appeal from being lodged. Secondly, the appeal court decides the case, even though the appeal may be on limited grounds only, and it has the power to set aside the decision of the court a quo; normally it can then substitute its own decision for that of the lower court. These features are not found in the procedure for a preliminary reference: the court a quo decides whether the reference should be made, and only specific issues are referred to the European Court. Once it has decided these, the European Court remits the case to the national court for a decision.”

The first decision on this matter is the Nordsea case, dated 1982.\(^{15}\) Here, the ECJ denied private arbitral tribunals jurisdiction to refer for preliminary rulings stating that: “An arbitrator who is called upon to decide a dispute between the parties to a contract under a clause inserted in that contract is not to be considered as a ‘court or tribunal of a Member State’ within the meaning of Article 177 of the Treaty [now called Article 267 TFEU]”.\(^{16}\) However, the ECJ did not leave a procedural gap for such circumstances. In fact, it also explained how the preliminary ruling shall be requested: “If in the course of arbitration resorted to by agreement between the parties questions of community law are raised which the ordinary courts may be called upon to examine either in the context of their collaboration with arbitration tribunals or in the course of a review of an arbitration award, it is for those courts to ascertain whether it is necessary for them to make a reference to the Court of Justice under Article 177 of the Treaty [now called Article 267 TFEU]”.\(^{17}\) Substantially, this decision entitles national courts to have a second look on arbitral tribunals' award and to examine their application of European Union Law in the context of any method of recourse available under the relevant national legislation. It also totally deprives arbitral tribunal of jurisdiction on the necessity to refer to the Court of Justice for a preliminary ruling.

Legal scholars started a debate on the ECJ's interpretation of Article 267 TFUE and strongly argued both pro and against it. From this debate it is clear that the issue is controversial and there are good legal arguments for reversing the ECJ case-law.\(^ {18}\) However, in 1994 the ECJ confirmed its previous interpretation and build further in the case Municipality of Almelo.\(^ {19}\) The ECJ stated that: “It follows from the principles of the primacy of Community law and of its uniform application, in conjunction with Article 5 of the Treaty, that a court of a Member State to which an appeal against an arbitration award is made pursuant to national law must, even where it gives judgment having regard to fairness, observe the rules of Community law, in particular those relating to competition

\(^{15}\) Judgment of the European Court of Justice of 23 March 1982, Nordsee Deutsche Hochseefischerei GmbH v Reederei Mond Hochseefischerei Nordstern AG & Co. KG and Reederei Friedrich Busse Hochseefischerei Nordstern AG & Co. KG., Case 102/81.

\(^{16}\) Ibid.

\(^{17}\) Ibid.


\(^{19}\) Judgment of the European Court of Justice of 27 April 1994, Municipality of Almelo and others v NV Energiebedrijf Ijsselmiij., Case 393/92.
In this specific case it was possible to appeal the award but the national court had to decide the case not using the body of national legislation but having regard to the principle of fairness. The fundamental legal principle implied in Municipality of Almelo is that no matter what is the substantial law, freely chosen by the parties to regulate the merit of the dispute, the national court has to guarantee that the EU law is observed and in particular that European competition law is observed.

This is a ground breaking principle for the review of arbitral awards by national courts. And it was clarified five years later in the Eco Swiss case. In Eco Swiss the ECJ starts quoting its Nordsea decision but, in light of scholars’ criticisms that followed the too wide principle expressed in Municipality of Almelo, it proceeds specifying how “it is in the interest of efficient arbitration proceedings that review of arbitration awards should be limited in scope and that annulment of or refusal to recognize an award should be possible only in exceptional circumstances” but then, the ECJ states that: “according to Article 3(g) of the EC Treaty (now, after amendment, Article 3(1)(g) EC), Article 85 of the Treaty [now called Article 101 TFEU, a competition law provision] constitutes a fundamental provision which is essential for the accomplishment of the tasks entrusted to the Community and, in particular, for the functioning of the internal market.” For this reason, according to the ECJ, a national court must set aside an arbitral award if the court considers that the award is in fact contrary to Article 101 TFEU, where its domestic procedural rules allow the court to set it aside on the ground of failure to observe national rules of public policy. The ECJ also states that: “the provisions of Article 85 [now called Article 101 TFEU] of the Treaty may be regarded as a matter of public policy within the meaning of the New York Convention.” To clarify the extent and fully understand the importance of this statement we have to shift our attention on the limitations to validity of arbitral award.

(b) Limitations to the recognition and enforcement of an arbitral award

All the European Union Member States are among the 142 United Nations Member States, that have signed and adopted the New York Convention of 10 June 1958 on the
Recognition and Enforcement of Foreign Arbitral Awards.\textsuperscript{26} The object of the New York Convention is to guarantee that an award granted by a foreign arbitral tribunal can be recognized and enforced in all the countries that have adopted the Convention. There is no need to explain why a widely enforceable arbitral award is a fundamental aspect for the functioning and efficiency of arbitration. In fact, as already mentioned in \textit{Eco Swiss}, the ECJ acknowledges the general principle of limited review of arbitral awards: “\textit{it is in the interest of efficient arbitration proceedings that review of arbitration awards should be limited in scope and that annulment of or refusal to recognise an award should be possible only in exceptional circumstances}”.\textsuperscript{27} In Article V(1)(c) and (e) and II(b) of the New York Convention we can find the limitation to the general principle of recognition and enforcement of arbitral awards. More specifically, under letter b), any national court has the power to set an arbitral award aside, under the condition that the recognition or enforcement of the arbitral award would be contrary to the public policy of that country. The same limitation is often present within national procedural regulations and it reflects the French general principle of “\textit{ordre public}”.\textsuperscript{28} To some extent this principle allows a form of action or review of a national arbitral award with the purpose to control how national mandatory norms are applied in arbitration and most importantly to impede the enforcement of a decision which is challenging the national public policy.\textsuperscript{29} However, the legal literature on arbitration acknowledges that the purpose of this limitation is not to provide an appeal judgement in front of national courts. It represents the last resort mechanism to avoid enforcing an award that results incompatible with the fundamental principles of a national legal system and that can be considered against the the national public policy provisions.\textsuperscript{30}

\textbf{(c) The importance of preliminary ruling for arbitration, when EU competition law is at stake}

In light of what said in (a) and (b) above, we can now understand the importance of the aforementioned \textit{Eco Swiss} case.\textsuperscript{31} The ECJ substantially declared Article 101 TFEU a

\textsuperscript{26} As of October 1, 2009.
\textsuperscript{27} See footnote 13, above.
\textsuperscript{28} See for instance: Article 1064 and 1064 of the Dutch Code of Civil Procedure; Article 829 and Article 839 of the Italian Code of Civil Procedure; Article 1502 of the New French Code of Civil Procedure; Article 187 and 190, paragraph 2, lett. e) of the Swiss “Loi fédérale sur le droit International privé”.
\textsuperscript{29} The concepts of mandatory norms and public policy rules are two different concepts but in the legal practice sometimes for judges is difficult to set the boundary.
\textsuperscript{30} Delains, Y., ‘Public Policy and the Law Applicable to the Dispute in International Arbitration’ (1987) ICCA Series No. 3
\textsuperscript{31} Judgment of the Court of Justice dated 1 June 1999 - Eco Swiss China Time Ltd v Benetton International NV - (Case C-126/97) available at this URL address: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?
matter of public policy, in respect both to the review of national arbitration and to recognition-enforcement of foreign arbitral awards under the New York Convention. Therefore, given that an arbitral award involves European competition law, a national court may inquiry whether a preliminary ruling is necessary to decide the case and set the award aside just because the arbitral tribunal gave its decision without being able to refer for a preliminary ruling. In order to render this problem of a more general interest, it is worth noting that, beyond competition law, it is uncertain which other articles of the EU Treaties are eligible to be considered European “public policy”. At any time, the ECJ may declare an EU law provision to be of fundamental importance for the EU legal order casting a shadow of uncertainty on all arbitration proceedings involving that provision.

When an arbitral tribunal is denied jurisdiction on reference for preliminary ruling and the same tribunal is facing a legal dispute that involves the private enforcement of European competition law, the effectiveness of the arbitral award is on the edge. Arbitrators have no way to make sure that their decision will not be set aside. In fact when the arbitral tribunal thinks a preliminary ruling is needed, it has no jurisdiction on the point, and no matter how the tribunal applies the EU law any national court may deem that a preliminary ruling was indeed necessary and refer the case at the ECJ. It is worth repeating that the procedure in front of a national court cannot represent an appeal procedure. Namely, an assessment on how arbitrators applied the law to the merit of the case is out of the scope of the national court's second-look procedure. On the contrary, national courts have just to guarantee that European competition law was duly taken into consideration in the arbitration proceeding and if it is not the case to set aside the award. However, the uncertainty created on this point by ECJ’s interpretation is reflected on the national courts’ case-law and should be object of further studies.

On the ground of these three preliminary remarks we can now move to the economic analysis.

(II) Participation Constraint Analysis

In the second part of the paper we structure the definition of the problem and outlines the general assumptions necessary for the economic analysis. Then we study how parties’ expected utility changes from the Priest-Klein model introducing a new definition of plaintiff's participation constraint, in line with the ECJ’s interpretation of Article 267 TFEU.
Description of the structure of the problem

Our interest focuses on cases involving European competition law rules, when the arbitral tribunal considers necessary a preliminary ruling from the ECJ to be able to correctly interpret and apply EU law to grant an enforceable award. This is a problem of application of EU competition law within arbitration proceedings. Our intention is to test and compare the two legal solutions that are theoretically available in the European legal system under Article 267 TFEU. One is the ECJ's current interpretation of Article 267 TFEU and the other is what it could be according to the legal scholars. We call them “legal rules” but they are actually the two possible interpretations that can be given of Article 267 TFEU in respect to private arbitration proceedings:

1. if, according to legal scholars’ opinion, the arbitral tribunal should have authority to request a preliminary ruling, it will suspend the procedure and requests the preliminary ruling to the ECJ. After receiving the ECJ’s decision the tribunal can grant an award in compliance with the application of the European “public policy” rules. Such award should not be overruled by national courts in the enforcement phase on the ground of European “public policy” issues. In fact, national courts' review will concern only whether the issue of preliminary ruling was duly taken into consideration;

2. alternatively, as per the state of the art of the ECJ’s interpretation of article 267 TFEU, if the arbitral tribunal is denied authority to request preliminary rulings, the award is on the edge. The arbitral tribunal has two options: (a) can cooperate with a national court and suspend the procedure requesting the national court to assess the preliminary ruling issue or (b) it can grant an arbitral award irrespective of a potential incompatibility with the European “public policy”. Such award can be voided by any Member State national court in light of the ECJ case-law on article 267 TFEU on the ground either of the national procedural law or of the Article V paragraph 2, let b) of the New York Convention. In this case the plaintiff will have to file a second arbitral procedure to obtain an enforceable award in the European Union.

Our goal is to test each rule in respect to its effect on parties' ex-ante incentives to choose to exclude competition law disputes from a contractual arbitration clause.

32 See footnote 11, above.
General assumptions

A first assumption is based on the fact that ECJ’s preliminary rulings do not concern the merit of the case but they are only a matter of EU law interpretation. Hence, we can assume that parties’ effort cannot directly influence the outcome of the preliminary ruling, it is out of parties sphere of control. On the contrary, parties’ investment in effort can influence the decision both of the arbitral tribunal, on the merit of the case, and of the national court, on whether a preliminary ruling is necessary for reaching a decision in light of Article 267 TFEU.

We can also assume that under the second rule, namely lack of authority to request a preliminary ruling, there is no overlap of respective jurisdiction between the arbitral tribunal and the national court. Their decisions making process are completely independent events. In fact, as mentioned above, on one hand it is a general principle of arbitration that national courts cannot review an arbitral award on the merit of the case. On the other hand, also the arbitral tribunal, even when cooperating with a national court, can express an opinion but does not have jurisdiction to address the need of preliminary ruling for the case.

In the light of these assumptions, we represent in Figure 1 and Figure 2 the dynamics of this problem respectively under the first and the second rule:

**Figure 1:**

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33 See footnote number 5 above.
**Figure 2:**

Arbitral Tribunal's lack of jurisdiction over Article 267 TFUE

1. Phase 1: Arbitrators have to decide without the preliminary ruling from the ECJ
2. Phase 2: National courts are obliged to verify whether a preliminary ruling is needed and refer for ECJ if necessary
3. Phase 3: Arbitral Tribunal decides the merits of the case, in light of the ECJ's preliminary ruling

**Definition of the participation constraint**

We focus now on the economic analysis of the two legal rules discussed above. Under the first rule, which we call $R_a$ that provides arbitral tribunals with authority to request preliminary ruling, parties' ex-ante participation constraint to the arbitration proceeding is described by the Priest-Klein's model:

$$R_a: p_a W - (1 - p_a) L - C - S > 0$$  \(1\)

With $p_a$ representing plaintiff's probability of victory; $W$ is the amount at stake in case plaintiff wins; $(1-p_a)$ is plaintiff's estimation of the probability of defendant's victory; $L$ is plaintiff's loss in case defendant wins a possible counter-claim. The term $C$ represents the cost of the procedure and $S$ is the lost opportunity of settlement. Only when this participation constraint is positive, namely $R_a > 0$, plaintiff will file a lawsuit.\(^{34}\)

This well known process of selection of disputes for litigation needs to be modified if we

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\(^{34}\) Priest, G.L., and B. Klein, ‘The selection of disputes for litigation’ (1984) 13 The Journal of Legal Studies, 1. The standard participation constraint indicated in the literature is: $pW - C > S$ and means that plaintiff's expected gain from litigation is bigger than the potential settlement amount. However we are not interested in the settlement, so we prefer a formulation that considers settlement as a cost-opportunity of litigation. Moreover, the formulation we choose here considers also the fact that defendant may have counterclaims, for instance reputation damages.
focus our attention on what happens under the second rule, namely when arbitral tribunals are denied authority to request a preliminary ruling. As illustrated in Figure 2 above, in this case, the parties are facing a three-phase procedure and according to our assumptions the adjudicator of each phase can only address a legal issue that is specific to the phase in which he/she has jurisdiction. Therefore, under the second rule, the participation constraint is not equal to $R_a$ any more. Plaintiff is facing a differently structured decision problem. We call $p_1$, $p_2$ and $p_3$ plaintiff's probability to win the legal argument respectively in the first, the second or the third phase of the procedure. Given the fact that this three probabilities are attached to three different and completely independent events (see what stated in the general assumptions, above, and in part (I) of this paper), to find a party's total probability of victory we have to multiply among themselves the probabilities of each independent event that need to jointly occur for reaching a positive outcome and then we sum them together. Figure 3, below represents all the possible outcomes of the multi-phase dispute with the relative probabilities and identifies in green those positive for plaintiff and in red those positive for defendant. We repeat, for the sake of clarity, that the third phase is a refile of the arbitration, which is needed if the first arbitral award is set aside by a national court in the second phase.

**Figure 3:**

![Diagram of all possible outcomes of the dispute with relative probabilities](image)
Each ending position represents a possible outcome of the multi-phase dispute that may be favourable or unfavourable to plaintiff and it is reached through a different combination of occurring independent events. The expression \( R_c \), below, represent how the participation constraint changes in this scenario in light of such definition of parties total probability of victory:

\[
R_c : \left[ p_1 p_2 + \left( 1 - p_1 \right) p_2 p_3 + p_1 \left( 1 - p_2 \right) p_3 \right] W - \left[ 1 - p_1 \right] \left( 1 - p_2 \right) + p_1 \left( 1 - p_2 \right) \left( 1 - p_3 \right) + \left( 1 - p_1 \right) p_2 \left( 1 - p_3 \right) \right] L+ - C - S > 0
\]

After calculating and simplifying the participation constraint, the following result is reached:

\[
R_c : \left[ p_1 p_2 + p_1 p_3 + p_2 p_3 - 2p_1 p_2 p_3 \right] W - \left[ 1 - p_1 \right] p_2 - p_1 p_3 - p_2 p_3 + 2p_1 p_2 p_3 \right] L - C - S > 0 \quad (2)
\]

For the sake of clarity, this multi-phase procedure affects the participation constraint in two ways: on one hand, the outcome depends on different and independent events that must occur simultaneously, in fact we multiply the probability for each singular outcome. But, on the other hand, in this scenario each party has the opportunity to revert an unfavourable decision, in fact to find the total parties’ probability of success we have to sum the probabilities of each outcome.

Therefore, in our model, the two legal rules under investigation are represented respectively by expression (1) and (2), above. To show the consistency of our model with the Priest-Klein’s one, in expression number (2) we can see that once we set: \( p_1 p_2 + p_1 p_3 + p_2 p_3 - 2p_1 p_2 p_3 = p_c \) the two expressions have the same structure:

\[
R_a : p_a W - \left( 1 - p_a \right) L - C - S > 0
R_c : p_c W - \left( 1 - p_c \right) L - C - S > 0 \quad \forall p_c = p_1 p_2 + p_1 p_3 + p_2 p_3 - 2p_1 p_2 p_3
\]

This statement may appear trivial but it confirms the suitability of our problem settings and it is a building block for the next part of this paper and for further research on this topic.

A possible critique may involve the introduction of a the third phase, since it is substantially equal to a re-enactment of the first phase in light both of the national court decision and of the ECJ’s one. We believe that such critique is not sound. The third phase is actually connected only to the ECJ’s decision which is independent from the previous two phases and from the merit of the case. If the third phase is reached, this means that the ECJ’s decision made the first phase award incompatible with public policy and that the national court set the award aside. The third phase is like a new dispute between the parties in a
new state of the world changed by the ECJ’s preliminary ruling. In fact, in the third phase, the merit of the dispute must still be decided by an arbitral tribunal (not necessary the same tribunal of the first phase) while complying with the outcome of the ECJ’s interpretation of European competition law rule, which in this case will be a binding legal rule for that arbitral tribunal. The reasoning above holds true also when exists a national regulation setting a cooperation procedure between arbitrators and national courts. Namely when the arbitral tribunal can suspend the first phase procedure and request a national court to deal with the preliminary ruling. Later on, when the arbitral tribunal resumes the first stage, it will address the merit of the case exactly as mentioned above. In fact, such scenario is substantially a three-phase procedure compatible with the structure of our model.

On this point, further research may be driven by considerations about individuals perception and estimation of the uncertain probability of winning in a multi-phase procedure. Priest-Klein showed that “disputes selected for litigation will constitute neither a random nor a representative sample of the set of all disputes”. They will be those disputes presenting two characteristics: (a) a probability of success estimated by the parties which is closer to the threshold probability and (b) the difference between the parties' expectations of the outcome is bigger. Namely, they will be the cases where parties are more likely to make an error in the assessment of the probability of success. In future it will be interesting to investigate this problem on the basis of decision theory. Since people are not good in estimating complex probabilities structure, the question is whether in a multi-phase procedure the intrinsic uncertainty of convincing more then one adjudicator will drive towards more or less litigation? However this is outside of the scope of this paper.

(III) Dissipation of parties' effort analysis
Our attention turns now on parties’ efforts under the two legal rules described above. Our purpose is to discover how the parties' level of effort will be affected by a multi-phase procedure, and whether it causes an higher lost treasure in comparison to the alternative rule. If it is true, since the multi-phase procedure is the rule currently applied, we could argue that the current ECJ's case law has the potential to lead parties away from arbitration on competition law disputes.

35 Ibid.
We intend to use the standard formulation of a rent-seeking game in litigation:

\[ p = \frac{\alpha A^r}{\alpha A^r + \beta B^r} \]

The probability \( p \) of winning the case, is a function of \( A \), namely plaintiff's level of effort in litigation, and \( B \), defendant's level of effort in litigation; with \( \alpha \) and \( \beta \) representing coefficients of parties respective position in the merit of the dispute. While the term \( r \) is a factor determining the productivity of rent-seeking expenditures. For the sake of simplicity, we shall assume that parties' stakes in the dispute are symmetric (\( W = L \)), in fact this is often the truth in contractual relationships. The model we are using to solve this problem is an adaptation of the one used by Dari-Mattiacci and Parisi to describe the rise of rent dissipation. We also choose to follow part of their notation and the useful simplification provided by the normalization of the value at stake \( W \).\(^{36}\)

In Dari Mattiacci-Parisi's model each party's share of the rent seeking competition (\( R_A \) for plaintiff and \( R_B \) for defendant) will be equal to:\(^{37}\)

\[ R_A = p_A - A \quad \text{and} \quad R_B = p_B - B \]

With \( p_A \) and \( p_B \) representing parties' respective probabilities to win the case in function of their respective efforts. As mentioned above, the parties value at stake \( W \) is not present in the formula because of the normalization.\(^{38}\) Regarding the first rule \( R_a \), assuming for simplicity that the parties have also symmetric merits in the dispute, namely \( \alpha = \beta = 1 \), the dissipation of effort analysis is perfectly identical to the one described by Dari Mattiacci and Parisi in their model of rent-seeking dissipation. Ex-ante, Parties' can expect that their net share of the rent (\( R_{na} \) for plaintiff and \( R_{nb} \) for defendant) is going to be:\(^{39}\)

\(^{36}\) Dari-Mattiacci, G., and F. Parisi, ‘Rents, dissipation and lost treasures: Rethinking Tullock’s paradox’ (2005) 124 Public Choice, 411. “In order to keep notation simple, we model the parties’ investment in rent-seeking as fractions of the rent. The literature has usually used capital letters like X and Y to denote the absolute values of the parties’ expenditures in rent-seeking and \( X/(X+Y)V \) and \( Y/(X+Y)V \) to denote the parties’ shares in the rent. Party X’s payoff is generally represented as \( X/(X+Y)V-X \) (the portion of the rent he or she earns minus the rent-seeking expenditure). In our model we use the labels A and B to denote the fractions of the rent that are spent on rent-seeking, rather than the absolute values of the expenditures. In our model, therefore \( A=X/V \). This merely represents a different way to measure effort, and it does not impinge upon the generality or the validity of the model. In our model, party A’s payoff is \( A/(A+B)V-AV=[A/(A+B)-A]V \). The absolute value of the rent, \( V \) [in our model this term \( V \) is called \( W \)], can thus be simplified (or simply normalized to 1), allowing us to concentrate on the parties’ expenditures and the magnitude of the dissipation as fractions of the rent.”

\(^{37}\) Please note that this is an upper case A to differentiate it from the term \( R_a \) representing the first legal rule, and the term \( R_{na} \), below, representing plaintiff’s share of the rent seeking competition under the first rule.

\(^{38}\) See footnote 23.

\[ R_{aA} = p_A - A = \frac{A'}{A' + B'} - A \]
\[ R_{aB} = p_B - B = \frac{B'}{A' + B'} - B \]

And the parties will maximize their own share of the rent by choosing \( A^* \) and \( B^* \) that satisfy the following first order conditions:

\[
\frac{\delta R_{aA}}{\delta A} : \frac{rA'^{-1}}{A' + B'} - 1 = 0
\]
\[
\frac{\delta R_{aB}}{\delta B} : \frac{rB'^{-1}}{A' + B'} - 1 = 0
\]

As proved by Dari-Mattiacci and Parisi, the levels of investment that satisfy (3) are \( A^* = B^* = r/4 \). This means that under the rule \( R_a \), namely when arbitral tribunal has authority to request preliminary ruling, if \( r = 2 \) each party will spend exactly 1/2 of the value of the dispute in rent-seeking and the two parties together will dissipate the whole value of the dispute.

Things get slightly more complicated in our adaptation of this model, describing parties' effort under the rule denying arbitral tribunals' authority to request a preliminary ruling. In our model's description of the problem, \( p_A \) and \( p_B \) are a function of \( p_1, p_2 \) and \( p_3 \) which are the probabilities that a party will win a respective phase of the three-phase procedure. They are functions of parties' respective effort in each phase, namely \( p_1(A_1, B_1), p_2(A_2, B_2) \) and \( p_3(A_3, B_3) \). Thus, parties respective probability of winning the case is \( p_A(p_{2A}, p_{2A}, p_{3A}) \), and \( p_B(p_{1B}, p_{2B}, p_{3B}) \) with the following extended formulation:

\[
p_{1A} = \frac{\alpha_1 A'_1}{\alpha_1 A'_1 + \beta_1 B'_1}; \quad p_{2A} = \frac{\alpha_2 A'_2}{\alpha_2 A'_2 + \beta_2 B'_2}; \quad p_{3A} = \frac{\alpha_3 A'_3}{\alpha_3 A'_3 + \beta_3 B'_3}
\]
\[
p_{1B} = \frac{\beta_1 B'_1}{\alpha_1 A'_1 + \beta_1 B'_1}; \quad p_{2B} = \frac{\beta_2 B'_2}{\alpha_2 A'_2 + \beta_2 B'_2}; \quad p_{3B} = \frac{\beta_3 B'_3}{\alpha_3 A'_3 + \beta_3 B'_3}
\]

In the light of this, we can accordingly change the formulation of Dari-Mattiacci and Parisi's model and make it compatible with the second rule, namely \( R_c \). In our model, parties' net shares of rent are derived from expression number (2), in part (II) of this paper (see "Ibid. As clarified in Dari-Mattiacci and Parisi: the second order conditions for this problem are \( \delta^2 R_{ac} / \delta A^2 = [- (A^*_c + B^*_c) / (A^*_c + B^*_c)] (rA^*_c B^*_c / (A^*_c + B^*_c)) \) and \( \delta^2 R_{ac} / \delta B^2 = [- (A^*_c + B^*_c) / (A^*_c + B^*_c)] (rA^*_c B^*_c / (A^*_c + B^*_c)) \). The reader may easily verify that the necessary values \( \delta^2 R_{ac} / \delta A^2 < 0 \) and \( \delta^2 R_{ac} / \delta B^2 < 0 \) are always guaranteed by \( A=B \) for any value of \( r \)."
above), and they are set as equal to:\(^{(4)}\)

\[
\begin{align*}
R_{CA}: & \quad p_{1A} p_{2A} + p_{1A} p_{3A} + p_{2A} p_{3A} - 2p_{1A} p_{2A} p_{3A} - |A_1 + A_2 + A_3| \\
R_{CB}: & \quad p_{1B} p_{2B} + p_{1B} p_{3B} + p_{2B} p_{3B} - 2p_{1B} p_{2B} p_{3B} - |B_1 + B_2 + B_3|
\end{align*}
\]

To make things simpler, without losing in precision, we can assume that since parties are not aware ex-ante of what will be the merit of the disputes they may assume to have symmetric cases in respect to the merits in all the phases of the procedure, namely that in all \( p_1, p_2 \) and \( p_3 \) the values \( \alpha = \beta = 1 \). Moreover, under such circumstance, the strategy for a party willing to maximize its chance to win the game is to divide its total effort in three equal amounts. The total amount that she is willing to invest in the litigation, namely the total effort will be compound of this three parts \( A_{\text{tot}} = A_1 + A_2 + A_3 \) and they will be all set equal to a value \( A_c = A_1 = A_2 = A_3 \). The same will be true for the counterpart \( B_{\text{tot}} = B_1 + B_2 + B_3 \) and with \( B_c = B_1 = B_2 = B_3 \). The obvious result of the above assumptions is that parties' probabilities of success in each phase of the dispute will be equal, i.e. \( p_1 = p_2 = p_3 \). These assumptions are not too restrictive. In fact we can expect that in line with the predictions of Priest-Klein's model on the selection of disputes for litigation, ex-post “when either plaintiff or defendant has a ‘powerful’ case, settlement is more likely because the parties are less likely to disagree about the outcome” of the trial. The contrary is true when a case is problematic, namely when the merit or the law applicable is uncertain.\(^{(42)}\) Therefore, ex-ante parties expect that ex-post they will settle cases in which one party has better merits and select for litigation those cases that will actually be characterized by both the most challenging merits and the most challenging interpretation of competition law. In other words, ex-ante parties will expect to litigate cases where the probability of winning is close to 50% in all the phases of the procedure.\(^{(43)}\)

After the simplification introduced by the above assumptions we can rewrite expression number (4) defining parties' net share of the rent in our model as equal to:


\(^{(43)}\) In further writings, it will be interesting to examine, this issue from the ECJ viewpoint which has an institutional mission to make the EU Law application clearer through it's case-law and therefore has an interest to hear such highly problematic cases.
\[ R_{cA} = 3p_A^2 - 2p_A^3 - 3A_c, \quad \forall p_A = \frac{A_c'}{A_c' + B_c'} \rightarrow R_{cA} = \frac{3A_c'^2}{|A_c' + B_c'|^2} - \frac{2A_c'^3}{|A_c' + B_c'|^3} - 3A_c \]
\[ R_{cB} = 3p_B^2 - 2p_B^3 - 3B_c, \quad \forall p_B = \frac{B_c'}{A_c' + B_c'} \rightarrow R_{cB} = \frac{3B_c'^2}{|A_c' + B_c'|^2} - \frac{2B_c'^3}{|A_c' + B_c'|^3} - 3B_c \]

In order to maximize their net share of the rent, for plaintiff in respect to A and for defendant in respect to B, the parties will choose \( A_c^* \) and \( B_c^* \) that satisfy the following first order conditions:

\[
\frac{\delta R_{cA}}{\delta A_c} : \frac{2rA_c'^{2r-1}B_c'^{2r}}{|A_c' + B_c'|^{4}} - 1 = 0
\]
\[
\frac{\delta R_{cB}}{\delta B_c} : \frac{2rB_c'^{2r-1}A_c'^{2r}}{|A_c' + B_c'|^{4}} - 1 = 0
\]

This result complies with the requirements set by the Dari Mattiacci-Parisi's model.\(^{44}\) In fact, when we compare expression number (5) with expression number (3), it is clear that they are qualitatively the same functions and they are diverging only quantitatively.\(^ {45}\) In fact, when \( A_c^* = B_c^* \) it is straightforward that in \( R_c \), namely under the rule denying authority to arbitrators, the levels of investment that satisfy (5) are \( A_c^* = B_c^* = r/8 \), while on the contrary in \( R_a \) above, the solution of (3), was: \( A^* = B^* = r/4. \(^ {46}\)

However, in our model the rents \( A_c^* \) and \( B_c^* \) are dissipated in each of the three phases of the litigation procedure and the total party's expenditure, namely \( A_{tot}^* \), is equal to 3 times \( A_c^* \) as well as \( B_{tot}^* \) is equal to 3 times \( B_c^* \). The following graphic clarifies our results comparing the two rules from a different perspective and representing the total lost treasure that occurs in the dispute resolution under the two analysed rules in function of the variable \( r \):

\(^{44}\) Second order conditions are always negative for any value of \( r \) given that \( A_c = B_c \).
\(^{45}\) In order to test this formulation we can set \( r = 1 \) and maximize each share function first in respect to A and then to B obtaining that the model provides results for \( A_c^* = B_c^* \) and the values of A and B are positively correlated to \( r \), namely when \( r \) increases A and B are going to increase as well.
Commenting the graph above, we can say that for all value of $r$ the second rule causes parties higher effort in litigation. In fact, under the rule granting arbitrators authority to use Article 267 TFEU ($R_a$) for $r = 1$ each party will spend $1/4$ of the value of the dispute in litigation with a total lost treasure will be equal to $1/2$ of the total value of the dispute. While under the rule denying arbitrators authority to use Article 267 TFEU ($R_c$), for $r = 1$ each party will dissipate $1/8$ of the dispute value, in each of the three-phases of the procedure. Namely, throughout the entire procedure each party will dissipate $3/8$ of the value of the case with a total dissipation, for the two parties together, equal to $6/8$ (simplified in $3/4$) of the value of the dispute instead of $1/2$ as under the first rule. Therefore, for $r = 1$ ECJ’s denied authority on arbitral tribunals will cost to parties and to the society a 25% higher rent-seeking dissipation value than what results when arbitral tribunals are granted such authority. The graph shows also that, under the two different rules, full dissipation of the value of the dispute will occur at different values of $r$. When the arbitral tribunal has authority to request preliminary ruling (the blue line, $R_a$) each party will spend exactly half of the value of the dispute in rent-seeking and the two parties together will dissipate the whole value of the dispute when $r=2$. On the contrary when the tribunal is denied such authority (the red line, $R_c$) the total dissipation is reached at a lower condition, namely $r=4/3$.\footnote{We should remember that, given our assumptions, to obtain the total party’s effort $A_{tot}$ and $B_{tot}$ the values $A_c$ and $B_c$ have to be multiplied by three, once for each phase of the procedure. Therefore $A_{tot} = 3A_c$ and $B_{tot} = 3B_c = 3r/8$, from which we derive that $A_{tot} = B_{tot} = 1/2$ if when $r=4/3$.}

Although it is out of the scope of this paper we shall specify that Dari-Mattiacci and Parisi
found that when such point is reached if parties have an exit-option, namely do not file a lawsuit, parties will start to use the exit option together with mixed participation strategies. “When parties randomize their participation in the game there is a positive probability that no party plays and the rent remains unexploited” creating a lost treasure loss.⁴⁸ As we can see from the graph the point at which the lost treasure loss starts sooner under $R_c$ then under $R_a$.

**Proposition 1:** Everything else constant, under a rule denying arbitral tribunals’ authority to refer for preliminary ruling, parties expenditure in rent-seeking and the total lost treasure in competition law disputes will be higher in comparison to those under a rule granting arbitral tribunals authority to apply Article 267 TFEU. When parties become aware of such principle, they may ex-ante exclude competition law from their contractual arbitration clauses preferring national litigation forums.

The policy implication is quite clear, this is an analytical argument for a reversal in the ECJ’s case-law. We could reformulate Proposition 1 in a more general form saying that multiple and independent jurisdictions in the decision of a dispute produce an increase in parties expenditure in a rent-seeking competition and lost treasure in comparison to a decision reached in front of a single adjudicator.

**Conclusion**

We applied two of the most fortunate law and economics models on litigation to analyse the effects of the European Court of Justice’s interpretation of Article 267 of the Treaty on the Functioning of the European Union. When the European Court of Justice denies arbitral tribunals authority to request a preliminary ruling it also causes adverse effects on parties incentives to use arbitration proceedings for resolving their competition law disputes. Consequently it impairs the effectiveness and efficiency of arbitration as a mechanism of private enforcement of EU competition law. The Priest and Klein’s model on the selection of disputes for litigation helped us to define the participation constraint for entering into litigation under the described ECJ’s case law. However the core of our analysis calls up the Dari Mattiacci and Parisi’s model on the dissipation of value through rent-seeking to show how parties level of effort is affected by the possible interpretations of Article 267 TFEU. As expected, the result of this exercise provides a strong argument for reverting the current interpretation of Article 267 TFEU. In fact holding every other variable

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constant, under the current ECJ’s interpretation of this rule, parties dissipation of value through rent-seeking will be higher. In conclusion the investigated ECJ’s case-law needs an amendment if we are willing to exploit the full potential that arbitration can offer to the private enforcement of EU competition law.

References


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