

## The Arbitrator's Jurisdiction to Determine Jurisdiction

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The boundaries of my language signify the borders of my world.  
-- Ludwig Wittgenstein<sup>1</sup>

### **Introduction: The Limits of Language**

Legal phrases, maxims and rules often enhance efficient dispute resolution by providing intellectual hooks on which to hang analysis, as well as mental handles with which to arrange otherwise complex arguments. Like the questions we ask, the language of the law can shape the choices ultimately made by arbitrators and judges.

Words can beget misunderstanding as well as insight, however. Expressions which bear multiple meanings often find themselves employed with promiscuous disregard to context and function.

The disorienting effect of language finds illustration in the principle that arbitrators may rule on their own authority. Often expressed as *Kompetenz-Kompetenz*<sup>2</sup>

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<sup>1</sup> Die Grenzen meiner Sprache bedeuten die Grenzen meiner Welt. LUDWIG WITTGENSTEIN, TRACTUS LOGICO-PHILOSOPHICUS (1921), at § 5.6. In the original, the juxtaposition of boundaries (*Grenzen*) and the verb to signify (*bedeuten*) is particularly striking, since linguistic meaning usually grounds itself in distinctions and demarcation. An Austrian philosopher who taught at Cambridge in the early 20th century, Wittgenstein continues to influence legal theory in certain quarters. See EDUARDO SILVA ROMERO, WITTGENSTEIN ET LA PHILOSOPHIE DU DROIT (2002), § 271 at 353-355; PROTRACTATUS, AN EARLY VERSION OF TRACTATUS LOGICO-PHILOSOPHICUS (B.F. McGuinness, T. Nyberg & G. H. von Wright, eds., D.F. Pears & B.F. McGuinness, trans., 1971); TRACTATUS LOGICO-PHILOSOPHICUS (Pierre Klossowski, trans., 1961), providing a slightly nuanced rendering of the cited phrase, “Les limites de mon langage signifient les limites de mon propre monde.” Id. at 86.

<sup>2</sup> Normally interchangeable, *compétence-compétence* and *Kompetenz-Kompetenz* often take their usage by the speaker’s preference for a German or a French formulation. Given a slight scholarly preference for the German phrase, that formulation will be used in this paper. See generally Pierre Mayer, *L’Autonomie de l’arbitre dans l’appréciation de sa propre compétence*, 217 RECUEIL DES COURS 320 (Académie de droit international de La Haye 1989); Emmanuel Gaillard, *L’effet négative de la compétence-compétence*, in ÉTUDES DE PROCÉDURES ET D’ARBITRAGE EN L’HONNEUR DE JEAN-FRANÇOIS POUDET 385 (J. Haldy, J-M. Rapp & P. Ferrari, eds., 1999); ADAM SAMUEL, JURISDICTIONAL PROBLEMS IN INTERNATIONAL COMMERCIAL ARBITRATION, Chs. 4 & 5, 177-274 (1989).

(literally “jurisdiction on jurisdiction”), the precept has been applied to questions such as *who* must arbitrate, *what* must be arbitrated, and *which* powers arbitrators may exercise.<sup>3</sup> As we shall see, this much-vexed principle possesses a chameleon-like quality that changes color according to the national and institutional background of its application.

The basic rule that arbitrators may decide on their own jurisdiction says nothing about who ultimately decides a particular case. Rather, the rule states only that the question of “who decides what” may itself be addressed by an arbitrator. At least until a competent court directs otherwise, arbitral proceedings need not stop just because one side challenges the arbitrator’s authority.

To say that arbitrators may make jurisdictional decisions tells only part of the story.<sup>4</sup> Every jurisdictional ruling by an arbitrator begs two further questions, one relating to timing and the other to finality.

The timing question asks when judges should intervene in the arbitral process to monitor possible jurisdictional excess. If an unhappy respondent denies having agreed to arbitrate, a court might be requested to declare the arbitration clause invalid. Should a judge entertain a “mid-arbitration” request to stop the proceedings? Or should the respondent be required to wait until an award has been rendered, and only then seek vacatur for alleged jurisdictional excess?

Each alternative carries its own risks and opportunities for mischief. Delay in

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<sup>3</sup> When the very existence of the arbitration agreement is challenged, the term “arbitrator” may turn out to be a misnomer. However, to avoid an unduly heavy style, discussions of arbitral jurisdiction often speak of “arbitrator” (rather than “alleged arbitrator”) even when that status remains an open question. In that context, the term is used for convenience, with no intent to presume ultimate conclusions on the matter.

<sup>4</sup> While thoughts may be simultaneous, words remain sequential, creating a chronically inadequate container for legal truth, reminiscent of the “treasure in earthen vessels” mentioned in Paul’s Second Epistle to the Corinthians (II Cor. 4:7).

judicial scrutiny can subject respondents to the expense of unauthorized proceedings before overreaching arbitrators.<sup>5</sup> However, early access to courts increases opportunities for dilatory tactics. In the business world, determining the scope of arbitration clauses may implicate time-consuming investigations into complex questions of fact and law related to matters such as agency relationships and the corporate veil.<sup>6</sup>

The second question relates to the effect that judges should give to arbitrators' jurisdictional rulings. In what circumstances (if any) should an arbitrator's decision on his or her authority be final?

Legal systems differ on whether and when an arbitrator's decision on his or her authority should foreclose judicial determination on the matter. Some countries (notably the United States) implement the litigants' agreement to have arbitral authority determined by the arbitrators themselves. Judges, of course, must still ask what (if anything) the parties actually expected the arbitrator to decide.<sup>7</sup> Assuming such an agreement exists, however, it will be respected.

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<sup>5</sup> Under some circumstances (depending on the applicable institutional rules and arbitral situs) the arbitrators may award costs against the losing party, including attorneys' fees. Not always, however, as proven by recent American case law. See *CIT Project Finance v. Credit Suisse First Boston*, 799 NYS2d 159, 2004 WL 2941331 (2004), holding an award of attorneys' fees to be permissible only if explicitly provided in the parties' agreement.

<sup>6</sup> See e.g., *Intergen v. Grina*, 344 F.3d 134 (1st Cir. 2003) (litigation between two parent entities, neither of which had signed arbitration clause, with one side seeking a "plaintiff friendly" court); *Bridas v. Turkmenistan*, 447 F.3d 411 (5th Cir. 2006) (government manipulation of oil company made it the state's alter ego); *Sarhank v. Oracle Corp.*, 404 F.3d 657 (2d Cir. 2005) (parent should not answer pursuant to arbitration clause signed by subsidiary); *Kazakhstan v. Istil Group*, [2006] EWHC 448 (Comm.) Queen's Bench (vacating award against Kazakhstan for lack of substantive jurisdiction.); *Fluor Daniel Intercontinental v. General Electric Co.*, 1999 WL 637236 (SDNY, 20 August 1999) (estoppel required signatories of arbitration clauses to arbitrate with non-signatory).

<sup>7</sup> In many instances the question will be more along the lines of what the parties expectations would have been had they given the matter any thought.

Other countries (notably Germany) seem to preclude such agreements to arbitrate arbitrability. This approach sacrifices liberty of contract in order to provide an extra measure of protection against inadvertent loss of the proverbial day in court.

This dual line of inquiry, looking at timing of judicial intervention and effect of arbitral determinations, can remove much of the mystification afflicting jurisdictional discourse in arbitration law. From a policy perspective, the correct answers will not always be self-evident. However, asking the right questions, rather than simply reciting a catch-phrase, permits attention to costs and benefits of each alternative, enhancing the transactional security and economic cooperation that can be facilitated by arbitration.<sup>8</sup>

## I. The Basics

### A. An Anti-sabotage Mechanism

#### 1. The Principle in Primitive Form

In its most primitive form, the principle that arbitrators may rule on their

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<sup>8</sup> While the rationale for arbitration varies according to context, its core value lies in the same principles that justify freedom of contract. Business managers can negotiate a “fix to fit the fuss” as people in the American South say. For international contracts, arbitration enhances neutrality (and thus predictability) and secures a significant treaty enforcement mechanism. In business-to-business transactions, arbitration can facilitate access to expertise, particularly in construction and reinsurance. By contrast, the motivator for American consumer arbitration often lies in avoiding jury trial. This does not mean that arbitration commends itself for all agreements. See Theodore Eisenberg and Geoff Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in Publicly-Held Companies' Contracts* (30 August 2006), Cornell Legal Studies Research Paper Series, which studies more than two thousand contracts contained as exhibits in 2002 for Form 8-K SEC filings, required under American securities laws for material events. The study finds that only 11 % of the contracts included arbitration clauses. The highest rates were to be found at 37% and 33% for employment and licensing contracts respectively.

jurisdiction serves as a measure to protect against having an arbitration derailed before it begins. The arbitral tribunal (and/or the relevant arbitral institution) need not halt the proceedings just because one side questions its authority. The principle reduces the prospect that proceedings will be derailed through a simple allegation that an arbitration clause is unenforceable, due to any number of contract law defenses. In most legal systems,<sup>9</sup> arbitrators can get on with their work until ordered to stop by a judge with authority to do so.<sup>10</sup>

The rule is not foolproof, of course, given the eternal ingenuity with which fools often acquit themselves. Recalcitrant parties can still mount troublesome court

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<sup>9</sup> Exceptions do exist, however. In China, for example, the power to rule on the validity of an arbitration agreement is given to “the arbitration commission” (which is to say, the supervisory arbitral institution) rather than the arbitrators. The assumption seems to be that *ad hoc* arbitration does not take place in China. Article 20 of the Arbitration Law of the People’s Republic of China (effective 1 September 1995) provides, “If a party challenges the validity of the arbitration agreement, he may request the arbitration commission to make a decision or apply to the People’s Court for a ruling. If one party requests the arbitration commission to make a decision and the other party applies to the People’s Court for a ruling, the People’s Court shall give a ruling.” See translation in CHENG DEJUN, MICHAEL J. MOSER, & WANG SHENGCHANG, *INTERNATIONAL ARBITRATION IN THE PEOPLE’S REPUBLIC OF CHINA* (2nd edn, 2000), at 727. Article 26 of the same statute provides that an arbitration agreement must designate an “arbitration commission”. While this term clearly includes Chinese arbitration institutions, it is not entirely certain to what extent foreign associations fall within its purview. See discussion in Jingzhou Tao, *Articles 16 and 18 of the PRC Arbitration Law*, 23 *ARBITRATION INTERNATIONAL* (2007), forthcoming.

<sup>10</sup> Anti-arbitration injunctions issued by courts with questionable authority over the arbitration raise issues beyond the scope of this paper. See Emmanuel Gaillard, *Reflections on the Use of Anti-Suit Injunctions in International Arbitration*, in *Pervasive Problems in International Arbitration* 203 (L. Mistelis & J. Lew, eds. 2006). See also Hakeem Seriki, *Anti-Suit Injunctions and Arbitration: A Final Nail in the Coffin?*, 23(1) *J. INT’L ARB.* 2 (2006). For the time being, let us assume that a Massachusetts court monitors an arbitration taking place in Boston, that a Paris judge is asked to recognize an award rendered against a French company, or that a Swiss judge is called to enforce an award by attaching assets in a Geneva bank. We can leave for another day the circumstances under which a court in Mumbai or Karachi might attempt to enjoin an arbitration in London.

challenges (even if not ultimately successful) designed to slow the train.<sup>11</sup> However, the principle does avoid conceptual barriers to arbitration that would exist if legal systems considered jurisdictional powers of judges and of arbitrators to be mutually exclusive.<sup>12</sup>

On occasion, analogies have been made between arbitral jurisdiction and the power of courts to construe constitutional provisions related to their authority. Such comparisons should be resisted. Few non-circular options exist for interpreting judicial authority, at least in western legal systems. By contrast, in commercial arbitration the enforcement of arbitral authority (initially a matter of the litigants' consent<sup>13</sup>) normally rests with national courts, which must undertake some investigation into the legitimacy of that authority as part of the enforcement process.

## 2. Diversity: The Timing and Impact of Court Intervention

Although most countries accept that a jurisdictional objection does not automatically stop an arbitration, little consensus exists on other aspects of an arbitrator's

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<sup>11</sup> See generally PHILIPPE FOUCHARD, EMMANUEL GAILLARD, & BERTHOLD GOLDMAN, *TRAITÉ DE L'ARBITRAGE COMMERCIAL INTERNATIONAL* (1996), Sections 660-682; W. LAURENCE CRAIG, WILLIAM W. PARK, & JAN PAULSSON, *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION* (3rd ed, 2000), at 48-49 & 512-515; W. MICHAEL REISMAN, W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, *INTERNATIONAL COMMERCIAL ARBITRATION* (1997), at 524-540 & 645-664; Antonias Dimolitsa, *Autonomie et Kompetenz-Kompetenz*, 1998 Rev. arb. 305.

<sup>12</sup> While few modern legal systems follow such an approach, vestiges can still be found in some court decisions. See *MBNA America Bank v. Loretta Credit*, 281 Kansas 655 (2006), discussed *infra*.

<sup>13</sup> Without such consent, there would be insufficient connections to the parties or transaction sufficient to justify any jurisdiction at all. The state does, of course, provide support for the parties' agreement, principally in the form of judicial enforcement of the award, conditioned on the respect for minimum standards of procedural fairness. The consent underlying arbitration remains qualitatively different from the implied submission to government courts that arguably results from living in society. Arbitration agreements empower a particular adjudicator to decide specific questions with respect to a limited number of persons, constrained by a contractually-conferred mission.



ruling on his or her authority. National practice diverges in both (i) the timing of court examination of arbitral authority and (ii) the impact that an arbitrator's jurisdictional ruling will have in a judicial proceeding.

Diversity results from the fact that an arbitrator's jurisdictional power, at least in commercial arbitration,<sup>14</sup> derives from national law and institutional rules,<sup>15</sup> not from the treaty framework imposed by the New York Convention.<sup>16</sup> Consequently, the expression *Kompetenz-Kompetenz* has thus taken on several lives, giving rise to a constellation of related but distinct notions, often subject to undue mystification.<sup>17</sup> While commentators sometimes refer to "the internationally recognized doctrine" of *Kompetenz-Kompetenz*,<sup>18</sup>

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<sup>14</sup> A different regime obtains for investment arbitration under the ICSID Rules, under which awards are subject to review not by national courts, but by an internal annulment process. See Article 52 of the 1965 Washington Convention. Treaty foundations also exist for other supra-national adjudicatory bodies, such as the European Court of Justice, the International Court of Justice, and the European Court on Human Rights.

<sup>15</sup> For institutional incarnations of the principle, see e.g., ICC Rules Article 6, UNCITRAL Rules Article 21, AAA International Rules Article 15, LCIA Rules Article 23 and ICSID Rules Article 41.

<sup>16</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 330 U.N.T.S. 38, 21 U.S.T. 2517, T.I.A.S. No. 6997 (1958). Twenty four countries originally signed the Convention. The rest have joined by accession or succession. The most recent adherents include Afghanistan, Liberia, Pakistan and the United Arab Emirates, bringing to one hundred thirty-eight (138) the total number of countries bound by the treaty. Although the Convention requires courts to respect arbitration agreements and awards, grounds for invalidating an arbitration clause lie with national law. For example, Article V(1)(a) speaks of the parties incapacity "under the law applicable to them" or the agreement's invalidity under "the law to which the parties have subjected it." In this, the Convention is not unlike Section 2 of the U.S. Federal Arbitration Act, which leaves the validity of an arbitration agreement to state contract law.

<sup>17</sup> Unfortunately, more than one symposium has given the principle an unfortunate oversimplification, with sweeping generalizations that derive either from the ignorance of a novice or (in some instances) the polemical mischief of someone who knows better but for ideological reasons suggests that "international jurisdictional standards" represents a synonym for the way things are done in France.

<sup>18</sup> DAVID JOSEPH, JURISDICTION AND ARBITRATION AGREEMENTS AND THEIR ENFORCEMENT (2005), Section 13.23, at 392. Compare Laurent Lévy, *Anti-Suit*

it would be more accurate to speak of doctrines in the plural.<sup>19</sup> Variations derive both from disparate implementations of the principle and from divergent views on what exactly is meant by a “jurisdictional question”.<sup>20</sup>

To illustrate, if German courts are asked to hear a matter which one side asserts is subject to arbitration, they would decide immediately on the validity and scope of the arbitration agreement.<sup>21</sup> In neighboring France, challenge of arbitration clauses must normally wait until an award has been rendered.<sup>22</sup>

Across the Channel in England, litigants have a right to declaratory decisions on

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*Injunctions Issued by Arbitrators*, in ANTI-SUIT INJUNCTIONS IN INTERNATIONAL ARBITRATION 115 (E. Gaillard, ed. 2005) suggesting that “in upholding their jurisdiction, arbitrators implicitly declare that any other court .. is prevented from ruling on the same matter.” *Id.* at 117. While consistent with French doctrine, this position would not represent expectations of most American arbitrators, familiar with possible judicial decisions on jurisdiction during arbitral proceedings. Other perspectives in this collection of essays on anti-suit injunctions include contributions by Axel Baum, Frédéric Bachand, Matthieu de Boisséson, José Carlos Fernández Rozas, Philippe Fouchard, Christopher Greenwood, Konstantinos Kerameus, Julian Lew, Michael Schneider and Steven Schwebel.

<sup>19</sup> In some literature, it has also been suggested that so-called “anti-suit injunctions” issued against arbitration violate the principle that arbitrators determine their own jurisdiction. See Emmanuel Gaillard, *Il est interdit d’interdire*, 2004 REV. ARB. 47 (2004), discussed *infra*. The usefulness of such a perspective depends on what version of *Kompetenz-Kompetenz* principles are taken as a standard baseline.

<sup>20</sup> As models for various wrinkles on the problem of *Kompetenz-Kompetenz*, the current paper focuses on the law of six legal systems: England, France, Germany, Switzerland, the United States and the UNCITRAL Model Law. This selection was made to further analytic clarity, and in no way implies a lack of interest or importance with respect to other legal systems.

<sup>21</sup> ZPO, Section 1032(1).

<sup>22</sup> NCPC, Article 1458. In some countries, notably Greece, distinctions seem to be made between decisions confirming jurisdiction (review permitted) and denying jurisdiction (review not permitted). See STELIOS KOUSSOULIS, JURISDICTIONAL PROBLEMS IN INTERNATIONAL ARBITRATION (2000) at 59-62.

arbitral authority only if they take no part in the arbitration.<sup>23</sup> In Germany the admissibility of such applications depends on whether the arbitral tribunal has already been constituted.<sup>24</sup> By contrast, it seems that courts may entertain applications for jurisdictional declarations at any time in Sweden<sup>25</sup> and in Finland.<sup>26</sup>

In Switzerland, courts asked to appoint an arbitrator will normally apply a *prima facie* standard in deciding whether the arbitration clause is valid, but engage in full consideration of jurisdiction (at least as to law) in the context of award review.<sup>27</sup> American courts, however, may order full examination of the validity of an arbitration clause at *any* stage of the arbitral process to determine whether, as a matter of fact and law, the parties have indeed agreed to arbitrate.<sup>28</sup>

The United States generally permits parties to give arbitrators the final word on some aspects of arbitral power.<sup>29</sup> A similar result would seem to obtain in Finland.<sup>30</sup> In

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<sup>23</sup> 1996 English Arbitration Act, Section 72.

<sup>24</sup> ZPO, Section 1032(2), permitting applications only before the tribunal's constitution.

<sup>25</sup> 1999 Swedish Arbitration Act, Section 2, discussed in Kaj Hobér, *Arbitration Reform in Sweden*, 17 *ARB. INT'L* 351 (2001) at 357-58; Christopher Seppälä, *Comment on Section 2 of the Swedish Arbitration Act of 1999 Dealing with the Right of Arbitrators to Rule on their Own Jurisdiction*, in *THE SWEDISH ARBITRATION ACT OF 1999 FIVE YEARS ON: A CRITICAL REVIEW OF STRENGTHS AND WEAKNESSES* 45 (Lars Heuman & Sigvard Jarvin, eds. 2006).

<sup>26</sup> Petri Taivalkoski, *Le nouveau droit finlandais de l'arbitrage international*, in *RECHERCHE SUR L'ARBITRAGE EN DROIT INTERNATIONAL ET COMPARÉ* 126 (1997). Making reference to Section 50 of the 1992 Arbitration Act (23 October 1992/967), Dr. Taivalkoski writes, "Quant à la demande principale concernant la validité de la convention d'arbitrage, le droit finlandais prévoit la possibilité d'intenter une action déclaratoire de nullité contre la convention d'arbitrage indépendamment de toute action au fond." *Id.* at 158 .

<sup>27</sup> LDIP, Articles 7 and 179(3).

<sup>28</sup> *Sandvik AB v. Advent Int'l Corp.* 220 F. 3d 99 (3d Cir. 2000).

<sup>29</sup> See discussion of *First Options*, *infra*.

other countries, however, the effect of such agreements remains far from clear.<sup>31</sup>

In light of this multiplicity of applications, the temptation exists to suggest that the term *Kompetenz-Kompetenz* be exiled from the arbitration lexicon, and that scholars abandon any hope of rationalizing the principle. Such radical change would be ill-advised, however. Only the most compelling reasons justify banishment of time-honored notions.<sup>32</sup> The remedy for confusion will normally lie in a fuller appreciation of the contextual application of the term, a task to which we now turn.

The modest suggestions of this paper are threefold. First, discourse about arbitral jurisdiction suffers considerable damage through loose jargon divorced from specific national practice. What matters is *when* courts examine the parties' actual agreements about arbitral authority and the *effect* (if any) that judge give those agreements. Second, agreements to submit jurisdictional questions to arbitration should be honored but not presumed. Finally, although arguments about the timing of judicial intervention remain finely balanced, the weightier considerations argue for postponing most jurisdictional

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<sup>30</sup> Gustaf Möller, *The Arbitration Agreement*, LAW AND PRACTICE OF ARBITRATION IN FINLAND 7 (Finnish Arbitration Association 2004), noting as follows: “[T]he parties may by a separate arbitration agreement confer on the arbitrators the power to finally determine the matter of jurisdiction in a final and binding award. A specific separate arbitration agreement as to the jurisdiction of the arbitral tribunal will give the tribunal the power to decide this question and has the effect that a party expressly waives his right to challenge the award on jurisdiction. Conversely, if the arbitral tribunal – subjectg to a specific agreement to make a final decision on jurisdiction – finds that it has no jurisdiction, such decision would be final.” *Id.* at 17.

<sup>31</sup> See discussion of jurisdictional agreements in German law, *infra*.

<sup>32</sup> One recalls the words of Jean Portalis, an illustrious author of the French Civil Code: Tout ce qui est ancien a été nouveau; l'essentiel est d'imprimer aux institutions nouvelles le caractère de permanence et de stabilité qui puisse leur garantir le droit de devenir anciennes. (“All which is old was once new; the essential is to imprint on new institutions the character of permanence and stability capable of guaranteeing their right to become old.”) Discours préliminaire sur le projet de Code civil (1804).

inquiry until after the award has been rendered.

B. Judicial Intervention: When and to What Extent?

1. The Shadow of Public Power

On its face, *Kompetenz-Kompetenz* addresses the powers of arbitrators, in particular their right to make jurisdictional rulings. The flip side of the equation, however, reveals a rule about courts, and the limitations on judges' ability to hear certain matters imposed when litigants decide (or allegedly decide) to submit controverted questions to private dispute resolution. This reverse perspective highlights the heart of understanding how the principle works in practice.

Although private, arbitration proceeds in the shadow of public coercion. Arbitrators have no marshals or sheriffs, and thus parties often ask judges to stay litigation, compel arbitral proceedings, seize assets or grant *res judicata* effect to an award so as to preclude competing court actions. The contours of arbitral power thus concern not only arbitrator and litigants, but also national legal systems which must establish guidelines for when and to what extent courts may intervene to review or to preempt the arbitrator's jurisdictional ruling.

From the perspective of a national legal system, challenges to an arbitrator's authority raise two distinct questions. The first relates to the point in the arbitral process when courts ought to examine arbitral authority to prevent or correct an excess of jurisdiction.<sup>33</sup> The second addresses the matter of when (if ever) courts should defer to an arbitrator's jurisdictional determination as final.

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<sup>33</sup> The somewhat awkward phraseology, "preventing or correcting" imposes itself by virtue of the fact that judges sometimes intervene at the beginning of the process (to compel arbitration or to consider competing court litigation) and sometimes at the end (to review awards).

## 2. Timing

The first inquiry concerns the *timing* of judicial intervention. Paradigms range from the American approach (courts may intervene at any moment) to the French model (courts wait until after an award is rendered). The difference becomes significant when one side to the dispute makes application to a court with supervisory (curial) competence over the arbitration, asking that the proceedings be stopped or that a case be heard notwithstanding an alleged arbitration clause.<sup>34</sup>

Between these two extremes, many legal systems provide hybrid timing solutions that vary according to the specific posture in which arbitral jurisdiction has been challenged. One standard might apply when a legal action is brought in respect of matters purportedly referred to arbitration. Another standard might pertain to motion for declaratory judicial determination of preliminary jurisdictional questions. Distinctions might be made depending on whether the applicant has or has not taken part in the arbitration.<sup>35</sup>

## 3. Effect of an Arbitrator's Determination

The other question relates to the *effect* of an arbitration agreement on jurisdictional questions. A legal system might take the position that all arbitral decisions

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<sup>34</sup> On the costs and benefits of different timing options, see Christopher Seppälä, *Comment on Section 2 of the Swedish Arbitration Act of 1999 Dealing with the Right of Arbitrators to Rule on their Own Jurisdiction*, in *THE SWEDISH ARBITRATION ACT OF 1999 FIVE YEARS ON: A CRITICAL REVIEW OF STRENGTHS AND WEAKNESSES* 45 (Lars Heuman & Sigvard Jarvin, eds. 2006).

<sup>35</sup> In England, for example, one can see the interaction of 1996 Act Sections 9 (stay of legal proceedings in respect of matters referred to arbitration), 30 (jurisdiction to determine jurisdiction), 32 (application for judicial determination of preliminary questions) and 72 (person who takes no part in arbitration may apply for court declaration). Compare the situation with respect to pre-award judicial intervention in Germany, Sweden and Switzerland, all discussed *infra*.

on jurisdiction may be reviewed *de novo* by the appropriate court.<sup>36</sup> However, such is not the only option, or even the most sensible one. An alternative would be for courts to ask what jurisdictional matters the parties agreed the arbitrator would decide, and to defer accordingly.

Each option presents its own risks, requiring lawmakers to navigate between policy dangers much as Odysseus had to sail between Scylla and Charybdis. If courts may defer to arbitrators on jurisdictional matters, intellectual sloppiness (or a desire to clear dockets) might lead judges to accept mere contract recitals rather than to engage in rigorous inquiry into what the parties really meant. The other risk lies in undue rigidity, precluding recognition even of the litigants' clearly expressed wishes for finality in arbitral determinations about jurisdiction issues.

In systems where courts may defer to an arbitrator's jurisdictional determination, judges must still examine arbitral authority. However, the analysis takes place at a different level, asking whether the parties intended an arbitrator to have the last word on a particular jurisdictional issue. The pertinent question is what the contract provides.<sup>37</sup>

With the obvious exception of challenges based on public policy (non-arbitrable subjects), analysis would normally focus on the parties' pre-dispute intent. Courts must examine the facts of each case as they bear on the parties' pre-dispute expectations. If

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<sup>36</sup> In most cases, courts *will* have the last word on jurisdiction, rendering misplaced the fretting about arbitrators' "unfettered discretion" such as evidenced in *Ottley v. Sheepshead Nursing Home*, 688 F. 2d 882 (2d Cir. 1982) at 898 (Lombard, J., dissenting).

<sup>37</sup> The alternative of no judicial review does not necessarily conflict with the first and second timing alternatives. It might be that an American court, examining jurisdiction early in the game when a motion is made to compel arbitration, comes to the conclusion that the parties intended for the relevant issue to be given to the arbitrator for decision. As discussed below, the two timing extremes are represented by the French model (which defers judicial intervention until the award stage) and the situation in the United States (where courts may address arbitral jurisdiction at any moment).

(and only if) the litigants intended arbitration of a particular jurisdictional question, the matter would be given to the arbitrator for ultimate disposition, not just an expression of preliminary views. However, in all events courts would first look seriously at the parties' expectations.

#### 4. A Cautionary Tale about an (Allegedly) Lazy Professor

The point about the binding nature of an agreement to arbitrate jurisdiction might be illustrated by the following scenario. Imagine a publication dispute between a law journal and a learned professor. Having written an article for the journal, the professor asserts that the editor agreed to pay a \$1000 royalty. On failure to pay, she files an arbitration claim based on what she believes to constitute a valid arbitration clause in the license to publish.

“No way!” the editor replies. “On its face, the clause provides that an arbitrator has jurisdiction *only* over claims filed within thirty days after the dispute arises. This lazy professor missed that deadline, having waited to file her claim on the 4th of July, more than two months after our early May disagreement on the matter.”

The professor sees things quite differently. She replies that no differences arose until the middle of June. She recalls no discussion in May, and challenges the editor's recollection.

Primitive *Kompetenz-Kompetenz* notions would permit an arbitration to go forward notwithstanding the challenge, at least until a competent court directs otherwise. The French approach would go further, allowing an arbitrator to address his or her authority free from judicial interference until after an award has been rendered.

It might be that the author and the journal decide to establish an explicit process



by which to resolve their jurisdictional differences. They sign a written agreement to have an arbitrator determine when the disagreement arose: the first week of May or the middle of June. They agree that the same proceeding will address entitlement to the \$1000, and that both questions will be addressed by an eminent French scholar whom they jointly appoint as sole arbitrator.

After hearing the witnesses and reading the parties' submissions, the arbitrator finds no evidence of a disagreement before the 15th of June.<sup>38</sup> This means the author's claim was timely filed on the 4th of July. Further, the arbitrator finds that the editor did indeed agree to pay \$1000 for the article.

Does any sound policy gives the editor a jurisdictional escape hatch? Having agreed to submit the time limits to arbitration, why should the Editor be allowed to renege on the bargain and ask courts to decide *de novo* when the disagreement occurred? Although a judge might be skilled at weighing the evidence, the parties submitted the question to arbitrators.

Any such a second bite at the jurisdictional apple would seem inconsistent with the whole thrust of modern arbitration law, aims to give *res judicata* effect to arbitral awards based on valid agreements. Any arbitral award should, of course, be subject to challenge for jurisdictional infirmity, such as physical coercion or forgery in the arbitration clause. However, an agreement accepted with informed consent, followed by fair proceedings, should bind both sides. Having lost the arbitration, the editor should not be permitted to refuse the author her \$1000 fee by re-opening the dispute. Indeed, if the

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<sup>38</sup> The time limits in this scenario, we remember, are restrictions on arbitral authority, not statutes of limitations. The latter remain substantive. The hypothetical presumes that the challenge is launched against the right to arbitrate, not substantive recovery.

award is made abroad, refusal to grant recognition might well violate the New York Convention.

In this cautionary scenario, a particular issue (the date of the Editor/author disagreement) started out being characterized as “jurisdictional” but ended (by the parties’ consent) as a matter of the “substantive merits” in their dispute. There is nothing unusual about such transformation. Without going as far as the proverbial Humpty Dumpty,<sup>39</sup> most thoughtful people accept that words have different meanings in different contexts, and that language would be misapplied if labels used against one background are transferred to another with no adjustment to take into account their function.<sup>40</sup>

#### 5. A Word on Procedural Context

The standards by which courts evaluate arbitration clauses often vary according to the procedural context in which the clauses present themselves. Much depends on what might be called the “mechanics” of judicial review, with some countries applying different criteria to pre-award and post-award judicial scrutiny, to distinguish between *prima facie* and full review. On occasion, legal systems permit jurisdictional challenges brought in the course of court actions (“stop the lawsuit so we can arbitrate”) but deny requests for declarations about ongoing arbitrations (“stop the arbitration because we

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<sup>39</sup> In an episode from the sequel to *Alice in Wonderland*, Humpty Dumpty asserted, “When I use a word, it means just what I choose it to mean -- neither more nor less.” LEWIS CARROLL, *THROUGH THE LOOKING GLASS* (1872). The whimsical reference serves as a warning against careless vocabulary. However, language can also be misapplied if labels in one context are transferred automatically to another, with no adjustment to take into account their purpose.

<sup>40</sup> Some things are said to go without saying. Nevertheless, they may go much better *with* the saying. For example, the word “run” can be used as a verb and noun, with quite different meanings, depending on its context. When we have a head cold, our noses run. As a financial institution fails, there may be a run on the bank.

should be in court”).<sup>41</sup> In some instances a court will address jurisdiction differently depending on whether or not the arbitration has actually begun.<sup>42</sup> Different rules might also apply according to whether the arbitration is conducted locally or abroad.<sup>43</sup>

Several scenarios merit consideration. First, applications might be brought to review awards, either partial or final. Such requests could be made at the place of arbitration (motions to vacate or to confirm an award) or at the enforcement situs (motions to recognize or to enforce an award). Second, a respondent in a court action might assert an arbitration clause as a bar to a lawsuit brought on the merits of claim, usually for breach of contract. Finally, a litigant considering that a dispute should be heard in court rather than in arbitration may petition for a judicial declaration (combined with an injunction in some countries) about the scope or validity of an arbitration clause. Such actions might be brought either before or during the arbitration.

## 6. Review Standards

Differences relate not only to when and whether courts may address arbitral jurisdiction, but on the standards of review applied when they do examine the validity of the arbitration clause. The most significant dividing line relates to whether the judge will

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<sup>41</sup> In systems that permit injunctions, like the United States, motions for declarations related to arbitrations would likely be combined with motions to enjoin or to compel the arbitral proceedings.

<sup>42</sup> See discussion of German ZPO Section 1032(2) and French NCPC Article 1458. In many countries, of course, the various procedural postures are not always easily separated. In the United States, for example, applications to stay lawsuits and motions to compel arbitration are often made before the same court at the same time. See e.g., *Intergen v. Grina*, 344 F. 3d 134 (1st Cir. 2003), 344 F. 3d 134, in which the defendants in a lawsuit moved both to compel arbitration and to stay legal proceedings. See discussion in George Smith & Sarah Holloway, *Intergen N.V. v. Grina: Fundamental Contract Principles Trump Policy Favoring International Arbitration where Nonsignatories are Involved*, 20 ADR & THE LAW 266 (AAA, 2006).

<sup>43</sup> Such seems to be the case in Switzerland, as discussed *infra*.

make a full inquiry into the parties' intent, or simply a summary examination, applying what is sometimes called a *prima facie* standard.

For example, a seller might bring a judicial action to collect the price of an engine. In response, the buyer (who alleges the engine was defective) might move to stay litigation, asserting that the parties had agreed to arbitrate their dispute. The seller might reply with allegations that the arbitration clause was void.

In the alternative, the buyer might file an arbitration for product malfunction, alleging an engine explosion that caused personal injury and loss of profits. Here it would be the seller (preferring to be in court) who asks a judge to address the validity and scope of the arbitration agreement, perhaps arguing that the person who signed the clause lacked authority, or that the clause was not broad enough to cover the tort action for personal injury or the financial claim for lost profits.

German law illustrates how these procedural postures evoke different judicial responses. Courts in Germany would address challenges to the arbitration clause in the context of a lawsuit, with the buyer arguing that the claim should be heard by arbitrators. A judge could also hear the seller's application (if brought before arbitration began) for a declaration that the arbitration clause was invalid. However, if the arbitration was in progress (and no lawsuit had been brought), the arbitrators would simply rule on their own jurisdiction and proceed with the case. Judicial pronouncement on the allegedly defective arbitration clause would await challenge to an award, whether partial or final.<sup>44</sup>

Matters get even more complicated in legal systems where different standards of

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<sup>44</sup> See German ZPO Article 1032(1) and Article 1032(2). Applications for declaratory relief seem permitted only before the tribunal has been constituted. Compare English Arbitration Act Section 9 and Section 72.

review apply according to the procedural posture of the arbitration. French judges, for example, asked to hear a claim can address the validity of an arbitration clause *only* in the most superficial manner, and *only* in the event no arbitral tribunal has been constituted. At that point the court can ask whether the clause was clearly void (for example, the document might lack any signature), but must put off until later any more complex questions (such as disputes about whether the scope of the arbitration clause covers the dispute).<sup>45</sup> Once the arbitration has started, however, judges must sit on their hands until the award is made, when they provide a full examination of alleged defects in the arbitration clause.<sup>46</sup>

In some countries, courts distinguish between arbitration held at home or abroad. Swiss courts, for example, make a full and comprehensive review of the validity of the arbitration clause when the arbitration has its seat abroad. By contrast, when the arbitration is held in Switzerland, judges engage only in a summary examination of arbitral jurisdiction (*examen sommaire*). Full review must wait until the award stage.

In other nations (such as the United States) courts engage in full examination of arbitral power regardless of whether the arbitration has begun, and irrespective of whether they are being asked to hear the merits of the claims. The court might decide that the lawsuit should stop and the arbitration should proceed. Or vice versa. Or, the court might pass this jurisdictional question back to the arbitrators themselves for their determination.

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<sup>45</sup> See also French NCPC Article 1458.

<sup>46</sup> NCPC, Article 1458, permitting pre-arbitration review only to determine if the arbitration clause is *manifestment nulle*. Standards for judicial review are contained in other provisions, for example Article 1502 for international arbitration.

## 7. The Judge's Role: Preventive or Remedial?

As a general matter, pre-award requests for declarations and injunctions implicate a *preventive* role for courts. The jurisdictional foundation of an arbitral proceeding must be monitored before anyone knows what the arbitrator will decide. The arbitrator's jurisdiction becomes an issue because judges are asked to make a respondent participate, or to tell a claimant that the arbitration lacks jurisdictional foundation.<sup>47</sup>

By contrast, when arbitral jurisdiction becomes an issue in the endgame, after an award is rendered, judges exercise a *remedial* function, correcting mistakes that allegedly occurred earlier in the arbitral process. The validity of an award might be subject to judicial scrutiny at the arbitral seat, through motions to vacate or to confirm under local law.<sup>48</sup> Or the award might be subject to scrutiny when presented for recognition abroad, by a winning claimant seeking to attach assets or a prevailing respondent asserting the award's *res judicata* effect to block competing litigation. Normally (but not always) the New York Arbitration Convention would be invoked.<sup>49</sup> At this point, a different set of options present themselves. Courts then face the choice of either giving effect to the

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<sup>47</sup> 9 U.S.C. § 4 provides that courts may compel arbitration “upon being satisfied that the making of the agreement for arbitration ... is not in issue.”

<sup>48</sup> 9 U.S.C. § 10 permits vacatur of an award “where the arbitrators exceeded their powers.” For a U.S. Supreme Court pronouncement on determining arbitral jurisdiction at the award stage, see *First Options of Chicago v. Kaplan*, 514 U.S. 938 (1995). In international cases, the New York Convention Article V provides that courts need not recognize an award if the arbitration agreement “is not valid” (Article V(1)(a)) or if the award “deals with a difference not contemplated by or not falling within the terms of the submission to arbitration.” (Article V(1)(c)).

<sup>49</sup> For a case where an award was found subject to *neither* the domestic provisions (Chapter 1) of the Federal Arbitration Act or the international provisions (Chapter 2), see *Bechtel Co v. Department of Civil Aviation of Dubai*, 360 F. Supp. 2d 136 (D.D.C. 2005). For a case implicating *both* national statute and the New York Convention, see *Yusuf Ahmed Alghanim & Sons v. Toys 'R' Us*, 126 F.3d 15 (2d Cir. 1997).

award (by confirmation, recognition or enforcement) or rejecting its validity (by vacatur or non-recognition).

### C. Three Meanings of *Kompetenz-Kompetenz*

When questions are raised about the validity or scope of a particular arbitration clause, one option would be for the arbitration to stop automatically, until matters have been clarified by a judge. It is against this extreme position, which denies arbitrators any right at all to rule on their own authority, that one must begin to explore the various meanings of *Kompetenz-Kompetenz*.<sup>50</sup>

If a legal system does allow the arbitration to proceed in the face of a jurisdictional challenge, the story could unfold in several ways. At least three different approaches might be envisaged.

First, the arbitrators might offer an opinion on the limits of their own authority, but without in any way restricting the court's consideration of the same question. Although the arbitration does not necessarily stop, neither do related judicial actions. Courts proceed pursuant to whatever motions might be available under local law.

Second, courts could refrain from entertaining any jurisdictional motions until *after* an award had been rendered. The arbitrators would then have the first word on jurisdiction.<sup>51</sup>

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<sup>50</sup> See e.g. the Kansas Supreme Court decision in *MBNA America Bank v. Credit*, discussed *infra*.

<sup>51</sup> As explained more fully below, some legal systems distinguish between judicial consideration of arbitral jurisdiction in connection with (i) request for a declaratory judgment and (ii) the context of a court action on the merits of the claim. Moreover, distinctions are often made between applications that can be filed before, as opposed to after, an arbitral tribunal has been constituted. Finally, varying evidentiary standards (full review as contrasted with summary examination) frequently apply depending on when (before or after the award is rendered) the court examines arbitral authority.

The third meaning given to *Kompetenz-Kompetenz* requires that courts defer completely to an arbitrator's decision about his or her own authority. The arbitrator gets the last word as well as the first. However, such a result requires that judges first determine that the parties did in fact agree to such finality.<sup>52</sup>

#### 1. No Automatic Stop to the Arbitration

Under the first hypothesis, the arbitrator's right to make jurisdictional rulings operates in tandem with a rule allowing judges to examine an arbitrator's jurisdiction before an award has been rendered. In some countries, courts may step in from day one, at any time in almost any circumstance.<sup>53</sup> In others, courts might have full power to address arbitral jurisdiction in the context of lawsuits on the merits of the claim, but only limited margin to maneuver through declaratory judgments.<sup>54</sup>

The arbitrator's right to rule on jurisdiction holds significant practical value (at least for the party wishing to arbitrate) notwithstanding the possibility of court intervention. A recalcitrant respondent cannot bring the proceedings to a halt just by

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<sup>52</sup> Depending on the legal system, judicial proceedings to address the finality of the arbitrator's ruling could take place either before or after the award had been rendered. This question of timing would be a separate issue from the matter of finality.

<sup>53</sup> In the United States, for example, courts address arbitration questions in connection with motions to stay court proceedings or to compel arbitration, as well as to confirm or vacate awards. Limits do exist on appellate review of lower court orders on arbitration. See 9 U.S.C. § 16. For United States cases, *see* *Three Valleys Municipal Water District v. E.F. Hutton*, 925 F.2d 1136 (9th Cir. 1991) (courts determine whether contracts void because of signatory's lack of power to bind principals); *Engalla v. Permanente Med. Group*, 938 P.2d 903 (Cal. 1997) (malpractice claim against health care provider referred to *ad hoc* arbitration that left administration to the parties rather than independent institution; habitual delays in the process found to constitute evidence of fraud by health care provider). See also *Brake Masters Systems Inc., v. Gabbay*, 206 Ariz. 360, 363 (2003), stating, "Our arbitration statutes and the weight of authority from other jurisdictions allow either a pre-arbitration or a post-arbitration determination of arbitrability."

<sup>54</sup> See German ZPO Section 1032(2).



challenging jurisdiction.<sup>55</sup> Moreover, whether courts ultimately substitute their own views for those of the arbitrators depends on the facts of each case. In some instances a judge might order the proceedings suspended, either permanently or until the jurisdictional facts have been determined.<sup>56</sup> In others, the arbitration clause may be found to be robust enough to cover the controverted dispute.<sup>57</sup>

As mentioned, even in countries that permit courts to address arbitral jurisdiction before an award is rendered, distinctions are often made between judicial actions on the merits of a dispute (where a defendant asserts the action is preempted by an arbitration clause) and requests for declaratory judgments about potential or ongoing arbitrations (where a respondent asserts defects in the arbitration clause). With respect to court actions on the merits, judges usually possess full power to address jurisdictional questions, particularly in countries following the UNCITRAL Model Arbitration Law. For declaratory decisions, however, the law sometimes limits the circumstances in which such applications may be made.<sup>58</sup>

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<sup>55</sup> See U.S. Supreme Court decisions in *Howsam*, *Bazzle* and *First Options*, discussed *infra*. For an English case expressing a similar view, see, e.g., *Christopher Brown Ltd v. Genossenschaft Oesterreichischer Waldbesitzer*, [1954] 1 Q.B. 8, stating that arbitrators whose authority is challenged are entitled to inquire into the merits of the jurisdictional issue, not for the purpose of binding the parties, but to satisfy themselves (as a preliminary matter) about whether they ought to proceed with the arbitration or not. The same basic principle has been enacted into the 1996 English Arbitration Act at § 30, although the Act now provides timing limitations on judicial review. See discussion of Act § 72, *infra*.

<sup>56</sup> See discussion *infra* of *Sandvik v. Advent*.

<sup>57</sup> See discussion *infra* of *Pacificare v. Book*.

<sup>58</sup> In England, only a person who takes no part in arbitration would normally be permitted to seek a court declaration on the arbitrator's jurisdiction. 1996 Arbitration Act, § 72. In Germany an application for a court declaration on the arbitration clause may be made only before the arbitral tribunal is constituted. The arbitration proceedings, however, may still be commenced while the court action is pending. See ZPO Section

In this regard, it is important not to confuse the allocation of functions between arbitrators and the supervisory arbitral institution with the allocation of responsibility between arbitrators and national courts. For example, under the Arbitration Rules of the International Chamber of Commerce, if the ICC Court is “*prima facie* satisfied” that an arbitration agreement may exist, any jurisdictional challenge of a deeper nature goes to the arbitrators. This does not mean, however, that national courts will be deprived of power to make jurisdictional determinations when asked to stay litigation, enjoin arbitration or vacate an award.<sup>59</sup>

## 2. Giving Arbitrators the First Word

In other legal systems, recourse to courts must wait until the end of arbitration, *after* an award has been rendered. This version of *Kompetenz-Kompetenz* lays down rules about the stages in the arbitral process at which judges may intervene. The positive part of the principle addresses itself to arbitrators, permitting them to decide challenges to their own authority. The so-called “negative effect” of the principle speaks to courts,<sup>60</sup> telling judge to wait until arbitration ends before inquiring about the validity or effect of

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1032(3). By contrast, in the United States courts may direct proceedings stayed during determination of issues on which arbitral jurisdiction depend. See *Sandvik AB v. Advent Int’l Corp.* 220 F. 3d 99 (3d Cir. 2000).

<sup>59</sup> But see *Apollo v. Berg*, 886 F.2d 469 (1st Cir. 1989), discussed *infra*, where the court relied in part on the ICC Rules to limit the court's own review function. When the defendant questioned whether the arbitration clause remained valid after contract assignment, the federal court turned the matter over to the arbitrators themselves.

<sup>60</sup> Emmanuel Gaillard, *L’effet negative de la competence-compétence*, in *ÉTUDES DE PROCÉDURES ET D’ARBITRAGE EN L’HONNEUR DE JEAN-FRANÇOIS POUDRET* 385 (J. Haldy, J-M. Rapp & P. Ferrari, eds., 1999). The “negative effect” might be considered as part of the arsenal of doctrinal tools to combat dilatory tactics of a party wishing to sabotage the proceedings. See Emmanuel Gaillard, *Les manoeuvres dilatoires des parties et des arbitres dans l’arbitrage commercial international*, 1990 REV. ARB. 759.

an arbitration clause.<sup>61</sup>

Best exemplified by French law, this approach means that if an arbitrator has already begun to hear a matter, courts must decline to hear the case. The judge has a limited jurisdiction to hear a case only if the arbitration has not begun, and only if the alleged arbitration agreement is found to be clearly void (*manifestement nulle*). Given the importance of French doctrine in this field, the full text merits consideration:

When a dispute which has been brought before an arbitral tribunal pursuant to an arbitration agreement is brought before a governmental court, the court must declare itself without jurisdiction. If the dispute has not yet been brought before the arbitral tribunal, the court must also declare itself without jurisdiction unless the arbitration agreement is clearly void.<sup>62</sup>

At issue here is the timing, rather than the extent, of judicial review. Going to court at the beginning of the proceedings can save expense for a defendant improperly joined to the arbitration. On the other hand, judicial resources may be conserved by delaying review until the end of the process, by which time the parties might have settled.

Even in countries that allow judicial intervention before an award is rendered, a

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<sup>61</sup> The negative effect of arbitration clauses sometimes extends beyond jurisdictional matters, to judicial orders for provisional measures, see Elliott Geisinger, *Les relations entre l'arbitrage commercial international et la justice étatique en matière de mesures provisionnelles*, 127 SEMAINE JUDICIAIRE 375 (December 2005); JEAN-FRANÇOIS POUURET & SÉBASTIEN BESSON, *DROIT COMPARÉ DE L'ARBITRAGE INTERNATIONAL* (2002), Section 6.3.2.2, at 554-555.

<sup>62</sup> See Article 1458, *Nouveau code de procédure civile*:

Lorsqu'un litige dont un tribunal arbitral est saisi en vertu d'une convention d'arbitrage est porté devant une juridiction de l'État, celle-ci doit se déclarer incompétente. Si le tribunal arbitral n'est pas encore saisi, la juridiction doit également se déclarer incompétente à moins que la convention d'arbitrage ne soit manifestement nulle.

Although certain provisions of domestic French arbitration law do not apply to international arbitration, such is not the case for Art. 1458, which falls within Title I of Book IV of the NCPC. See NCPC Art. 1507 and Décret du 12 mai 1981, Arts. 55 and 56, providing for non-application of certain provisions in Titles IV, V and VI.

core element of modern arbitration law resides in recognition of separate spheres of responsibility for courts and arbitrators. Pale hints of the negative aspect of *Kompetenz-Kompetenz* can be found, for example, in a recent U.S. Supreme Court decision which adopted a “wait and see” approach with respect to public policy questions related to arbitration of treble damages claims.<sup>63</sup>

This is not to say, however, that the French timing mechanism itself has gained widespread acceptance. Such across-the-board deference to arbitrators (or alleged arbitrators) commands no wide international consensus. Outside the French hexagon, legal systems follow a more flexible and nuanced approach with respect to court intervention. Significant departures from French practice can be seen not only in the United States, but also in important arbitral venues such as England, Sweden and Switzerland, as well as nations such as Germany which follow the UNCITRAL Model Arbitration Law.<sup>64</sup>

The point is not trivial, since scholars sometimes cloak the Gallic perspective with wider acceptance than may actually be the case. Readers even encounter references to principles “generally recognized in comparative law”<sup>65</sup> which, on closer examination,

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<sup>63</sup> See discussion *infra* of *Pacificare v. Book*.

<sup>64</sup> See discussion *infra*, Section I-D.

<sup>65</sup> See Emmanuel Gaillard, *Il est interdit d'interdire*, 2004 REV. ARB. 47 (2004), suggesting that anti-suit injunctions (courts prohibit lawsuits or arbitrations through contempt-of-court sanctions) “fail to recognize this principle very generally accepted in comparative law”. (Anti-suit injunctions “*méconnaissent ce principe [compétence-compétence] principe très généralement reconnu en droit comparé.*”) *Id.* para. 21, page 61. While not explicitly addressing “positive” (arbitrator rights) and “negative” (judicial restraint) principles, the essay’s context (court actions that trump arbitration) clearly infers reference to the latter. The essay’s title derives from a leftist slogan (“It is forbidden to forbid”) of the May 1968 Paris uprisings, when university walls sported gems such as *Ni Dieu ni maître!* (Neither God nor master!), *La lutte continue* (The struggle continues) and *Sexe, c'est bien, a dit Mao, mais pas trop souvent*. (Sex is good,

describe nothing more than the parochial French approach (however commendable).

Whatever the optimum policy might be on timing judicial intervention, the temptation to blur lines between the “is” and the “ought” of legal doctrine must be resisted.<sup>66</sup>

### 3. The Arbitrator’s Decision is Final

#### a) Jurisdiction as a Question of Substantive Merits

Regardless of when judges entertain motions on arbitral jurisdiction, the parties might agree, expressly or impliedly, to subject the jurisdictional question to arbitration. In legal systems following this third approach, jurisdictional questions themselves are considered capable of settlement by arbitration, pursuant to agreement by the parties.<sup>67</sup>

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said Chairman Mao, but not too often). Professor Gaillard presents a more subtle message in *La reconnaissance, en droit Suisse, de la seconde moitié du principe d’effet négative de la compétence-compétence*, in INTERNATIONAL LAW, COMMERCE & DISPUTE RESOLUTION: LIBER AMICORUM IN HONOUR OF ROBERT BRINER 311 (2005) at 312: “*La même unanimité [compétence des arbitres pour connaître de leur compétence] ne se retrouve pas en droit comparé lorsque la règle s’adresse non plus aux arbitres mais aux juridictions étatique.*” (The same unanimity [jurisdiction on jurisdiction] does not appear in comparative law when the rule addresses itself to courts).

<sup>66</sup> As a policy matter, Professor Gaillard suggest that “anti-suit injunctions negate the very basis of arbitration, that is, the parties’ consent to submit their disputes to arbitration.” See Emmanuel Gaillard, *Reflections on the Use of Anti-Suit Injunctions in International Arbitration*, in *Pervasive Problems in International Arbitration* 203 (L. Mistelis & J. Lew, eds. 2006), at 213. While true in many cases, this approach might on occasion presume its own conclusion, in that some legal systems see the “basis of arbitration” as more limited than full party autonomy. The policy underpinning for the “negative” jurisdictional principle was also summarized by Professor Gaillard in his contribution to the Briner *Festschrift*, cited *supra*: “Il convient également [en plus de permettre aux arbitres de poursuivre leur mission lorsque leur compétence est contestée] de s’assurer que le même contentieux ne puisse être aussitôt porté devant les juridictions étatiques qui, en l’absence de convention d’arbitrage, auraient été compétentes pour connaître le fond de l’affaire.” (One must also [in addition to allowing arbitrators to pursue their mission when jurisdiction is contested] provide that the same dispute is not brought before state courts which, in the absence of an arbitration clause, would be competent to address the merits of the matter.) *Id.* at 312.

<sup>67</sup> On the notion of “merits” in an international arbitration, see Veijo Heiskanen, *Dealing with Pandora: The Concept of Merits in International Commercial Arbitration*, forthcoming in ARBITRATION INTERNATIONAL.

Under these circumstances, an arbitrator's determination on his or her own authority will be final. The parties' agreement transforms the jurisdictional difference into a disputed question of fact or law, whose substantive merits the litigants submit to final determination by an arbitrator.<sup>68</sup>

The application of this line of reasoning will in all events depend on the facts of each case. In some instances, the parties may indeed have agreed to submit a jurisdictional question to final and binding arbitration. In other instances, an assertion that they have done so will be preposterous, unable to withstand analysis except by ignoring reality in favor of fiction. The parties' agreement, determined on a case-by-case basis, will determine whether this brand of *Kompetenz-Kompetenz* makes sense. In each instance, the question for judges will be: what did the parties intend to submit to arbitration?

Legal systems disagree on whether judges should ever be permitted to accord finality to an arbitrator's decision on his or her authority, even on a finding of the parties' prior consent. In practice, giving arbitrators the last word on jurisdictional questions means that some litigants may well lose their access to court. The peril derives not so much from isolated mistakes, whether by arbitrators or by courts, but from the risk that an overburdened judiciary might fall into a systematic proclivity toward granting jurisdictional authority to arbitrators, even when contracts are ambiguous on the matter.

Long gone are the days when judges exhibited blanket hostility to arbitration. Today, courts often perceive arbitration as a way to clear crowded dockets. Even the best of judges may be tempted to exchange rigorous reasoning for the convenience of a

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<sup>68</sup> For an illustration, see the "cautionary tale" discussed *infra* in connection with the new German approach to *Kompetenz-Kompetenz*.

finding that the parties really did want jurisdictional questions addressed by arbitrators. Such a tendency seems to have been a factor in recent changes in German law, which now reduces the prospect of never-bargained-for arbitrations by requiring that all questions of arbitral authority go to judges.<sup>69</sup>

This approach, however, may create even more problems than it resolves. A judicial monopoly on final resolution of jurisdictional questions imposes serious restrictions on party autonomy, particularly among sophisticated business managers. The result is a serious limit on the liberty of contract that has long bolstered healthy commercial transactions in free economies.

b) German Doctrine: Then and Now

Prior to Germany's adoption of the UNCITRAL Model Law in 1998, court decisions had recognized that an arbitral tribunal might be granted the power to rule on its own jurisdiction pursuant to a specific clause, accepted by both parties, that implicitly dispensed with subsequent judicial review. In a landmark decision, Germany's highest court, the *Bundesgerichtshof*, had decided that the parties to a commercial contract could submit the question of arbitral authority to final and binding arbitration.<sup>70</sup> What the court called a *Kompetenz-Kompetenz-Klausel*, or "jurisdiction on jurisdiction clause", was deemed sufficient to insulate the arbitrator's decision on the matter from judicial scrutiny.

Currently, the prevailing opinion in Germany (both scholarly and judicial) seems

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<sup>69</sup> See references to work by Peter Schlosser and decisions of the BGH, discussed *infra*.

<sup>70</sup> BGH, 5 Mai 1977, III ZR 177/74. Reported in 68 BGHZ 356, at 358. See discussion in Peter Schlosser, *DAS RECHT DER INTERNATIONALEN PRIVATEN SCHIEDSGERICHTSBARKEIT* (1989) at § 556. See generally, JAN K. SCHÄFER, RICHARD H. KREINDLER & REINMAR WOLFF, *SCHIEDSGERICHTSBARKEIT KOMPENDIUM FÜR DIE PRAXIS* (2006), at §§ 191-193.

to hold that such *Kompetenz-Kompetenz* clauses are invalid. Germany case law has held that the parties may not restrict judges from examining arbitral jurisdiction in the context of challenges to either interim or final awards.<sup>71</sup> Whether such a position constitutes sound doctrine remains open to debate, as discussed later.

c) French and Swedish Perspectives

French law seems to include a more nuanced position with respect to the finality of an arbitrator's jurisdictional determinations.<sup>72</sup> Unlike Germany, France has known no marked break with prior case law, which may account for the fact that the Gallic position seems to be elaborated through scholarly comment.<sup>73</sup>

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<sup>71</sup> See BGH, 13 Januar 2005, III ZR 265/03. Reported NJW 16/2005 at 1125. The case states that a court may decide on arbitral jurisdiction without waiting for a preliminary award to be rendered under ZPO Section 1040 (the equivalent of Article 16 of the UNCITRAL Model Law). See also BGH decision (February 2006) reported in 2006 SCHIEDSVZ 161, at 164, finding no violation of *ordre public* when jurisdiction was addressed only in a final (rather than preliminary) award, given that courts would have the opportunity to address the matter then. Review of a final award would normally be made under ZPO Section 1059, while review of a preliminary jurisdictional award would proceed under ZPO Section 1040. As discussed *infra*, other provisions of German law relevant to arbitral jurisdiction in other contexts include ZPO Article 1032(1) (courts before which an action is brought shall consider the validity of an arbitration clause raised as a defense to the action) and ZPO 1032(2) (application for determining the admissibility of arbitration may be brought prior to constitution of the arbitral tribunal.)

<sup>72</sup> See e.g., Laurence Franc, *Contractual Modification of Judicial Review of Arbitral Awards: The French Position*, 10 AM. REV. INT'L ARB. 215 (1999), suggesting that French law prohibits party agreement on any modification of judicial review.

<sup>73</sup> See PHILIPPE FOUCHARD, EMMANUEL GAILLARD, & BERTHOLD GOLDMAN, *TRAITÉ DE L'ARBITRAGE COMMERCIAL INTERNATIONAL* (1996), § 659 (at 414), asserting that the arbitral power to make jurisdictional rulings has "all too often" been understood as giving arbitrators power to decide alone on their authority, which would be "neither logical nor acceptable". (*Trop souvent encore, le principe de la compétence-compétence est compris comme donnant aux arbitres le pouvoir de décider seuls de leur investiture, ce qui ne serait ni logique, ni acceptable.*) The French original speaks of arbitral "investiture", which might be interpreted as appointment, a narrower notion than jurisdiction. However, the English version clearly uses the term "jurisdiction". See FOUCHARD, GAILLARD & GOLDMAN (E. Gaillard & J. Savage, eds. 1999) at § 659 (page 400).



As a starting point, it is clear that the legal framework for judicial review of awards bears a mandatory character. The grounds on which courts set awards aside (enumerated in *Nouveau code de procedure civile*) may not be abrogated by contract.<sup>74</sup>

Less evident, however, is the proposition that a ban on waiver of statutory annulment standards necessarily means limitation of the questions which by contract may be submitted for final determination by arbitrators. What might be a jurisdictional question in some contexts could become a matter of the merits in an arbitration where both sides clearly submitted the issue to arbitration.

For example, one party to a bill of lading might contend that it incorporated by reference the arbitration clause in a related charter party. Posed in those terms, the matter would normally be a jurisdictional question ultimately to be determined by courts. However, nothing in French law suggests that the two parties cannot, in a clear and distinct agreement, agree to be bound by an arbitrator's determination on that question.

Sweden seems to take a similar position, albeit in a more explicit fashion. After providing that arbitrators may rule on their own jurisdiction, Section 2 of the Swedish Arbitration Act adds that this principle "shall not prevent a court from determining such a question" and that the decision of arbitrators on their jurisdiction "is not binding" but rather subject to the full panoply of grounds for challenging awards.<sup>75</sup> Again, it is not

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<sup>74</sup> For cases in which French courts have voided arbitration clauses attempting to change judicial review, see Cour d'appel de Paris, 27 Oct. 1994, *Diseno v. Société Mendes*, 1995 Rev. Arb. 261. See generally cases cited in FOUCHARD, GAILLARD & GOLDMAN § 1597, speaking of the "mandatory nature" of the organization of challenge to awards" (*le caractère impératif de l'organisation des voies de recours*). For a critique of the logic of the French position, see Alan Scott Rau, *The Culture of American Arbitration and the Lessons of ADR*, 40 TEX. INT'L L.J. 449, at 454 n. 22 (2005).

<sup>75</sup> Arbitration Act 1999, 4 March 1999. See generally, Christopher Seppälä, *Comment on Section 2 of the Swedish Arbitration Act of 1999 Dealing with the Right of Arbitrators to*

certain that the mandatory nature of judicial review necessarily prohibits parties from submitting jurisdictional questions to arbitration if they so wish.

d) The American “Arbitrability Question”

In the United States, a clear line of judicial pronouncements holds that in some situations arbitrators may rule on their own powers without subsequent *de novo* review by courts. In the sense used by American courts, such grants of jurisdictional power are *not* legal fictions, but require evidence of the parties’ real intent expressed in concrete language either in the main contract or in a separate agreement.

Jurists from outside the United States may find the terminology unfamiliar. Court decisions speak of the “arbitrability question” in the same way that the rest of the world refers to a jurisdictional issue. If an “arbitrability question” has been submitted to arbitration, then courts defer to the arbitrator on the matter.

Admittedly, the words “*Kompetenz-Kompetenz* clause” do not figure in American cases. However, after the “arbitrability question” decisions have been broken down and decorticated, one finds that judges in the United States have been using the same conceptual framework as the pre-1998 German cases. In this context, one might recall how the middle-aged cloth merchant in Molière’s *Bourgeois Gentilhomme* learned, much to his delight, that he had actually been speaking prose all along, without ever being aware of this rhetorical skill.<sup>76</sup> The difference, however, is that courts in the United

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*Rule on their Own Jurisdiction*, in THE SWEDISH ARBITRATION ACT OF 1999 FIVE YEARS ON: A CRITICAL REVIEW OF STRENGTHS AND WEAKNESSES (Lars Heuman & Sigvard Jarvin, eds. 2006; Symposium Proceedings, University of Stockholm, October 2004).

<sup>76</sup> Jean-Baptiste Poquelin (Molière), *Le Bourgeois Gentilhomme* (The Would-Be Gentleman) (1670), Act II, Scene 4. Monsieur Jourdain, a *nouveau riche* draper, has hired a philosophy teacher to increase his oratorical skill. On learning that language which is not poetry is prose, the newly enlightened merchant exclaims with amazement

States seem happily oblivious to the link between American legal notions and the doctrines elaborated in the rest of the world to meet similar juridical problems.

In addressing jurisdiction, American courts sometimes say the issue is not only “who decides what,” but also “who decides who decides”. This formulation provides another way of asking when arbitrators may determine the contours of their own decision-making authority.<sup>77</sup>

The American approach often involves the transformation of a jurisdictional matter (normally for courts) into the substantive merits in the arbitration itself (for the arbitrators). Jurisdictional challenges usually relate to the arbitrator’s authority to decide an issue or to exercise a particular procedural power. Once it has been determined that the parties agreed to entrust to the arbitrator the adjudication of disputes on such questions, then almost by definition the question is no longer one of jurisdiction. Arbitrators receive their power from the parties’ consent. If a court decides that the parties asked the arbitrator to decide a matter (for example, time eligibility requirements for arbitration), then in essence this constitutes the court’s jurisdictional determination.

When the very existence of an agreement to arbitrate is disputed, however, courts will generally refuse to compel arbitration until they resolve whether the arbitration clause exists at all.<sup>78</sup> In some events, the existence and content of the parties’ agreement

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and pride, “Par ma foi! il y a plus de quarante ans que je dis de la prose sans que j’en susse rien.” (“My Lord! For more than forty years I have been saying prose without knowing anything at all of the matter.”)

<sup>77</sup> See e.g., Alan Scott Rau, *The Arbitrability Question Itself*, 10 AM. REV. INT’L ARB. 287 (1999). See also discussion *infra* of *First Options v. Kaplan*.

<sup>78</sup> See *Sandvik AB v. Advent Int’l Corp* 220 F. 3d 99 (3d Cir. 2000).

may have to be determined by a jury.<sup>79</sup>

The recent decision in *Alliance Bernstein Investment v. Schaffran*<sup>80</sup> illustrates the various ramifications of the American approach. A former employee of a New York hedge fund alleged wrongful termination, claiming that he had been fired for cooperating with government investigations into wrongdoings by his employer.<sup>81</sup>

The employment relationship was subject to rules of the National Association of Securities Dealers (NASD), which provided for mandatory arbitration with one important exception: claims of employment discrimination.<sup>82</sup> Normally, the arbitration clause would have been invoked by the employer, on the assumption that juries tend to possess a more sympathetic predisposition toward employees.<sup>83</sup>

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<sup>79</sup> *China Minmetals Materials Ltd. V. Chi Mei*, 334 F.3d 274 (3d. Cir. 2003), involving allegations of a forged contract in a dispute about what (if anything) a New Jersey company (Chi Mei) agreed to sell to a Chinese corporation (Minmetals). The court stated, “If there is doubt as to whether such an agreement exists, the matter, upon a proper and timely demand, should be submitted to a jury. Only when there is no genuine issue of fact concerning the formation of the agreement should the court decide as a matter of law that the parties did or did not enter into such an agreement.” *Id.* at 281.

<sup>80</sup> 445 F.3d 121 (2d Cir. 2006). Contrary to the suggestion by some commentators, this case seems to be focused on jurisdiction from a contractual perspective, not subject matter arbitrability in the public policy sense. Compare note in 17 *WORLD ARB. & MED. REP.* 171 (2006), at 172.

<sup>81</sup> In particular, the former employee asserted that his employer had violated the “whistle blower” provisions of the Sarbanes-Oxley Act, 18 U.S.C. § 1514A.

<sup>82</sup> NASD Rule 10201(b) provides that “a claim alleging employment discrimination ...in violation of a statute is not required to be arbitrated” unless the parties have explicitly agreed to arbitration of the discrimination action either before or after the dispute arose. In other words, the submission of a discrimination claim must be specific, rather than covered in a broad “blanket” arbitration clause covering disputes in general.

<sup>83</sup> Not all wrongful dismissals will be the result of discrimination. For example, an employee might be wrongfully terminated because he is fired without reason in violation of his or her contract, or for a reason not otherwise permitted by law, such as reporting on the misbehavior of a boss. Discrimination has traditionally been conceptualized as dismissal for reasons of bias based on race, religion or gender. In this case, the question

In this case roles were reversed. For reasons that are not entirely clear from the face of the decision, the employer (not the employee) moved for a declaratory judgment that the “whistle blower” action (alleging retaliation for cooperation with government investigator) constituted an “employment discrimination” claim by the employee, and thus was not subject to arbitration. The arbitrator’s authority thus depended on whether the employee’s claim could be characterized as an “allegation of discrimination” within the meaning of the NASD Rules.

The court did not see its role as deciding whether or not the arbitrator possessed jurisdiction to hear the claim.<sup>84</sup> Rather, the question was *who* (judge or an arbitrator) would decide whether the allegations of termination for “whistle blowing” were subject to arbitration, or instead amounted to the type of discrimination claim that was carved out of the scope of the arbitration clause.<sup>85</sup>

The starting point for analysis lay in the relevant NASD Rules, under which the arbitrators were expressly “empowered to interpret and determine the applicability of all provisions under the [NASD] Code” in a way that was “final and binding” on the

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was whether the allegedly unfair termination (retaliation) was to be characterized as “discrimination” or simply a firing that was contrary to the law for other reasons.

<sup>84</sup> The claim of non-arbitrability related to the scope of a contract provision (NASD Rule 10201), not any public policy limits on arbitration of “whistle-blower” claims. If public policy had been at issue, the result would likely have been different.

<sup>85</sup> In its opening paragraph, the court stated that the issue before it was not “whether the claims *must* be arbitrated, but rather ... *who* will decide the arbitrability question.” 445 F.3d 121 (2d Cir. 2006). The distinction is sometimes ignored. A recent summary of *Alliance Bernstein* suggested that the case “held that an employee’s claim [for violation of the statute] is for an arbitrator to decide. See 17 WORLD ARB. & MED. REP. 171 (2006). While the commentary later states the holding correctly, the introductory slip of the pen reveals a general tendency to conflate the two issues.

parties.<sup>86</sup> The court's job, therefore, was to ascertain what the parties meant by that language.<sup>87</sup>

According to the Second Circuit, a presumption exists that the parties would normally intend an "arbitrability question" to be determined by a judge.<sup>88</sup> The presumption might, however, be overcome.<sup>89</sup> To do so would require "clear and unmistakable" evidence that the parties wished the question to be decided by arbitrators.<sup>90</sup> This intent could be found, for example, in a separate agreement providing for arbitration of "any and all controversies" including interpretation of the provisions of

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<sup>86</sup> NASD Rule 10324 provides, "The arbitrators shall be empowered to interpret and determine the applicability of all provisions under this Code and to take appropriate action to obtain compliance with any ruling by the arbitrator(s). Such interpretations and actions to obtain compliance shall be final and binding upon the parties.

<sup>87</sup> Since American contract law is generally a matter for states, the court normally looks to state law for guidance about the parties' intent. See *First Options v. Kaplan*, 514 U.S. 938, at 944 (1995); *John Hancock Life Ins. v. Wilson*, 254 F. 3d 48, at 53 (2d Cir. 2001).

<sup>88</sup> *First Options*, *supra*, at 944-45.

<sup>89</sup> See also *PaineWebber v. Bybyk*, 81 F. 3d 1193 (1996), holding that whether an investor's claims against a brokerage firm were subject to arbitration was a question for the arbitrators. The matter in *Bybyk* involved NASD time limitations on eligibility for arbitrations. Although the court on occasion referred loosely to these arbitration eligibility requirements as a "statute of limitations" the case did not concern a proper statute of limitations arising under the applicable law, which would clearly have been for the arbitrator. See discussion of "admissibility" *infra*.

<sup>90</sup> *Contec Corp. v. Remote Solution Co.*, 398 F. 3d 205, at 208 (2d Cir. 2005). The case at bar was covered by the American Arbitration Association Commercial Arbitration Rules (for domestic transactions), which provided in Rule R-7 that "the arbitrator shall have power to rule on his or her own jurisdiction, including any objections to the existence, scope or validity of the arbitration agreement." One might note that this language could be subject to misinterpretation if the "arbitrability question" presented was whether one side had indeed signed the arbitration agreement. Clearly, arbitrators cannot pull themselves up by their own jurisdictional bootstraps. Question of "scope" of an arbitration clause (which might be subject to an arbitrator's binding jurisdictional determination) must be distinguished from questions about who is a party (on which an arbitrator will rarely have the last word, absent a clear separate agreement on the matter, concluded by the very party contesting jurisdiction).

the relevant arbitration rules.<sup>91</sup>

In *Alliance Bernstein* the court was careful to keep close to the language of the arbitration provisions. The language of the relevant rule did not provide for “any and all” matters to be arbitrated, but only for power to “interpret and determine the applicability of” provisions under the NASD code, which would include the scope of the exclusion for discrimination claims.<sup>92</sup> Since there was no disagreement that both sides had accepted the NASD rules,<sup>93</sup> the parties’ intent to arbitrate their differing interpretations of the rules could be ascertained from the four corners of the documentation before the court. The arbitrator’s decision on this matter would not be subject to later judicial second guessing. Rather, the “whistle blower” claim would be subject to arbitration if, and only if, the arbitrator so determined.

The Court found the question of whether “whistle blower” claims were arbitrable was for the arbitrators, and thus insulated that finding from review for “excess of powers” under the Federal Arbitration Act.<sup>94</sup> The award might well be attacked on other jurisdictional grounds, however. For example, the arbitrator would still lack power if an irregularity could be found in signature of the agreement containing the reference to arbitration. Perhaps the person who signed was not authorized to do so. Or, the signature might have been compelled by a gun at the head. Or, maybe the signature was

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<sup>91</sup> In cases where only one party to the dispute is a member of the NASD, a separate agreement would be required to indicate such a clear intent to arbitrate jurisdictional questions. See *John Hancock*, 254 F. 3d at 54-55.

<sup>92</sup> NASD Rule 10324.

<sup>93</sup> The employer was a member of the NASD itself, and the employee had signed a so-called “Form U-4” agreeing “to arbitrate any dispute, claim or controversy that may arise between me and my firm ... under the rules, constitutions or by-laws” of the NASD.

<sup>94</sup> 9 U.S.C. § 10(4).

a forgery. But the decision on jurisdiction over the “whistle blower” claim could not be disregarded because a judge later disagreed with the arbitrator’s interpretation of the rules.

Under this approach, once a precise question has clearly been delegated to an arbitrator, it ceases to be “jurisdictional” in the context of the case to which it is relevant. Since the arbitrator has been empowered to hear the matter, any further inquiry must be limited to “What did the arbitrator decide?” That decision might relate to a matter which, in the abstract, would be characterized as jurisdictional. However, the parties’ intent prevails, and the arbitrator will determine the matter in a final way.

Such allocation of functions between judges and arbitrators explains itself principally by reference to contract principles.<sup>95</sup> Absent an express or implied waiver of the right to go to court, a litigant will not normally be denied recourse to otherwise competent tribunals. But once such a waiver has been given in the form of an arbitration clause, it is hard to see why a litigant should be permitted to renege on this bargain to arbitrate.

Reasonable people, of course, might argue about what the parties had in mind when they made their bargain. One judge might think that another judge got it wrong, or was misguided, in her reading of how the relevant arbitration rules or contract affected the questions that would be submitted to arbitration. But these debatable matters of fact, do not call into question the jurisdictional principle that the parties to a dispute may

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<sup>95</sup> Regulatory impulses also come into play, although usually only at the margins. Even if the parties to a dispute authorize adjudication through arbitration, courts will hesitate to enforce private decision-making that runs afoul of public policy, either by virtue of touching subjects too sensitive to be removed from government tribunals (e.g., claims of discrimination) or because the decision-making process is tainted with bias or corruption.



empower arbitrators to decide controversies about the pre-conditions to arbitration.

American judges who review questions of jurisdiction must look beyond labels, and instead fix their scrutiny on the parties' real deal. If two litigants intended to submit a question to final and binding arbitration, then the arbitral determination holds, regardless of whether the question would initially have fallen within the arbitrator's mission. In this sense, the *Kompetenz-Kompetenz* clause remains alive and well in the United States.

In defining "arbitrable questions", courts are in the business of drawing lines between jurisdiction and merits, often in a manner that enlarges the arbitrator's authority. Although issues of substance (merits of the dispute) and jurisdiction (arbitrator's right to hear the case) should be treated differently by courts, the two categories are not fixed immutably in the real world. A particular question might be characterized as "substantive merits" in one dispute and "jurisdiction" in another. If indeed the parties to an arbitration agreement clearly intend for a matter to be decided by arbitration, then a "jurisdictional" label would be inappropriate if it were to lead courts to usurp the arbitral function. To ignore this possibility might, in some circumstances, put a country in breach of its New York Convention obligations. The wrinkles on this topic are sizable, and thus it has been addressed in greater detail below in the discussion of the new German arbitration law.

#### D. Paradigms and Hybrids: Another Look at Timing

##### 1. Policy Concerns

Fixing the point in time for court intervention involves a relatively clear (albeit difficult) choice between costs and benefits related to the expenditure of either public or private resources. Under one model, a party unhappy with having to arbitrate may go to

court at *any* moment for the purpose of contesting arbitral power. Another paradigm, however, provides for court challenge of arbitral authority only *after* an award is rendered.

Court challenge to jurisdiction at the beginning of the process can save time and expense for the litigants. If a judge finds the alleged arbitral clause to be void, or too narrow in scope to cover the dispute, then neither side need waste time or money in arbitration. The parties are free to pursue their litigation in the appropriate judicial forum.

By contrast, government funds can be preserved by delaying judicial review until after the award has been rendered. In many legal systems, similar or analogous concerns about economy of judicial resources impose restraints on appeal of interlocutory lower court decisions.<sup>96</sup>

If questions of authority are left to the end game, perhaps there will not even be a jurisdictional challenge in court. The case might settle, or the party resisting arbitration might prevail. And if the matter does go to court, the arbitrator may have done much of the intellectual heavy lifting, sorting facts and law to provide the reviewing judge a helpful analytic road-map.

## 2. Extremes: France and the United States

### a) United States

American arbitration law traditionally has given parties a right to raise a matter of

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<sup>96</sup> See, e.g., Section 16 of the U.S. Federal Arbitration Act (9 U.S.C. § 16). See also discussion of the “collateral order” doctrine in *Lauro Lines SRL v. Chasser*, 490 U.S. 495 (1989) and *Digital Equipment Corp. v. Desktop Direct, Inc.*, 511 U.S. 863 (1994). See also 28 U.S.C. Section 1292(b), involving appeal when an order involves “a controlling question of law as to which there is substantial ground for difference of opinion”. See also, *International Ass'n of Machinists and Aerospace Workers Local Lodge*, 410 F.3d 204 (5th Cir. 2005); *ATAC Corp. v. Arthur Treacher's, Inc.*, 280 F.3d 1091 (6th Cir. 2002); *Salim Oleochemicals v. M/V Shropshire*, 278 F.3d 90 (2d Cir. 2002). For conversations on this topic, thanks are due to Ward Farnsworth, Gary Lawson and Louise Ellen Teitz.

arbitral authority at any time, whether before or after the award. Such determinations would usually be made pursuant to litigation under Sections 3 and 4 of the Federal Arbitration Act, providing for stay of court litigation and orders to compel arbitration.<sup>97</sup>

This approach means that a party who never agreed to arbitrate will not need to waste time and money in a proceeding that lacks an authoritative foundation. Moreover, either side can request clarification about the scope of the arbitrator's power before substantial sums are spent needlessly. The prospect of award vacatur on jurisdictional grounds cannot be excluded, but it may be less likely to hang as a Sword of Damocles in cases of obvious jurisdictional defect.

b) France

By contrast, the French model delays court consideration of jurisdictional matters until the award review stage.<sup>98</sup> This approach reduces the prospect of dilatory tactics designed to derail an arbitration. A bad-faith respondent will be less able to add the cost of a court challenge at the same time that the arbitration is going forward.<sup>99</sup>

Another benefit from the French paradigm lies in its potential for higher quality jurisdictional review by judges, who will be able to benefit from the arbitrators' earlier

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<sup>97</sup> See generally discussion in *Three Valleys Municipal Water District v. E.F. Hutton*, 925 F. 2d 1136 (9th Cir. 1991). In *Allied-Bruce Terminix v. Dobson*, , 513 U.S. 265 (1995) and *Vimar Seguros v. Sky Reefer*, 515 U.S. 528 (1995) judges determined arbitral jurisdiction at the outset of the process, rather than waiting to see what the arbitrators would decide. See also the U.S. Supreme Court decisions in *Pacificare*, *Howsam*, *Bazzle*, and *Buckeye*, *infra*.

<sup>98</sup> NCPC, Article 1458.

<sup>99</sup> For a recent case of the *Cour de Cassation* interpreting the French version of *compétence-compétence* in the context of an ICC arbitration, see *SARI Métru System France*, Cass. 1re civ., C., 1 Dec. 1999, holding that only the clear nullity of an arbitration agreement would bar application of the principle by which an arbitrator was permitted to rule on his own jurisdiction.

consideration of the matter. And government resources may be conserved for the simple reason that a settlement might obviate the need for judicial review.

A cynic, of course, might note that the French rule can have practical advantages for arbitrators themselves, who will not be declared incompetent until after collecting their fees. But as Rudyard Kipling might have written, that is another story.

### 3. Hybrids: England, Switzerland and the UNCITRAL Model

Countries that delay judicial intervention until the award stage aim to preserve government resources. By contrast, legal systems that permit court rulings on arbitral jurisdiction at any moment allow litigants to avoid the expense of an invalid proceeding.

Attempts to find a middle way in the timing of jurisdictional challenge have not always proved easy. Like the man who hoped to get his girlfriend drunk without emptying the wine bottle,<sup>100</sup> efforts at meeting both goals have often served disappointment.

Nevertheless, some legal systems do explore hybrid solutions. England, Switzerland and the UNCITRAL Model provide examples.

#### a) England<sup>101</sup>

The position in England seems once to have been roughly analogous to that in the United States, in that arbitrators addressed jurisdiction subject to general control by the

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<sup>100</sup> In Italian, the observation traditionally takes on a more matrimonial nuance: *Non puoi avere la botta piena e la moglie ubbriaca.*

<sup>101</sup> Since the 1996 Arbitration Act does not apply in Scotland, but governs arbitrations with their juridical seat in England, Wales or Northern Ireland, this paper will resist reference to “British” arbitration law. Since 1536 England and Wales have been part of the same legal system. However, to avoid the cumbersome expression “England and Wales or Northern Ireland”, more convenient terms such as “English arbitration” or “arbitration in England” will be used.

competent court.<sup>102</sup> Such remains the case with respect to final awards, where dissatisfied litigants may challenge arbitrators' mistakes on substantive and procedural jurisdiction.<sup>103</sup> Things have become a bit more complex since 1996.<sup>104</sup> Today, the English Arbitration Act gives an arbitral tribunal the right to rule on its own substantive jurisdiction.<sup>105</sup> The right to challenge arbitral jurisdiction by declaration or injunction is open only to a person "who takes no part in the proceedings."<sup>106</sup> This power can be particularly useful in connection with what are sometimes called "unilateral" arbitration clauses, which permit one side the option to litigate in court rather than to arbitrate. If the other side begins an arbitration before the option has been exercised, the power to request

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<sup>102</sup> See e.g., opinion by Devlin, J., in *Christopher Brown Ltd v. Genossenschaft Oesterreichischer Waldbesitzer*, [1954] 1 Q.B. 8. See MICHAEL J. MUSTILL & STEWART C. BOYD, *COMMERCIAL ARBITRATION* (1982 edition) at 514-15, discussing the possibility of declaratory relief on questions of jurisdiction under the law as it stood prior to 1996.

<sup>103</sup> See 1996 Act, Section 67 (substantive jurisdiction) and 68(2) ("serious irregularity" defined to include "the tribunal exceeding its powers").

<sup>104</sup> The Chartered Institute of Arbitrators has attempted to provide comprehensive enlightenment through two valuable studies: *Guidelines for Arbitrators as to How to Deal with Challenges to Their Jurisdiction*, 68 *ARBITRATION* 3 (2002) and *Guideline on Jurisdictional Issues in International Arbitration*, 70 *ARBITRATION* 308 (2004), also reproduced in 17 *WORLD TRADE & ARB'N MATERIALS* 113 (April 2005). See also Peter Aeberli, *Jurisdictional Disputes under the Arbitration Act 1996: A Procedural Route Map*, 21 *ARB. INT'L* 253 (2005)

<sup>105</sup> 1996 Act, Section 30.

<sup>106</sup> English Arbitration Act § 72. Non-participants may challenge jurisdictional defects regardless of whether failure to participate was by choice or by inadvertence, and regardless of whether in hindsight non-participation seems justified. The English Arbitration Act in § 30 provides for arbitrators to determine their own jurisdiction as a preliminary matter but in § 67 also permits judicial challenge of any jurisdictional determination. In § 9 the Act provides for stay of litigation only if the court is satisfied that the arbitration agreement is not "null and void, inoperative or incapable of being performed."

a declaration provides the machinery for vindicating the right to litigate.<sup>107</sup>

Most challenges to substantive competence must wait until an award has been rendered.<sup>108</sup> At that time courts will have an opportunity to review excess of authority as well as the arbitrators' improper arrogation of powers.<sup>109</sup> On occasion, a jurisdictional ruling may also give rise to allegations of procedural irregularity.<sup>110</sup>

The Act does permit application for judicial determination on a "preliminary point of jurisdiction." In this latter context, courts may consider the matter only on agreement of all parties, or if the arbitral tribunal grants permission and a court finds that addressing the question is likely to produce substantial savings in costs.<sup>111</sup>

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<sup>107</sup> See *Law Debenture Trust Corp. v. Elektrim*, [2005] 1 All E.R. 476, 2005 WL 1630790. The case is discussed in Simon Nesbitt & Henry Quinlan, *The Status and Operation of Unilateral or Optional Arbitration Clauses*, 22 *ARB. INT'L* 133 (2006).

<sup>108</sup> Arbitration Act § 67.

<sup>109</sup> See Arbitration Act § 68. See *Lesotho Highlands Development Authority v. Impreglio SpA* [2005] UKHL 43.

<sup>110</sup> For a case in which an arbitrator's jurisdictional decision was challenged on grounds of procedural irregularity, see *Aoot Kalmneft v. Glencore International A.G.* ([2002] 1 Lloyd's Rep. 128 (Queen's Bench, 27 July 2001), 2001 WL 825106). An *ad hoc* London arbitration addressed a dispute between an oil trading company and an oil production entity in Kalmykia. The oil trader claimed that it had paid for oil never delivered, while the production company alleged it had been the victim of fraud by one of its officers, who allegedly had no authority to conclude the agreement. In an interim decision, the sole arbitrator ruled that he had jurisdiction. The production entity challenged this award *inter alia* on the grounds that a finding of validity for the arbitration clause prejudged the case on the merits. By finding that the officer had authority to commit to arbitration, the arbitrator gave an implicit preview of his views with respect to the binding nature of the main agreement. Justice Coleman rejected the challenge, finding that an arbitrator may "rule on his own jurisdiction at the outset, even if that involves deciding whether there was a binding contract to arbitrate and even if his decision on that matter gives rise to a conclusion in respect of a major issue on the merits of the underlying claim in the arbitration." *Id.*, Paragraph 84. See discussion in Robert Knutson, *Procedural Fairness, Kompetenz-Kompetenz and English Arbitral Practice*, 6 *LCIA NEWS* 5 (November 2001).

<sup>111</sup> 1996 Arbitration Act, § 32. If the parties have not all agreed, an application requires permission of the arbitral tribunal. In this latter instance, the court must be satisfied not

Otherwise, a party seeking annulment of an arbitrator's decision for excess of jurisdiction may do so only after attempting to remedy the problem through the appropriate arbitral procedures. In the interest of arbitral efficiency, court challenges to awards can only be brought after any available institutional review.<sup>112</sup> And a “use it or lose it” principle requires that challenges for excess of authority must be made “forthwith” or within the time provided by the arbitration agreement.<sup>113</sup> To rebut the presumption that the right to object has been waived, the challenging party must show that it did not know, and could not with reasonable diligence have discovered, the grounds for objection.<sup>114</sup> In this respect, the Act leads to a result different from the one obtaining in Switzerland, where defendants may lose their right to challenge an award's jurisdictional underpinnings by boycotting the proceedings.<sup>115</sup>

Arbitral jurisdiction might also be tested in court if one party brings a court action for a claim which the other party says is covered by the arbitration agreement. Arbitral authority is put at issue in a motion to stay legal proceedings, and the point is decided then and there. Like analogous provisions in Article 8 of the UNCITRAL Model Law,

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only of potential cost savings, but also that the application was made without delay and that there is “good reason” why the matter should be judicially decided.

<sup>112</sup> Act § 70(2) speaks of “any available arbitral process of appeal or review.” However, courts are not necessarily bound by the arbitral institution's decision on the matter. Challenge to an award must also be delayed until exhaustion of any application to correct an award under Act § 57, in default of the parties’ agreement otherwise.

<sup>113</sup> 1996 Arbitration Act § 73 (1). In some instances, the arbitral tribunal may set the appropriate time limits for challenge.

<sup>114</sup> *Id.*, Section 73. The English Act is more severe than the analogous provisions in Article 4 of the UNCITRAL Model Arbitration Law, which covers only a party who actually “knows” of a procedural defect.

<sup>115</sup> See *Westland Helicopters v. Emirates Arabs Unis, Arabie Saoudite, Etat du Qatar, ABH et Arab Organization for Industrialization (AOI)*, Swiss *Tribunal fédéral*, 19 April 1994, 120 II 155 ATF (1994), also reported in 12 ASA BULLETIN 404 (1994).

English arbitration law contemplates that in some instances there might be simultaneous proceedings by courts and arbitrators regarding the competence of the arbitral tribunal.<sup>116</sup>

b) Switzerland<sup>117</sup>

Although not free from scholarly debate,<sup>118</sup> Swiss case law seems to distinguish between arbitration held inside and outside of the country. Federal statute provides that arbitral tribunals shall rule on their authority, normally through interlocutory decisions,<sup>119</sup> and that objections to jurisdiction must be raised before the tribunal prior to any defense on the merits.<sup>120</sup> Moreover, state courts must decline jurisdiction unless they find that the arbitration clause void, inoperative or incapable of being applied.<sup>121</sup>

If the seat of the arbitration is in Switzerland, courts engage in only summary

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<sup>116</sup> 1996 Arbitration Act § 9. This section requires a stay of proceedings only so far as they concern that matter to be referred to arbitration and only if the court is satisfied that the arbitration agreement is not “null and void, inoperative or incapable of being performed.”

<sup>117</sup> See generally, BERNHARD BERGER & FRANZ KELLERHALS, *INTERNATIONALE UND INTERNE SCHIEDSGERICHTSBARKEIT IN DER SCHWEIZ* (2006) at Chapter 2, Section 7 (II), paragraphs: 607-617; PIERRE LALIVE, JEAN-FRANÇOIS POUURET & CLAUDE REYMOND, *LE DROLIT DE L'ARBITRAGE* (1989), at 379-386; WERNER WENGER, Commentary on Article LDIP 186, in *INTERNATIONAL ARBITRATION IN SWITZERLAND* 459-477 (2000). See also Zina Abdulla, *The Arbitration Agreement*, in *INTERNATIONAL ARBITRATION IN SWITZERLAND* 15 (G. Kaufmann-Kohler & B. Stucki, eds. 2004), at 29-32.

<sup>118</sup> See work by J.-F Poudret & G. Cottier, discussed *infra*. See also Werner Wenger, *Kommentar zum schweizerischen Privatrecht, Internationales Privatrecht*, Basel, discussed in *Tribunal fédéral*, ATF 122 III 139, (Fondation M v. Banque X, 29 April 1996) and Andreas Bucher, *Le nouvel arbitrage international en Suisse*, at 55, n. 130, discussed in *Tribunal fédéral*, ATF 121 III 38 (Compagnie de Navigation et Transports SA v. MSC Mediterranean Shipping Company SA, 16 January 1995).

<sup>119</sup> Article 186 of the *Loi fédérale sur le droit international privé* (LDIP) provides that such jurisdictional rulings should be made “*en general / in der Regel*”.

<sup>120</sup> *Id.*, Article 186(2).

<sup>121</sup> *Id.* Article 7, providing for courts to verify that the arbitration clause is not “*caduque, inopérante ou non susceptible d’être appliqué*.”



examination of arbitral authority.<sup>122</sup> When the arbitral seat lies outside of Switzerland, however, the *Tribunal fédéral* has called for a fuller and more comprehensive examination of the validity of the arbitration agreement.<sup>123</sup> This inquiry would generally occur at the time the clause is invoked in a Swiss court action on the merits of the dispute, allegedly brought in disregard of the agreement to arbitrate. In applying Article II of the New York Convention (requiring reference to arbitration unless the clause is void, inoperative or incapable of being performed), courts would *not* limit themselves to a summary (*prima facie*) examination of the validity of the agreement to arbitrate.

The logic of this distinction (which has not gone unquestioned<sup>124</sup>) seems to be that when arbitration occurs abroad, Swiss courts might not get a chance at a later time to

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<sup>122</sup> *Tribunal fédéral*, ATF 122 III 139, *Fondation M v. Banque X* (29 April 1996), which holds at consideration 2(b): “Il est généralement admis que, si le juge étatique est saisi d’une exception d’arbitrage et que le tribunal arbitral a son siège en Suisse, le juge se limitera à un examen sommaire de l’existence *prima facie* d’une convention d’arbitrage, afin de ne pas préjuger de la décision du tribunal arbitral sur sa propre compétence.” (“It is generally accepted that if a state judge hears a defence based on arbitration, and the arbitral tribunal has its seat in Switzerland, the judge will limit himself to a summary examination of the *prima facie* existence of the arbitration agreement, in order not to prejudge the arbitral tribunal’s decision on its own jurisdiction.”)

<sup>123</sup> *Tribunal fédéral*, ATF 121 III 38, *Compagnie de Navigation et Transports SA v. MSC Mediterranean Shipping Company SA* (16 January 1995). The court stated at consideration 3(b), “En revanche, si le tribunal arbitral a son siège à l’étranger, le juge étatique suisse, devant lequel une exception d’arbitrage est soulevée, doit statuer sur ce moyen de défense avec plein pouvoir d’examen quant aux griefs soulevés, et en particulier celui déduit de l’article II al. 3 de la Convention de New York, sans pouvoir se limiter à un examen *prima facie*.” (By contrast [to arbitration conducted inside Switzerland] if the arbitral tribunal has its seat abroad, the state judge before whom the arbitration exception is raised must decide on this defense with full powers of examination concerning the grounds for challenge, and in particular that of Article II (3) of the New York Convention, without limiting himself to a *prima facie* examination.)

<sup>124</sup> See Jean-François Poudret and Gabriel Cottier, *Remarques sur l’Application de l’Article II de la Convention de New York*, 13 ASA BULLETIN 383 (1995). The authors write, “Si cette solution doit certes être approuvée, la motivation qui la soutient repose toutefois sur une distinction peu convaincante et même infondée...” *Id.*, at 387. See also works by Wenger and Bucher, cited *supra*.

correct an arbitrator's erroneous decision about jurisdiction under the questionable agreement. By contrast, most arbitration conducted inside Switzerland will be subject to judicial review on the grounds enumerated in the federal conflicts of law statute, which include excess of jurisdiction.<sup>125</sup>

Comparisons are sometimes made between jurisdictional review in France and in Switzerland. Notwithstanding some inferences to the contrary, one can see as many (or more) differences as similarities. For arbitrations inside the forum state, both countries delay full judicial review of arbitral authority until the award stage. There the similarity ends, however. Swiss law contains nothing equivalent to the extreme French position that requires courts, while the arbitration is ongoing, to refrain from addressing even the clearest indications of an arbitration clause's invalidity.<sup>126</sup> On the contrary, Swiss courts verify the validity of arbitration clauses in a summary fashion (*prima facie*) when asked either to appoint an arbitrator or to hear disputes allegedly subject to arbitration.<sup>127</sup> And as already noted, when the arbitral seat is outside Switzerland, Swiss courts are free to engage in a full inquiry into the validity of the arbitration clause.

Moreover, Swiss case law has held that an arbitrator will be deprived of jurisdiction to hear a matter if a case has already begun before a foreign court. This application of *lis pendens* has been criticized, since it permits a bad-faith litigant to

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<sup>125</sup> *Loi fédérale sur le droit international privé*, Article 190. In some instances the parties may waive challenge to the award. See discussion *infra* of LDIP Article 192.

<sup>126</sup> Article 1458, French Nouveau code de procédure civile.

<sup>127</sup> See Articles 7 and 179(3) of the *Loi fédérale sur le droit international privé*. See decision of Swiss *Tribunal fédéral*, ATF 122 III 139, *Fondation M v. Banque X*, discussed *supra* and in François Perret, *Parallel Actions Pending Before an Arbitral Tribunal and a State Court*, ASA Special Series No. 15 (January 2001) at 65-66. With respect to consideration of arbitration clauses prior to appointment of an arbitrator, the federal statute calls for an *examen sommaire* (summary examination).

paralyze an arbitration by starting litigation abroad before a Swiss arbitral proceeding has begun.<sup>128</sup> Recent federal legislation gives arbitrators sitting in Switzerland the right to rule on their own jurisdiction even if a foreign court has already been seized of the matter.<sup>129</sup>

In some events an arbitrator's excess of jurisdiction may escape any judicial scrutiny, even if the arbitral seat lies in Switzerland. Although proper monitoring for excess of authority would normally be provided under the federal conflicts of law

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<sup>128</sup> See *Fomento de Construcciones y Contrats S.A. v. Colon Container Terminal S.a.*, Swiss *Tribunal fédéral*, 14 mai 2001 (Ie Cour Civile), BGE 127 III 279/ATF 127 III 279; reported in 2001 REV. DE L'ARBITRAGE 835 (commentary by Jean-François Poudret); Elliot Geisinger and Laurent Lévy, *Applying the Principle of Litispendence* [2000] Int'l A.L.R. (Issue 4). See also Adam Samuel, *Fomento - A tale of litispendance, arbitration and private international law*, in *Liber Amicorum Claude Reymond: Autour de L'Arbitrage* 255 (Bredin, Lalive, Poudret & Terré, eds. Litec, Paris 2004). Under Article 9 of the Swiss LDIP, an arbitral tribunal in Geneva was required to suspend its work in deference to a judicial action begun in Panama. Some observers consider the case might have been better decided on the rationale that participation in the Panama litigation constituted a waiver of the right to arbitrate. See also, Matthias Scherer & Teresa Giovannini, *Geneva Court Will Not Enforce Foreign Anti-Arbitration Injunction*, IBA Arbitration Committee Newsletter 42 (September 2006) (commenting on decision of Geneva Tribunal of First Instance, 2 May 2005, rejecting an application to stay arbitration (2005 ASA Bulletin 728, with note by M. Stacher). For a more general perspective on parallel court proceedings, see Martine Stückelberg, *Lis Pendens and Forum Non Conveniens at the Hague Conference*, 26 BROOKLYN J. INT'L L. 949 (2001). For another perspective on anti-suit injunctions, see John Fellas, *Anti-suit Injunctions in Aid of Arbitration*, 20 INT'L ARB. REP. 25 (April 2005).

<sup>129</sup> See Article 186, al 1bis, LDIP, which provides as follows: "Il [le tribunal arbitral] statue sur sa compétence sans égard à une action ayant le même objet déjà pendante entre les mêmes parties devant un autre tribunal étatique ou arbitral, sauf si des motifs sérieux commandent de suspendre la procédure." ["The arbitral tribunal decides on its jurisdiction without regard to an action with the same object pending between the same parties before another national court or arbitral body, unless serious reasons demand suspension of the procedure."] Modification du 6 octobre 2006. The provision is expected to enter into force early in 2007, either the day of its acceptance by the voters in the event a referendum, or (if no referendum is held) on the first day of the second month following the deadline for a referendum, which has been fixed at 25 January 2007. See also Communiqué, Département fédéral de justice et police (Alexander Markus, Office fédéral de la justice) 17 May 2006.

statute,<sup>130</sup> the parties may by agreement dispense with such review if both sides are non-Swiss.<sup>131</sup>

c) The UNCITRAL Model Law

Countries that follow the UNCITRAL Model Arbitration Law provide yet another twist on the timing of judicial review. The statute dates from 1985, when the United Nations sponsored a Model Law on International Commercial Arbitration<sup>132</sup> which has been enacted in more than fifty countries.<sup>133</sup>

The UNCITRAL Model gives the arbitral tribunal an explicit right to determine its own jurisdiction in the form of a “preliminary” award, subject to challenge on a request from a party within thirty (30) days.<sup>134</sup> Arbitrators, of course, may choose to delay decisions on jurisdictional matters until the final award.

The Model Law does not prevent courts from finding an arbitration clause to be

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<sup>130</sup> Loi fédérale sur le droit international privé, Article 190(2)(b) & (c).

<sup>131</sup> *Loi fédérale sur le droit international privé*, Article 192. Non-Swiss parties are defined as having neither domicile, habitual residence or business establishment in Switzerland.

<sup>132</sup> Drafted by the U.N. Commission for International Trade Law (UNCITRAL), the Model Law on International Commercial Arbitration received General Assembly approval on 11 December 1985. See U.N. General Resolution 40/72, 40 GAOR Supp. No. 53, A/40/53, at 308. See generally HOWARD M. HOLTZMANN & JOSEPH E. NEUHAUS, *GUIDE TO THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION* (1989); Henri C. Alvarez, Neil Kaplan, & David W. Rivkin, *Model Law Decisions* (2003); Pieter Sanders, *The World of UNCITRAL Arbitration and Conciliation* (2nd edn, 2004).

<sup>133</sup> The geographically and culturally diverse countries that have adopted the UNCITRAL Model Law include Australia, Canada, Egypt, Germany, Hong Kong, India, Iran, Mexico, Nigeria, Russia, Scotland, Singapore, Spain, and New Zealand. Within the United States, California, Connecticut, Illinois, Oregon, and Texas have adopted the Model Law on a state level.

<sup>134</sup> Article 16, Model Arbitration Law of the United Nations Commission on International Trade Law.

void in the context of a judicial action on the substantive merits of the case, assuming judicial jurisdiction exists over the relevant parties and/or dispute.<sup>135</sup> The Model Law envisions the possibility of simultaneous proceedings by courts and arbitrators regarding the competence of the arbitral tribunal.<sup>136</sup> Article 8 provides that a court must refer parties to arbitration only if it finds the arbitration agreement not to be “null and void, inoperative or incapable of being performed.”

Controversy does exist on the standard for pre-award review. Some authorities hold to “full review” while others adopt a “*prima facie* review” approach that refers parties to arbitration unless the arbitration clause appears void on its face.<sup>137</sup>

The “*prima facie*” approach leaves open the question of whether a court’s decision is subject to being re-opened at a later stage. A judge might say, “I’ve given the clause a quick glance, and it looks fine to me.” Presumably this would not preclude a later jurisdictional attack on the award, which under the UNCITRAL Model would be available for invalidity of the arbitration agreement or arbitral decisions falling outside the scope of the arbitration submission. By contrast, if the judge’s quick glance determines the clause is void, the parties would seem to be stuck with that decision, since by definition there would be no award to review.

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<sup>135</sup> See HOWARD HOLTZMANN & JOSEPH NEUHAUS, GUIDE TO THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION (1989), at 306: “This provision provoked debate between those who considered that the court should have power to stay the arbitral proceedings in order to prevent potentially needless arbitration and those who would have ... had the court suspend its own proceedings in order to avoid delay and needless court intervention.”

<sup>136</sup> Holtzmann and Neuhaus note that “a court might still consider the jurisdiction of the tribunal in considering whether a substantive claim should be referred to jurisdiction....” See HOWARD HOLTZMANN & JOSEPH NEUHAUS, *supra* at 486.

<sup>137</sup> See Frédéric Bachand, *Does Article 8 of the Model Law Call for Full or Prima Facie Review of the Arbitral Tribunal’s Jurisdiction?*, 22 ARB. INT’L (2006).

## E. The First Word and the Last

### 1. Base-line Positions

One way to summarize the different base-line positions on determinations of arbitral authority might be to ask when arbitrators have the first word on their jurisdiction, and when they have the last. Here is how the landscape might be described.

1. In most modern legal systems, an arbitrator will have the “first word” on his/her jurisdiction, unless a court of competent jurisdiction says otherwise. The arbitral tribunal need not stop the proceedings just because a party questions some aspect of arbitral authority.
2. The fact that arbitrators *can* have the first word does not mean that they always *do* have the “first word”. A litigant might go to court to challenge arbitral jurisdiction without waiting for an award. Such is the situation in the United States and Germany.
3. By contrast, in other countries courts must generally wait to examine jurisdiction until an award is rendered. This is the rule in France, subject to certain narrow exceptions.
4. In all major legal systems, the “last word” on arbitral jurisdiction will normally be for courts at the time an award is subject to scrutiny in the context of a motion to vacate, confirm or grant recognition.
5. Countries differ dramatically, however, on whether and when the parties may entrust a jurisdictional matter to final and binding arbitration, thus in effect transferring the “last word” from the courts to the arbitrators. In the United States, deference to an arbitrator’s jurisdictional decision requires a finding that “the arbitrability question” has clearly been given to the arbitrators. Courts might make this finding either at the beginning of the arbitral process (when one side tries to compel arbitration) or at the end (when an award is presented for review). Other legal systems (notably Germany) deny deference to agreements that purport to subject jurisdictional questions to final determination by arbitrators. Results may depend on whether the purported agreement on jurisdiction takes the form of a separate agreement or a clause in the main commercial contract.

### 2. The Devil in the Detail

Being human, judges like arbitrators sometimes get it wrong. Errors can creep into a judge’s understanding of the parties’ intent on jurisdictional questions. The results may be either denial of a party’s day in court (in a so-called “pro-arbitration” decision) or

disregard of the parties' bargain to arbitrate (in a so-called "anti-arbitration" decision)."

Although trivial, the point is of utmost importance in connection with rules on arbitral jurisdiction. The establishment of any principle bears a danger of misapplication, a fact that might be taken into account by policy-makers in determining whether the rule is likely to provide an optimum balance of efficiency and fairness.

Some risks are greater than others. By allowing parties to grant arbitrators final authority on jurisdictional matter, a legal system increases the peril that faulty contract interpretation will result in some litigants will being denied their day in court. Judges might take a mere contract recital for a manifestation of genuine party consent. The problem is particularly delicate in complex large-scale commercial fact patterns, where legal principles often end up being indicative rather than dispositive.<sup>138</sup>

The complexity of other policy concerns facing legislators can be seen in the various wrinkles engrafted on the major guidelines set down for establishment of arbitral jurisdiction. As has been mentioned elsewhere, these include (i) special rules on declaratory court decisions,<sup>139</sup> (ii) mechanisms to address preliminary points of arbitral jurisdiction,<sup>140</sup> (iii) varying appellate procedures for decisions that implicate arbitral

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<sup>138</sup> In contrast, the United States federal court decisions set forth relatively firm rules for problems that repeat themselves with routine regularity in American arbitration: class actions in consumer lending, and time limits in securities complaints against brokers. See discussions of *Bazzle* and *Howsam*, *infra*.

<sup>139</sup> Some countries such as England and Germany restrict the right of courts to provide declaratory decisions about arbitral authority, but not the power to address arbitral jurisdiction in the context of an action on the underlying dispute.

<sup>140</sup> Compare UNCITRAL Article 16 (immediate appeal of jurisdictional ruling) with Section 32 of the 1996 English Arbitration Act, which permits an application to the court for a determination on substantive jurisdiction if made by all parties or with the permission of the arbitral tribunal. English law also provides for interim awards on jurisdiction, subject to court review. See Sections 31(4) and 67 of the 1996 Act. On the policies behind bifurcated hearings to address jurisdictional decisions separately, see John

jurisdiction,<sup>141</sup> (iv) different standards by which courts address arbitral jurisdiction before (as opposed to after) an arbitration has begun, or before (as opposed to after) an award has been rendered.<sup>142</sup> As to the wisdom of these nuances, only time will tell.

## II. Clarifications

### A. Supra-National Adjudicatory Bodies

In most instances, *Kompetenz-Kompetenz* refers to how national courts exercise supervisory competence, as discussed earlier. However, the phrase *Kompetenz-Kompetenz* has also been applied in forms of international dispute resolution that proceed largely independent of close national court supervision, including the practice of the Permanent Court of Arbitration and arbitration under the rules of ICSID, the International Centre for the Settlement of Investment Disputes.<sup>143</sup> The import of this jurisdictional principle takes on a different cast when the arbitral tribunal is not subject to immediate and well-established forms of control by national courts.

An example of arbitration removed from the review of national courts can be found in the ICSID system, which pursuant to treaty provides a structure for arbitration of

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Gotanda, *An Efficient Method for Determining Jurisdiction in International Arbitrations*, 40 COLUMBIA J. TRANS. L. 11 (2001).

<sup>141</sup> For the position in the United States, see 9 U.S.C. § 16, providing different standards for appeal of lower court decisions on arbitral jurisdiction, depending on whether the court finds for or against the arbitrator's power.

<sup>142</sup> French courts address arbitral jurisdiction only if the arbitral tribunal has not yet been "seized" of the matter, and must limit their inquiry to whether an arbitration clause is clearly void (*manifestement nulle*). NCPC Article 1458. Compare the situation under UNCITRAL Article 8. Similarly, in Switzerland courts generally review an arbitration clause on a *prima facie* basis (*examen sommaire*) before the award, but reserve plenary review following an arbitrator's decision. LDIP Articles 7 and 179(3).

<sup>143</sup> See generally cases summarized in Pierre Lalive, *Some Objections to Jurisdiction in Investor-State Arbitration*, in INTERNATIONAL COMMERCIAL ARBITRATION: IMPORTANT CONTEMPORARY QUESTIONS 376 (2002 ICCA Congress, London) at 378-380.



investment disputes between host states and foreigners.<sup>144</sup> ICSID tribunals render their awards outside the framework of national arbitration statutes. The Convention forecloses challenge to awards on normal statutory grounds<sup>145</sup> in favor of ICSID's special system of quality control under its own internal challenge procedure.<sup>146</sup>

Consequently, jurisdictional determinations are by necessity subject to the arbitrators' jurisdiction alone, absent evidence that the parties never consented in any way to ICSID arbitration.<sup>147</sup> While this may at first blush appear to be similar to the situation in other forms of arbitration,<sup>148</sup> there is no judiciary to exercise supervisory

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<sup>144</sup> The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Washington 18 March 1965 (ratified by 140 nations) established the International Centre for Investment Disputes (ICSID) to hear disputes between Convention states and investors from another party to the Convention. *See generally* EMMANUEL GAILLARD, *LA JURISPRUDENCE DU CIRDI* (2004); RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* (1995); Abby Cohen Smutny, *Arbitration Before the International Centre for Investment Disputes*, 3 *BUS. LAW INT'L* 367 (September 2002).

<sup>145</sup> For ICSID arbitration in the United States, this rule has never been tested in a court action raising the conflict between the Federal Arbitration Act (allowing motions to vacate awards) and the Washington Convention (which excludes such vacatur). The US Constitution in Article VI (2) lists both treaties and federal statutes as the "supreme Law of the Land," without establishing a hierarchy. On some matters statutes clearly override treaties. *See, e.g.,* Pub. L. No. 96-499 § 1125, providing that no treaty shall require "exemption from (or reduction of) any tax imposed" on gains from disposition of US realty. When Congress is silent courts look to canons of statutory interpretation such as "last in time prevails" or "specific restricts general." *See* Detlev Vagts, *The United States and its Treaties: Observance and Breach*, 95 *AM. J. INT'L L.* 313 (2001).

<sup>146</sup> *See* Convention on the Settlement of Investment Disputes Between States and Nationals of Other States Article 52, ICSID Basic Documents 25 (1985). *See generally* W. MICHAEL REISMAN, *SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION* 46-50 (Duke 1992).

<sup>147</sup> Convention Article 41 provides that "The Tribunal shall be the judge of its own competence." *See also* Rules of Procedure for Arbitration Proceedings, Rule 41. The Centre's jurisdiction is addressed in Article 25 of the Washington Convention itself.

<sup>148</sup> *See* CHRISTOPH SCHREUER, *THE ICSID CONVENTION* (2001) at 521, comparing ICSID Article 41 with ICC Rule 6 and Article 21 of the UNCITRAL Arbitration Rules.

power, since Article 26 of the Washington Convention provides that consent to ICSID jurisdiction shall (unless otherwise stated) be deemed to constitute consent to arbitration “to the exclusion of any other remedy.”<sup>149</sup>

Similar non-national *Kompetenz-Kompetenz* principles might be appropriate for the emerging field of tax treaty arbitration. Recent proposals have been elaborated by the Organization for Economic Cooperation and Development<sup>150</sup> and in research sponsored by the International Fiscal Association.<sup>151</sup>

#### B. Applicable Law

If a question arises about whether an arbitral tribunal has jurisdiction to decide its jurisdiction, what procedural law should be applied to test the limits of the principle? The quick answer (not very helpful) would be that the matter will be determined under whatever arbitration principles might be deemed appropriate by the forum where the challenge arises. For example, if the arbitrators’ jurisdictional determination has been

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<sup>149</sup> See CHRISTOPH SCHREUER, *THE ICSID CONVENTION* (2001) at 347, noting that consent to ICSID arbitration means that “the parties have lost their right to seek relief in another forum, national or international.”

<sup>150</sup> See *Proposals for Improving Mechanisms for Resolution of Tax Treaty Disputes*, Public discussion draft, February 2006 (OECD Committee on Fiscal Affairs), proposing amplification of the “Mutual Agreement Procedure” in Model Income Tax Convention Article 25.

<sup>151</sup> WILLIAM W. PARK & DAVID R. TILLINGHAST, *INCOME TAX TREATY ARBITRATION* (2004). In this connection, the IFA-sponsored study makes the following proposal: “In the event that an arbitral tribunal fails to decide a claim because it deems the matter to be outside the scope of the convention, and thus governed solely by national law, either Contracting State or the taxpayer may challenge this finding before a Jurisdictional Review Panel. This Panel shall be constituted according to the process provided in Article 5. The Panel shall consider de novo whether the claim is governed by the Convention. The decision of the Panel shall be final. Following a decision that a claim is governed by this Convention, a new arbitral tribunal shall be constituted pursuant to Article 5 and shall be bound by the Panel’s jurisdictional determination.” *Id.*, page 97, including Proposed Article 8(c) of Supplement to Double Tax Convention Article 25,

questioned before French courts, the applicable procedural law would be the Nouveau Code de Procédure Civile. In the United States, the Federal Arbitration Act. In England, the 1996 Arbitration Act. And should a litigant, by some extraordinary boldness, challenge the principle of *Kompetenz-Kompetenz* in ICSID arbitration the judges seized of the matter would (one hopes) look to the 1965 Washington Convention.

The answer is much more complex in reality. National legal systems quite rightly look to other legal systems through a variety of mechanisms, including reference to a transnational procedural *lex mercatoria*<sup>152</sup> or in some cases the law applicable to the merits.<sup>153</sup> In a federal system, the laws of different political subdivisions might compete. Depending on the issue, procedural questions in the United States might be subject to one of three different chapters of the Federal Arbitration Act,<sup>154</sup> as well as state contract principles regarding interpretation of the New York Convention.<sup>155</sup> Or state law might

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<sup>152</sup> *Rhône Méditerranée v. Achille Lauro*, 712 F.2d 50 (3d Cir. 1983). See also *Isover St. Gobain v. Dow Chemical France et al.*, ICC Case 4131 (1982), ICC COLLECTION OF ARBITRAL AWARDS, Volume I: 1974-85 (Sigvard Jarvin & Yves Derains, eds., 1990), upheld by the Paris Cour d'appel, 21 October 1983, 1984 REV. ARB. 98; English language extracts in 9 ICCA YEARBOOK COMMERCIAL ARBITRATION 132 (1984).

<sup>153</sup> *Pepsico v. Oficina Central de Asesoría*, 945 F.Supp. 69 (S.D.N.Y. 1996). See also DICEY, MORRIS & COLLINS, *THE CONFLICT OF LAWS* (14th edition, L. Collins, gen. ed., 2006), Rule 57(1), at 712, suggesting that “the material validity, scope and interpretation of an arbitration agreement” are governed by the parties’ chosen law or (in the absence of choice) the law most closely connected with the arbitration agreement, normally that of the arbitral seat. This formulation is a considerable improvement over that in the prior edition, which included the “effect” of an arbitration agreement in the ambit of applicable law.” While true as far as it goes, the rule fails to mention that the “effect” of arbitration agreements can also be determined by the arbitration law of the arbitral seat, the treaty context, and law of the recognition forum, regardless of the parties’ choice.

<sup>154</sup> FAA Ch. 2 implements the New York Convention, and Ch. 3 the Panama Convention.

<sup>155</sup> Article II of the New York Convention requires “an arbitral clause in a contract or an arbitration agreement, signed by the parties....” See *Kahn Lucas v. Lark Int’l*, 186 F.3d 210 (2d Cir. 1999), holding that “signed by the parties” applies to arbitral clauses in contracts as well as separate arbitration agreements. For a contrary holding, see *Sphere*

apply, either by virtue of the arbitral seat<sup>156</sup> or the parties' choice.<sup>157</sup>

### C. The Autonomy of the Arbitration Clause

A frequent source of confusion about the arbitrator's right to rule on his or her jurisdiction lies in the interaction of *Kompetenz-Kompetenz* principles and the doctrine of "separability" or the "autonomy" of the arbitration clause.<sup>158</sup> Many eminent authorities have addressed the interaction of the two principles,<sup>159</sup> which when all is said and done are designed to create presumptions that help the arbitration process run smoothly.<sup>160</sup>

*Kompetenz-Kompetenz* is distinct from, but intersects functionally with, the notion

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Drake Ins. PLC v. Marine Towing, Inc., 16 F.3d 666, 669 (5th Cir.1994). Little evidence indicates how many arbitrators reflect on the comma before taking jurisdiction.

<sup>156</sup> New England Energy v. Keystone Shipping Co., 855 F.2d 1 (1st Cir. 1988).

<sup>157</sup> Mastrobuono v. Shearson Lehman Hutton, 514 U.S. 52 (1995); Volt Information Sciences v. Board of Trustees, 489 U.S. 468 (1989).

<sup>158</sup> See Alan Scott Rau, *Everything You Really Need to Know About "Separability" in Seventeen Simple Propositions*, 14 AM. REV. INT'L ARB. 121 (2003); Adam Samuel, *Separability of arbitration clauses - some awkward questions about the law on contracts, conflict of laws and the administration of justice*, [2000] ADRLJ 36; Christian Herrera Petrus, *Spanish Perspectives on the Doctrines of Kompetenz-Kompetenz and Separability: A Comparative Analysis of Spain's 1988 Arbitration Act*, 11 AM. REV. INT'L ARB. 397 (2000).

<sup>159</sup> See e.g., Pierre Mayer, *L'Autonomie de l'arbitre dans l'appréciation de sa propre compétence*, 217 RECUEIL DES COURS 320 (Académie de droit international de La Haye 1989) at 339-352.

<sup>160</sup> Redfern and Hunter state, "There are essentially two elements to this [jurisdictional] rule: first, that an arbitral tribunal can rule on its own jurisdiction; and secondly that, for this purpose, the arbitration clause is separate and independent from the terms of the contract containing the transactions between the parties." ALAN REDFERN, MARTIN HUNTER, NIGEL BLACKABY & CONSTANTINE PARTASIDES, *LAW & PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION* (4th ed. 2004), Section 5-42, at 254. See also JULIAN D.M. LEW, LOUKAS A. MISTELIS & STEFAN KRÖLL, *COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION* (2003), Section 14-19 at 334. These authors write, "While competence-competence empowers the arbitration tribunal to decide on its own jurisdiction, separability affects the outcome of this decision... Without the doctrine of separability, a tribunal making use of its competence-competence would potentially be obligated to deny jurisdiction on the merits since the existence of the arbitration clause might be affected by the invalidity of the underlying contract."

that an arbitration agreement can be operationally detached from the main contract in which it is found. Often conceptualized as a matter of “separability,” the principle that an arbitration clause possesses contractual autonomy permits the arbitrators to do their job, notwithstanding what their award might say about the validity of the contract in dispute. The separability doctrine gives the arbitration clause the status of a contract autonomous from the principal agreement in which it is encapsulated.<sup>161</sup> Thus arbitrators may decide issues relating to the validity of the main contract (such as allegations of fraud in the inducement, or “per se” violations of antitrust law) without risk that their power will disappear retroactively. The autonomy of the arbitration clause recognizes the contracting parties’ presumed intent that the arbitrator should be empowered to decide on the validity or survival of the principal commercial contract. Otherwise the arbitrators might be stripped of power at the very moment when evaluating important aspects of the parties’ business relationship.<sup>162</sup>

Separability and *Kompetenz-Kompetenz* can serve much of the same function, in that both notions create mechanisms to prevent a bad faith party from stopping the

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<sup>161</sup> See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). Surprisingly, one recent decision has invoked *First Options v. Kaplan* to question the validity of the separability doctrine. See *Maye v. Smith Barney*, 897 F. Supp. 100 (S.D.N.Y. 1995).

<sup>162</sup> Many countries permit the arbitration agreement to be subject to a different law than that of the main contract. On separability, see generally Peter Gross, *Separability Comes of Age in England*, 11 ARBITRATION INTERNATIONAL 85 (1995), discussing *Harbour Assurance Co. (U.K.) v. Kansa General International Assurance Co.*, [1993] 3 All E.R. 897; MATTHIEU DE BOISSESON, *DROIT FRANÇAIS DE L'ARBITRAGE* (2d Ed., 1990), at pages 482-484 and 491-493 (§§575 and 579); and cases discussed in ADAM SAMUEL, *JURISDICTIONAL PROBLEMS IN INTERNATIONAL COMMERCIAL ARBITRATION* (1989), at 155-172. See generally Adam Samuel, *Separability and the US Supreme Court Decision in Buckeye v. Cardegna*, 22 *Arbitration International* 477 (2006).; Adam Samuel, *Separability of arbitration clauses - some awkward questions about the law on contracts, conflict of laws and the administration of justice*, [2000] *ADRLJ* 36.

arbitral proceedings before they have begun. The autonomy of the arbitration clause operates with respect to defects in the main contract which might otherwise taint the arbitrator's jurisdiction. The doctrine of *Kompetenz-Kompetenz*, on the other hand, gives the arbitrator the right to pass upon even alleged infirmities in the arbitration clause itself.

To illustrate the difference between the separability of the arbitration clause and *Kompetenz-Kompetenz*, assume that an arbitration clause has been included in a marketing agreement by which a consultant agreed to help an American corporation obtain a public works contract in the Ruritania. It might be alleged both that (i) the person who signed the agreement for the American corporation was not authorized to do so and (ii) the consulting agreement was void because the payments thereunder were earmarked in part to bribe government officials.<sup>163</sup> Separability notions would permit the arbitrators to find the main contract void for illegality without destroying their power under the arbitration clause to do so.<sup>164</sup> Separability would not, however, prevent the court from determining whether the individual who signed the agreement was authorized to bind the corporation to arbitrate; nor would separability save from ultimate annulment or non-recognition an award based on an arbitrator's erroneous assumption about such

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<sup>163</sup> Or the illegality might derive from a violation of antitrust law, or a lender not being authorized to engage in banking in the relevant jurisdiction. *See* *Worthen B. & T. Co. v. United Underwrit. Sales Corp.*, 251 Ark. 454 (1971); *but see* *Shepard v. Finance Associates of Auburn, Inc.*, 366 Mass. 182 (1974). *Compare* *Harbour v. Kansa Harbour Assurance*, [1993] Q.B. 701 and 10 ARBITRATION INTERNATIONAL 194 (1994); Peter Gross, *Separability Comes of Age in England*, 11 ARB. INT'L 85 (1995).

<sup>164</sup> Contracts to engage in bribery are generally void throughout the world, while contracts to arbitrate are not. A court probably could, however, refuse to enforce the award if the arbitrator had decided that the contract did *not* implicate bribery when in fact (in the court's view) it did. While the arbitrator's finding on the validity of the contract would normally be entitled to deference, many statutes and treaties contain explicit provisions for judicial refusal to enforce awards that violate public policy. *See e.g.*, French N.C.P.C. Article 1502(5) and New York Convention Article V(2)(b).

corporate power.<sup>165</sup>

On the other hand, French principles permit the arbitrators to go to the end of the proceedings and decide the matter of the corporate signature, rather than having the question to be referred to the appropriate court at the outset of the arbitration.<sup>166</sup>

However, without a separability principle, the arbitrators' right to rule on their own jurisdiction would not save the validity of an award that had declared the main contract void because of illegality.

The situation in American case law has been subject to several key decisions of the United States Supreme Court. In the landmark American *Prima Paint* decision,<sup>167</sup> a claim was brought for fraud in the inducement of the purchaser of a paint business. The buyer sought rescission in court rather than before the bargained-for arbitral tribunal. The court in essence asked, "Who, court or arbitrator, shall decide whether there was fraudulent inducement of a contract?" Without the autonomy of the arbitration clause, the question would have been for the court, since an arbitrator could not have declared the main agreement to be rescinded without thereby invalidating the arbitration clause. Separability of the arbitration clause permitted the fraud charge, with respect to the main agreement, to be characterized as related to the merits of the case, rather than to the jurisdiction of the arbitrator.

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<sup>165</sup> See e.g., *South Pacific Properties v. Egypt*, French Cour de Cassation (6 January 1987), [1987] REV. ARB. 469, note Ph. Leboulanger. Translation and note by Emmanuel Gaillard, 26 I.L.M. 1004 (1987).

<sup>166</sup> German law as it now stands might permit the parties to enter into a "*Kompetenz-Kompetenz* clause" that could insulate the arbitrator's findings on the signature from any judicial review, although it is not clear whether such findings would withstand a challenge to the validity of the *Kompetenz-Kompetenz* clause itself.

<sup>167</sup> *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

The principle was recently affirmed in *Buckeye Check Cashing, Inc. v. Cardegna* where the United States Supreme Court affirmed the doctrine in the context of a consumer dispute heard in state court and involving an alleged violation of state statute.<sup>168</sup> This classic separability case involved a challenge to arbitral jurisdiction based on the alleged invalidity of a loan agreement. Had the view of the state court prevailed, the arbitrators would have had no power to consider their own jurisdiction. From the start, the charge of “void contract” would have taken away that opportunity, since the allegedly invalid loan agreement would have been inseparably linked to the arbitration clause.<sup>169</sup>

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<sup>168</sup> 126 S.Ct. 1204 (2006). A decision by Justice Scalia found that the Florida Supreme Court failed to adhere to the teachings of *Prima Paint* in a putative class action against a check cashing service accused of making usurious loans in violation of Florida law. Claimants argued that because the contract was allegedly void, the arbitration clause was unenforceable. The action was brought by the borrowers, with lenders seeking to compel arbitration. The Court held that the illegality did not invalidate the arbitration clause, which was separable (autonomous) from the main agreement. Although the Court reached the right result, a bit of careless phraseology has the potential to create mischief in subsequent cases. Justice Scalia asserted, “Applying them [general arbitration principles] to this case, we conclude that because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court.” *Id.* at 1209 These sentences imply both too little and too much. First, an arbitration clause might well be invalid even if a challenge aims at the main agreement, as in event of forgery or lack of capacity. Second, arbitrators do not lose the right to “consider” jurisdiction simply due to challenge launched against the arbitration provisions. Instead, any consideration of the provisions is simply subject to judicial scrutiny, absent the parties’ agreement otherwise. Justice Alito did not participate and Justice Thomas dissented on the basis that the FAA does not apply in state court proceedings to displace a state law prohibiting enforcement of an arbitration clause. See generally, Alan Scott Rau, *Separability in the United States Supreme Court*, 2006 STOCKHOLM INT’L ARB. REV. 1 (2006); Adam Samuel, *Separability and the U.S. Supreme Court Decision in Buckeye v. Cardegna*, 22 ARB. INT’L 477 (2006).

<sup>169</sup> Whether the arbitration law of the United States should allow arbitration of such consumer disputes remains open to question. In Europe the pre-dispute arbitration clause in the usurious loan agreement would most likely be void. See Article 6.1 of the 1993 European Union Directive on Unfair Contract Terms, which invalidates “unfair” contract



### III. Taxonomy: What is a Jurisdictional Question?

#### A. Existence, Scope and Public Policy

In practice, an arbitrator's right to decide a question will often depend on how that question is characterized by the reviewing court. Labeling matters as "jurisdictional" puts them into the realm where judges would normally expect to exercise some scrutiny, depending on the circumstances of the case and the approach of the relevant legal system.

To reduce the risk of simply presuming one's own conclusions about what is or is not jurisdictional, it might be helpful to suggest three common categories of defects in arbitral authority.

(i) Existence of an arbitration agreement. In some instances there may be no binding agreement to arbitrate (for example, due to absence of signatory authority), or strangers to the agreement might have been joined through fraud, forgery or duress.<sup>170</sup>

(ii) Scope of authority. An arbitrator might be asked to decide substantive questions which the arbitration clause never submitted to his or her determination. Or the arbitrator might disregard party-agreed rules on how the arbitration was to be conducted, perhaps by exceeding limits on arbitral powers;<sup>171</sup>

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terms in consumer contracts. Articles 3 and 4.1 set out the basic notion of an unfair contract, which include terms not individually negotiated if they cause a significant imbalance in the parties' rights and obligations arising under the contract. An annex contains an indicative and non-exclusive list of "the terms which may be regarded as unfair" including paragraph "q" which presumes a term to be unfair if it has the effect of "excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions..."

<sup>170</sup> See e.g., *Chastain v. Robinson- Humphrey*, 957 F. 2d 851 (11th Cir. 1992) (forgery); *Gibson v. Neighborhood Health Clinics*, 121 F. 3d 1126 (7th Cir. 1997). See also decisions in *Sphere Drake v. All American*, *Three Valleys* and *Sandvik*, discussed *infra*. See generally, BERNARD HANOTIAU, *COMPLEX ARBITRATIONS* (2005).

<sup>171</sup> On occasion, arbitral institutions may also play a role in excess of authority. For example, if disputes are to be settled by arbitrators appointed by the International Chamber of Commerce, a tribunal should not normally be constituted by the American Arbitration Association or the London Court of International Arbitration. See *Maritime International Nominees Establishment (MINE) v. Republic of Guinea*, 693 F.2d 1094 (D.D.C. 1982).

(iii) Public policy. An arbitration might purport to address subjects that a relevant legal system says may not be arbitrated (subject matter arbitrability<sup>172</sup>), or which a court feels lie within its exclusive purview.<sup>173</sup> Or an award might give effect to illegal conduct.<sup>174</sup>

The first two flaws relate to the contours of the parties' contract. The third derives from public policy, regardless of what the parties might have agreed.

There is no magic in this tripartite classification, which commends itself only as a starting point for analysis. Jurisdiction remains a notoriously slippery term. Different statutes employ different terms, and divergent intellectual pigeon-holes to organize grounds for jurisdictional challenge.<sup>175</sup> In the real world, an alleged problem sometimes involves a combination of factors, or represents shades of gray on a jurisdictional continuum.

Violations of public policy, of course, will defeat the enforcement of arbitration agreements regardless of the parties' wishes, at least within the forum whose norms have been offended.<sup>176</sup> The problem with public policy, of course, lies in its malleability and

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<sup>172</sup> Subject matters that have traditionally been sensitive (notwithstanding that many are not considered arbitrable) include competition law, securities regulation, bankruptcy and intellectual property. See e.g., Alain Prujiner, *Propriété intellectuelle et arbitrage: quelques réflexions après l'arrêt Caillou*, CAHIER DE PROPRIÉTÉ INTELLECTUELLE, MÉLANGES VICTOR NABHAN (2004).

<sup>173</sup> See discussion *infra* of *United States v. Stein*, concerning the right to legal fees in a criminal tax investigation.

<sup>174</sup> An arbitrator would not likely be permitted to render an award giving effect to a sale of illegal arms to terrorists or ordering payment for slaves or heroine. Nor would an arbitrator be permitted to reinstate a pilot dismissed from employment for showing up drunk at the cockpit. See discussion *infra*.

<sup>175</sup> Compare: 1996 English Act, Section 67 and Section 68, French NCPC Article 1502, Swiss LDIP Article 190, FAA Section 10 FAA, UNCITRAL Model Law Article 34.

<sup>176</sup> It might be that one country finds it intolerable for the arbitrator to have applied the parties' choice-of-law clause in a way that disregards its competition law, while another country might be offended if the arbitrator does ignore the choice-of-law clause.

potential for mischief when applied through a parochial lens. Although courts can hardly be expected to enforce an arbitration agreement related to an arms sale to terrorists, the “public policy” shibboleth frequently finds itself invoked with respect to concerns of much less magnitude.<sup>177</sup>

The other two categories of jurisdictional shortcoming (existence and scope of the clause) might be remedied by the parties’ agreement. If the challenge relates to the very validity of the arbitration clause, the issue could be submitted to final arbitral determination through a second agreement legitimately concluded by the party sought to be bound. Such a result has been accepted in some legal systems,<sup>178</sup> but not others.<sup>179</sup> Without such a subsequent agreement, however, arguments about proper parties will inevitably be subject to review by a court asked to enforce the award.<sup>180</sup>

Problems of scope might be addressed in the initial arbitration clause itself. At the time of concluding their transaction, foresighted parties could give arbitrators explicit authority to adjudicate challenges to the extent of their powers and the range of matters

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<sup>177</sup> See e.g., *Nagrampa v. MailCoups Inc.* 469 F.3d 1257 (9th Cir. 2006), refusing to recognize an arbitration agreement because it would have required a California resident to travel to Boston for arbitration, notwithstanding that she was an admittedly savvy businesswoman who “knew her industry inside and out.” *Id.* at 1310 (dissent by Kozinski). Finding an arbitration clause unconscionable (a matter held to be for judge rather than arbitrator), the Ninth Circuit reversed a lower court decision dismissing a California state action brought by the franchisee. The prize for parochialism may well go to *Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire Co.*, 484 F. Supp. 1063, 1068-69 (N.D. Ga. 1980), vacating award simply because it applied a French interest rate to an international contract involving a company from France.

<sup>178</sup> See *Astro Valiente Compania Naviera v. Pakistan Ministry of Food & Agriculture* (Emmanuel Colocotronis No. 2), [1982], 1 W.L.R. 1096, 1 All E. R. 578 (disagreement on whether charter party terms incorporated into a bill of lading). See also discussions of the law in the United States (*infra*) and Finland (*supra*).

<sup>179</sup> See discussion *infra* of the German BGH decision of 13 January 2005.

<sup>180</sup> The subsequent arbitration agreement would in essence transform a jurisdictional question (in the first dispute) into one of the substantive merits (in the second).

covered by the arbitration clause. Again, the extent to which a grant of jurisdictional power will be recognized in court depends on the relevant judicial system.

Even if a legal system does not give final effect to an arbitrator's jurisdictional ruling, it might well accord interim deference by delaying judicial review until after an award. The timing for challenge, however, remains a question separate from the effect of the jurisdictional decision and the parties' intention in that regard.

#### B. Common Trouble Spots

An arbitrator's jurisdiction to hear a matter will normally depend on several distinct lines of inquiry: (i) the existence of an agreement to arbitrate; (ii) the scope of the agreement with respect to parties, subject matter and procedural powers; (iii) public policy that might override the agreement, by making the subject non-arbitrable or the governing law inapplicable.

With respect to the first two "contract-related" categories, common questions arise with respect to implied agency; waiver of right to arbitrate (for example, by initiation of court litigation or undue delay), survival of an arbitration clause after assignment, and authority of a corporate officer. Even if a valid arbitration agreement exists, its substantive and procedural limits may be circumscribed in ways that require serious examination. Did the parties intend that tort claims arising out of the contract would be subject to the arbitrator's jurisdiction? Were statutory causes of action (for example, relating to antitrust violations) included within the arbitrator's mission? Did the arbitrators exceed their authority by disregarding the applicable law<sup>181</sup> or the basic

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<sup>181</sup> For example, arbitrators who apply provisions of United States antitrust law, notwithstanding the merchants' agreement that the contract shall be subject to the laws of another country, might exceed their jurisdiction, unless the mandatory norms of the

terms of the contract?<sup>182</sup> While some countries create presumptions about certain aspects of jurisdiction,<sup>183</sup> care must be taken that they not be misapplied.

The process for constitution of the arbitral tribunal also affects arbitral power. Arbitrators possess jurisdiction only if appointed according to the parties' agreement. If the parties agreed to arbitration by a tribunal appointed by the International Chamber of Commerce, there is no basis to oblige the defendant to participate in an arbitration convened by the American Arbitration Association.<sup>184</sup> Interpreting the parties' intent as to the constitution of the arbitral tribunal becomes particularly problematic when courts are called to repair pathological clauses lacking particulars about the arbitral situs or institutional rules.<sup>185</sup> In some cases, the arbitrators' qualifications will be established in part by the institutional rules to which the arbitration agreement refers.<sup>186</sup>

Procedural powers exercised by arbitrators can also become jurisdictional issues.

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United States (as place of performance) preempt the contractually-designated law. *See Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985).

<sup>182</sup> *See e.g.*, *Mobile Oil v. Asamera*, 487 F. Supp. 63 (S.D.N.Y. 1980).

<sup>183</sup> In England, for example, the House of Lords decision in *Lesotho Highlands* (discussed *infra*) might be seen as creating the presumption that arbitrators who exercise statutory powers do so within their mandate, notwithstanding that the powers have been exercised incorrectly.

<sup>184</sup> For an analogous problem, *see* *Guinea v. MINE*, 693 F.2d 1094 (D.C.C. 1982), and *Geneva Office des Poursuites*, 26 I.L.M. 382 (1987).

<sup>185</sup> *See e.g.*, *Jain v. De Méré*, 51 F.3d 686 (7th Cir. 1995); *National Iranian Oil Company v. Ashland Oil, Inc.*, 817 F.2d 326 (5th Cir. 1987); *Marks 3-Zet-Ernst Marks GmbH v. Presstek, Inc.*, 455 F.3d 7 (1st Cir. 2006). In the last case, the contract between German and American entities provided only for "arbitration in the Hague under the International Arbitration rules."

<sup>186</sup> For example, the rules of the International Chamber of Commerce require arbitrator "independence." Arbitration qualifications incorporated into a contract through reference to institutional rules often overlap public policy limits on biased arbitrators, just as arbitration rules on notice and the right to present one's case will frequently echo due process requirements of municipal arbitration law.

Did the parties authorize the arbitrators to consolidate two proceedings? Did the parties authorize the arbitrators to punish a party for failing to produce documents? Did the parties authorize the arbitrators to award compound interest?

Sound analysis will depend on the contextual configuration in which jurisdictional questions are asked. The problem areas sketched below have in the past fertilized disagreements about arbitral authority.

a) Who is a Party?

When arbitrators assume jurisdiction over a non-signatory to the arbitration agreement (perhaps because two or more corporations are related through common ownership), the task of determining who agreed to arbitrate may be complicated by the form in which contract documents were signed.<sup>187</sup> Corporate restructuring provides another fertile source for confusion as to the proper party to an arbitration agreement.<sup>188</sup>

b) Meaning of Contract Terms

In commercial arbitrations, disputes frequently raise questions about what controverted events are covered by the clause, and what procedural powers have been

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<sup>187</sup> For example, in *South Pacific Properties v. Egypt*, an arbitral tribunal had to determine whether the government of Egypt was bound by an arbitration clause in an investment contract concluded by an Egyptian state-owned corporation but also initialled by a government minister with the ambiguous words "approved, agreed and ratified." *Egypt v. Southern Pacific Properties, Ltd.*, Judgment of July 12, 1984, Cour d'appel, Paris 1987 J.D.I. (Clunet) 129; 1986 Rev. Arb. 75. See 23 I.L.M. 1048 (E. Gaillard trans. 1984). Affirmed by Cour de cassation Judgment of Jan. 6, 1987, Cass. civ. I, 1987 J.D.I. (Clunet) 469 (with commentary by Ph. Leboulanger), reprinted in 26 I.L.M. 1004 (E. Gaillard trans. 1987). The I.C.C. award itself (Case No. 3493) is published in 22 I.L.M. 752 and 1986 Rev. d'Arbitrage 105. Following a subsequent ICSID award against Egypt (ICSID Case No. ARB/84/3, 20 May 1992), the parties reached a final settlement in December 1992. See 8 Int. Arb. Rep. 328 (Jan. 1993).

<sup>188</sup> See also discussion *supra* of U.S. Court of Appeals decisions in *Sarhank, Intergen*, and *Bridas v. Turkmenistan*; English Queen's Bench decision in *Kazakhstan v. Istil* and U.S. district court decision in *Fluor Daniel v. General Electric*.

given to an arbitrator. For example, a party might assert that a transaction occurred before the arbitration clause entered into effect, or that the arbitrator's power to award punitive damages had been expressly circumscribed.<sup>189</sup>

c) Waiver, Delay and Other Post-Contract Events

Arbitrators are often presented with questions arising out of events subsequent to contract formation. Invalidity might be asserted on the basis of assignment,<sup>190</sup> waiver of the right to arbitrate,<sup>191</sup> failure to observe statutory or contractual time limits, or undue delay in pursuing a claim.<sup>192</sup> For example, the arbitrator might be asked to determine whether one party's recourse to courts constitutes waiver of the right to compel arbitration, or whether delay in bringing a claim bars arbitration by virtue of a statute of limitations or an eligibility requirement contained in arbitration rules.<sup>193</sup>

d) Ab Initio Invalidity of the Arbitration Agreement

The validity of an arbitration clause may be in doubt not only because of gross consensual defects related to physical duress and forgery, but also due to the lack of

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<sup>189</sup> See also discussion *infra* of the Scalia opinion in *Pacificare*.

<sup>190</sup> *Apollo v. Berg*, 886 F.2d 469 (1st Cir. 1989).

<sup>191</sup> *Cabintree v. Kraftmaid*, 50 F.3d 388 (7th Cir. 1995).

<sup>192</sup> *Smith Barney Harris Upham & Co. v. Luckie*, 85 N.Y.2d 193, 647 N.E.2d 1308 (1995).

<sup>193</sup> See, e.g., *Paine Webber v. Landay*, 903 F. Supp. 193 (D. Mass. 1995) (six year time limit for bringing claim under NASD Code of Arbitration Procedure held to be a question for arbitrator to decide); *Smith Barney v. Luckie*, New York Ct. App., 21 Feb. 1995, 63 U.S. Law Week 2531 (7 March 1995) (statute of limitations questions must be resolved by courts; New York law not pre-empted by Federal Arbitration Act). Compare New York cases cited in *Paine Webber v. Landay* at n. 5 of Judge Woodlock's opinion. See also *Zwitserse Maatschappij van Levensverzekering en Lijfrente v. ABN International Capital Markets*, 996 F. 2d 1478 (2d Cir. 1993) (initiation of judicial proceedings in the Netherlands resulted in waiver of right to arbitrate); *Khalid Bin Alwaleed Foundation v. E.F. Hutton*, U.S. Dist. Ct. N. D. Ill., E.D. (1990), reported in XVI Yearbook Comm. Arb. 645 (1991) (participation in pre-trial discovery did not constitute waiver of right to arbitrate).

authorized signatures required by the corporate by-laws or inadequate incorporation of institutional arbitral rules.<sup>194</sup>

e) Procedure

In addition to excess of jurisdiction with respect to substantive contract questions, an arbitral tribunal may act outside the limits to their authority set by the parties with respect to procedural matters. The arbitral tribunal may be improperly constituted (under a set of institutional rules other than the ones specified in the contract), or the arbitral tribunal may deny one side its right to be heard during the arbitral proceedings. An increasingly important source of jurisdictional difficulty lies in the multiparty dimension of many business disputes. Problems arise from attempts to consolidate related arbitrations<sup>195</sup> and to appoint arbitrators for claims against more than one defendant.<sup>196</sup> For better or for worse, the Federal Arbitration Act does not authorize forced consolidation of different arbitration proceedings, even if they present similar questions of law and fact.<sup>197</sup>

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<sup>194</sup> See *Three Valleys Municipal Water District v. E.F. Hutton & Co.*, 925 F.2d 1136 (9th Cir. 1991), concerning securities law violations brought by government entities against investment company. The government entities resisted arbitration on the grounds that the individual who signed the agreements allegedly on their behalf did not have authority to do so. The Court of Appeals held that whether the signatory had authority to bind the plaintiffs was a question for the courts to decide, and remanded the case to the district court for a determination on the matter.

<sup>195</sup> Consolidation difficulties are illustrated by the now legendary story of the Macao sardine case as retold in Michael Kerr, *Arbitration v. Litigation*, 3 ARB. INT'L 79 (1987).

<sup>196</sup> *Siemens and BKMI v. Dutco*, Cour de cassation (France), 7 January 1992, Chambre Civile No. 1, Cass., 1992 Rev. d'Arbitrage 470. (two defendants and a three person arbitral tribunal).

<sup>197</sup> See *United Kingdom v. Boeing*, 998 F.2d 68 (1993). The United Kingdom moved to consolidate arbitrations with Boeing and Textron, Inc., both of which had contracted with British Ministry of Defense to develop an electronic fuel system. The Court ruled that consolidation of separate proceedings cannot be ordered absent the parties' consent. An



Since specific examples often provide greater insight than general definitions,<sup>198</sup> a list of illustrative jurisdictional problems has been appended to this essay.<sup>199</sup> In no way do these scenarios exhaust the variety of situations in which the arbitrator's right to make a jurisdictional ruling could become an issue. Rather, they are presented as further examples of when and how challenges to arbitral power arise.

### C. Admissibility

Often we understand what something is by considering what it is not. The essence of arbitral jurisdiction might be put into starker relief through a comparison with what is sometimes called "admissibility".

A precondition to arbitration (limiting an arbitrator's right to hear the case) is not the same thing as a precondition to recovery (restricting one side's right to obtain damages). For example, arbitrators might well have authority to hear a dispute over mismanagement of a brokerage account, but deny the claim on the basis that the statute of limitations had passed.<sup>200</sup>

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earlier decision in *Neurus Shipping*, 527 F.2d 966 (2d Cir. 1975), was distinguished on its facts. In the United States, forced consolidation will be possible only in a jurisdiction (like Massachusetts) that does provide for joinder of related parties. See *New England Energy, Inc. v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988), discussed *infra*.

<sup>198</sup> Sylvia Plath once observed that "the concrete can save when the abstract might kill." SYLVIA PLATH, *THE JOURNALS OF SYLVIA PLATH* 287 (1982).

<sup>199</sup> Appendix I, *infra*.

<sup>200</sup> Other illustrations of pre-conditions to recover can be found in long-term supply contracts, which often provide for arbitration of disputes about price adjustments. Frequently, price modification will require the arbitrators (i) first to find a change in market conditions, and (ii) then to establish how far (and in what direction) the prices should be modified to reflect such changed conditions. Both questions remain matters of the substantive merits of the case, since the parties intended them to be addressed by the arbitrators rather than courts. The two-fold nature of the arbitrators' task simply represents the parties' assessment of the most efficient and logical way for analysis to proceed.

Notions of admissibility would normally be used to describe constraints on the right to file claims in cases clearly subject to arbitration. Since the matter is properly before the arbitrators, their decisions would usually *not* be reviewable in court.<sup>201</sup> Admissibility might relate to whether a claim is ripe enough (or too stale) for adjudication, or to arbitral preconditions (such as mediation) or time bars (a prohibition on claims more than six years after the alleged wrong).<sup>202</sup>

In some instances, jurisdictional and admissibility questions may overlap. For example, a brokerage contract might be subject to rules that make an investor's claim ineligible for arbitration unless filed within six years after the allegedly inappropriate advice or trade. In addition, a statute of limitations might exist in the law applied to the merits of the dispute. The latter question (statute of limitations) would clearly fall to the arbitrators as part of their decision on the merits.<sup>203</sup> The former (eligibility for arbitration) might or might not be for arbitrators, depending on the parties' intent as

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<sup>201</sup> There might, however, be some situations in which valid jurisdictional challenges could be mounted to improper decisions on admissibility. If a contract says no actions may be filed before 2010, a putative award in 2005 would appear to most observers as an *excès de pouvoir* (subject to annulment) rather than simply an unreviewable mistake about calendars.

<sup>202</sup> For a comparison of jurisdiction and admissibility in investment arbitration, see *Ian A. Laid, A Distinction without a Difference? An Examination of the Concepts of Admissibility and Jurisdiction in Salini v. Jordan and Methanex v. USA*, in *INTERNATIONAL INVESTMENT LAW AND ARBITRATION: LEADING CASES FROM THE ICSID, NAFTA, BILATERAL TREATIES AND CUSTOMARY INTERNATIONAL LAW* 201 (T. Weiler ed. 2005). See also contribution by Jan Paulsson in *INTERNATIONAL LAW, COMMERCE & DISPUTE RESOLUTION: LIBER AMICORUM IN HONOUR OF ROBERT BRINER* 601 (2005).

<sup>203</sup> Statutes of limitations relating to arbitration law (rather than the underlying claim) are for judges. For example, in a motion to compel arbitration opposed on the basis that it was made too late, an American court found that the Federal Arbitration Act failed to provide its own statute of limitations, and thus borrowed analogous limitations from state law principles at the place where the court was sitting. See *National Iranian Oil v. Mapco Int'l*, 983 F.2d 485 (3d Cir. 1992).

evidenced in the applicable arbitration rules.

It may not always be apparent why distinctions should be made between (i) the time bar in a statute of limitations and (ii) a time restriction on arbitration eligibility. However, the difference is crucial. The statute of limitations (a matter of admissibility) bars recovery itself, whether before courts or arbitrators. The limitation applies to the claimant's right to receive damages, regardless of the forum. By contrast, the jurisdictional limit, restricting eligibility for arbitration, says only that the case must be brought in court rather than before the arbitrator.

Preconditions to arbitration do not always lend themselves to facile analysis. In one intriguing case, *Vekoma v. Maran Coal*,<sup>204</sup> Switzerland's highest court annulled an award in which the arbitrators had declared themselves competent to hear a claim arguably brought after the contractually stipulated time limits. The contract required claims to be filed within thirty days after the parties agreed that their differences could not be resolved by negotiation. The arbitrators found that settlement negotiations had broken down in April 1992, and thus a May filing was timely. The respondent took the position that failure to settle occurred in January, when a letter from the claimant met with silence.

The court vacated the award, finding the arbitration clause lapsed by May when

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<sup>204</sup> See *Tribunal fédéral (Bundesgericht)* decision in *Transport-en Handelsmaatschappij Vekoma B.V. v. Maran Coal Co.*, Civil Division I, 17 Aug. 1995, reprinted 14 (No. 4) ASA BULL. 673 (1996) with commentary by Philippe Schweizer. See generally, Paul Friedland, *Swiss Supreme Court Sets Aside an ICC Award*, 13 (No. 1) J. INT'L ARB. 111 (1996); Pierre Karrer & Claudia Kälin-Nauer, *Is There a Favor Iurisditionis Arbitri?*, 13 (No. 3) J. INT'L ARB. 31 (1996); François Knoepfler & Philippe Schweizer, *Jurisprudence suisse en matière d'arbitrage international*, 1996 REV. SUISSE DR. INT'L & DR. EUROPÉEN 573. Compare an arbitral tribunal's treatment of missed deadlines, deemed not to rise to the level of a jurisdictional defect. *Tribunal fédéral* Decision of 24 March 1997, 15 ASA BULLETIN 316 (1997).

the claim was filed. Saying that negotiations might fail as a matter of either fact or law (“*tatsächlich oder normativ*”), the court found failure as a matter of law when the January offer went unanswered.<sup>205</sup> Whether the court was right to review the arbitrators’ determination about time limits depends largely on the parties’ intention in drafting their contract. Here as elsewhere, jurisdictional determinations often remain very fact sensitive.

One questionable aspect of this decision is that the Swiss court apparently deemed its review powers greater on questions of law than of fact, perhaps analogizing to review of cantonal court decisions. As a policy matter, this distinction is highly problematic. If arbitrators wrongly assume Company A acted as agent for Company B in signing an arbitration clause, they exceed their authority as to Company B whether from misunderstanding the law of agency or from a factual mistake about who signed the contract.

At this point, the distinction between “admissibility” and “jurisdiction” might provide a helpful segue into a deeper analysis of the nature of jurisdictional challenges. As we shall see, it is not always an easy task to distinguish between a decision that goes beyond the arbitrator’s mandate and one that is simply wrong.

#### D. The Nature of Authority: Out of Bounds or Just Wrong?

##### 1. Party Consent

The party raising questions about the arbitrator’s authority is not just saying that the arbitrators have made (or might make) an incorrect decision about whatever question has been put at issue. Rather, jurisdictional challenges argue that arbitrators have gone

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<sup>205</sup>See 14 ASA BULLETIN 676-78, at ¶ 3.

(or will go) out of bounds whatever their decision, whether right or wrong. At stake is *not* whether claimant breached the contract or owes \$10 million, but rather the identity of the forum (arbitration or court proceeding) that will address and adjudicate the questions of contract breach and damages. Even if the respondent did breach, and does owe the money, an arbitrator lacking jurisdiction would not be authorized to hear the arguments.

A jurisdictional challenge asserts that the arbitrator has no right at all to hear a matter or exercise a procedural power. The challenge may be directed at the case in its entirety, a particular question (such as a competition counterclaim), or the exercise of a procedural power (such as imposing sanctions for failure to produce documents or granting interest). The problem may also rest with the absence of a precondition to arbitration, such as the expiry of time limits.<sup>206</sup>

The labels applied to excess of authority may vary from country to country, with related terms (“jurisdiction”, “authority”, “powers” and “mission”) often used almost interchangeably, or with slight contextual nuances to indicate *what* the arbitrator was authorized to decide rather than *how* the arbitrator was authorized to decide. In some legal systems, excess of authority may overlap with notions related to clear legal error. For example, courts in the United States have given themselves power to set aside awards for “manifest disregard of the law”,<sup>207</sup> a malleable term most often applied when

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<sup>206</sup> A precondition to recovery, of course, is not the same thing as a precondition to arbitration. For example, arbitrators might well have the right to hear a case, but deny the claim on the basis that the statute of limitations had passed. The distinction is sometimes referred to as between jurisdiction and “admissibility”. See discussion *infra*.

<sup>207</sup> See e.g., Noah Rubins, “*Manifest Disregard of the Law*” and *Vacatur of Arbitral Awards in the United States*, 12 AM. REV. INT’L ARB. 363 (2002); Hans Smit, *Manifest Disregard of the Law in New York Court of Appeals*, 15 AM. REV. INT’L ARB. 315 (2004). See also Stephan Wilske & Nigel Mackay, *The Myth of the ‘Manifest Disregard of the Law’ Doctrine*, 24 ASA Bulletin 216 (2006).

arbitrators have exceeded their authority,<sup>208</sup> also a statutory basis for vacatur.<sup>209</sup>

These jurisdictional questions remain neutral as to the merits of the case. It makes no difference whether claimant or respondent is right on the question of contract interpretation. The only issue is whether the arguments should be heard by arbitrators rather than courts.

Attempts to grapple with the nature of arbitral jurisdiction often fall prey to two divergent intellectual tendencies. The first conflates substantive errors on the merits (misinterpretation of the law) with errors of jurisdiction for the purpose of subjecting arbitral decisions to judicial review. After all, it might be argued, the parties never authorized the arbitrators to make a mistake. Thus from one perspective, each time the arbitrators go wrong in law they go beyond their mandate.<sup>210</sup> According to this view,

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<sup>208</sup> See Alan Scott Rau, *The Culture of American Arbitration and the Lessons of ADR*, 40 TEX. INT'L L.J. 449, at 530-533 (2005), analyzing the doctrine through the lens of two recent Court of Appeals cases, *Hoeft v. MVL Group*, 343 F. 3d 57 (2d Cir. 2003) and *George Watt & Son v. Tiffany*, 348 F3d 577 (7th Cir. 2001).

<sup>209</sup> For a recent rejection of a losing party's "manifest disregard" challenge, see *St. John's Mercy Medical Center v. Delfino*, 414 F.3d 882 (8th Cir. 2005) ("The arbitrator did not cite relevant law and then ignore it..."). By contrast, the court did vacate for "manifest disregard" in *Patten v. Signator Insurance Agency*, 441 F. 3d 230 (4th Cir. 2006), where the arbitrator dismissed a claim against an insurance company by one of its sales agents, invoking a time limitation in an earlier contract with a different company. In theory the Court distinguished non-reviewable error in contract interpretation from reviewable excess of authority. The court then lost its way, however, and went on to cite substantive Massachusetts law to find that the award was in "manifest disregard of the law".

<sup>210</sup> Such was the position once taken in England by Lord Denning, who once suggested (albeit in an administrative context) that "Whenever a tribunal goes wrong in law it goes outside the jurisdiction conferred on it and its decision is void." See LORD DENNING, *THE DISCIPLINE OF THE LAW* 74 (1979). See also *Pearlman v. Keepers and Governors of Harrow School*, [1978] 3 W.L.R. 736, 743 (C.A.) ("The distinction between an error which entails absence of jurisdiction and an error made within jurisdiction is [so] fine . . . that it is rapidly being eroded."). See generally the House of Lords decision in *Anisminic Ltd. v. Foreign Compensation Commission* [1969] 2 AC 147, [1969] 1 All ER 208. Happily for the health of English law, the House of Lords in 2005 rejected this position a year ago in the *Lesotho Highlands* decision.

since mistakes are not authorized, by definition they constitute an excess of authority.

The reverse tendency conflates jurisdictional questions with the dispute's substantive merits, but for the opposite purpose: to deny courts the opportunity to second-guess arbitrators. Rather than saying that mistakes of law are questions of jurisdiction, some American courts find that jurisdictional questions have become questions of substance, submitted to the arbitrators by virtue of the parties' agreement. Such a characterization exercise has been performed on questions such as time bars to arbitral authority, the right to consolidate cases, and the power to grant punitive damages.<sup>211</sup>

Admittedly, it is not easy to articulate an intellectually rigorous test for distinguishing jurisdictional error from other types of mistakes, either for commercial arbitration or for law in general.<sup>212</sup> As with most legal problems, the difficulties lie at the fringes.<sup>213</sup> However, definitional difficulty does not mean that vital distinctions cease to exist between a decision that is wrong and one that exceeds the authority of the purported

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<sup>211</sup> See discussion *infra* in Part V.

<sup>212</sup> For an inquiry into similar questions in public international law, see W. MICHAEL REISMAN, *NULLITY AND REVISION* (1971). See also Alex Lees, *The Jurisdictional Label: Use and Misuse*, 58 *Stanford L. Rev.* 1457 (2006), addressing more rigid applications of jurisdictional rules that operate "to shift authority from one law-speaking [sic] institution to another." *Id.* at 1460. The matter was addressed by the U.S. Supreme Court in *Kontick v. Ryan*, 540 U.S. 443 (2004) (bankruptcy time prescription for creditor objections not jurisdictional in the sense of dispositive), which described jurisdiction as a word with "many, too many, meanings". *Id.* at 454.

<sup>213</sup> In some instances, the very same facts might be relevant both to the merits of a dispute and to jurisdiction. See *Jackson v. Fie Corporation*, 302 F.3d 515 (5th Cir. 2002), involving enforcement of a default judgment arising from the misfire of a pistol allegedly made by an Italian manufacturer. Testimony of the plaintiff's firearms expert (stating the gun was made by Fratelli Tanfoglio) proved relevant both to the merits of the products liability action and the court's personal jurisdiction over the foreign company.

decision-maker.<sup>214</sup>

In deciding challenges to arbitral authority, the parties' intent should serve as the touchstone and the lodestar. If the arbitrators have addressed (or are likely to address) questions that the parties submitted to arbitration, they do not exceed their power.

## 2. The Arbitrator's Job: Competing Principles

Judicial deference to an arbitrator's jurisdictional determination implicates several principles sometimes in tension one with another.<sup>215</sup> First, the arbitrators' decisions are normally final on the questions submitted to them, usually referred to as the merits of the dispute. Second, the arbitrators' decisions are *not* final on issues that the parties did not submit, which is to say, which fall outside the scope of the arbitral authority. Finally, courts will not defer to arbitrators' decisions that violate basic notions of public policy in the forum asked to endorse or give effect to the award.

Renunciation of the right to seek justice through government courts means that an

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<sup>214</sup> The world of education provides a relatively simple illustration of the difference between simple mistake and excess of authority. In American law faculties, the professor who teaches a course normally bears responsibility for grading exams. If the lecturer decides that a paper merits a "B", then the student receives a "B", perhaps adjusted for classroom participation, again by the professor. Now assume that a colleague happens by chance to read the exam, and finds the grade excessively severe (the student deserved an "A") or unduly generous (the paper merits only a "C"). The second professor's views do not matter, whether correct or not. Each professor bears the authority and duty to grade his or her exams. That being said, not all authors would agree that a distinction can be made between the merits of a dispute and jurisdiction, at least in the context of court actions. See Evan Tsen Lee, *The Dubious Concept of Jurisdiction*, 54 HASTINGS LAW J. 1613 (2003), examining links between words such as "power" and "ability" in the context of jurisdiction. One wonders whether the thesis has not been overstated. Simply because the line between merits and jurisdiction sometimes runs thin does not mean the line never exists.

<sup>215</sup> By deference, of course, one means something more than hypocritical adornment to soften the blow of an annulment, where a judge prefaces the vacatur with words such as, "With greatest respect for the distinguished arbitrator" while really thinking that this is an award that must be seen to be believed.



arbitrator has the right to get it wrong, in the sense of evaluating a controverted event differently than would the otherwise competent judge.<sup>216</sup> Assuming the risk of a bad award on the merits of the dispute does not, however, mean giving arbitrators power to decide matters never submitted to them. The arbitrator's job is to decide the case. The court's job is to support the arbitral process, but only to the extent it does not exceed the mission conferred by the parties or the limits of public policy.

This distinction between a mistake on the merits and an excess of authority goes to the heart of what arbitration is all about. Arbitration is a consensual process unfolding within an enclosure created by contract. Litigants accept the risk of arbitrator mistake only for decisions falling within the borders of arbitral authority. A simple error is normally not subject to challenge, since the parties asked an arbitrator to decide the legal and factual merits of their dispute. But no court should recognize an award falling beyond the arbitral authority that gives legitimacy and integrity to the process.

Most modern arbitration statutes acknowledge this prohibits appeals related to the substantive merits of an award. Unlike judges, arbitrators do not normally find their decisions reversed for mistake of law. Arbitration statutes do, however, allow challenge to awards that go beyond the arbitrators' mission,<sup>217</sup> whether described as an "excess of

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<sup>216</sup> In mandated, court-annexed "arbitration" within the United States however, the parties normally retain a right to a *de novo* trial, making the so-called arbitrator a conciliator in reality. See 28 U.S.C. § 655. See generally Lisa Bernstein, *Understanding the Limits of Court-Connected ADR: A Critique of Federal Court-Annexed Arbitration Programs*, 141 U. PENN. L. REV. 2169 (1993). Some state statutes, however, seem to ignore the principle of consensuality. See e.g. Minnesota's statute requiring arbitration of motor vehicle accident claims not in excess of ten thousand dollars (\$10,000) (Minn. Statutes § 65B.525), where the state has in essence given an adjudication franchise to the American Arbitration Association.

<sup>217</sup> Some arbitral regimes permit annulment for excess of authority only when a tribunal "manifestly" goes beyond its powers. See Article 53(1)(b) of the 1965 Washington

jurisdiction,” “excess of authority” or “excess of powers”.<sup>218</sup>

A party disappointed by an award will sometimes attempt a “backdoor” appeal through arguments which depict the arbitrator’s mistake as an excess of authority rather than a contract misinterpretation. Errors of law in contract interpretation seem to lend themselves to being portrayed as excess of jurisdiction. An award allowing lost profits, for example, might be portrayed as an arrogation of power not granted by the contract.<sup>219</sup> Sound distinctions between simple mistake and excess of authority rest on two fundamental principles. First, an agreement to arbitrate normally means accepting that the arbitrator might make a mistake in evaluating the merits of the parties’ claims and defenses. It would make little sense to say that an award will be final and binding if litigants automatically get a second bite at the apple, turning arbitration into foreplay to court proceedings.

### 3. Consent and Presumptions

Equally important, however, is the principle that litigants in arbitral proceedings do not expect to be bound by overreaching intermeddlers. Decisions on matters never submitted to arbitration deserve no more deference than the opinions of a random

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(ICSID) Convention, insightfully discussed in Philippe Pinsolle, *Manifest Excess of Power and Jurisdictional Review of ICSID Awards*, in ICSID Annulment, 2 TRANSNAT’L DISPUTE MANAGEMENT 39 (April 2005).

<sup>218</sup> For the purpose of this analysis, the terms jurisdiction, authority, and powers are used interchangeably. Slight nuances might exist in certain contexts. For example, “excess of jurisdiction” might apply to *what* the arbitrator is authorized to decide, and “excess of powers” to *how* the decision is made. However, each expression describes arbitrator behavior that goes beyond what is permitted by the relevant legal and contractual framework. See generally statement by Lord Phillips in *Lesotho Highlands* (at paragraph 51, discussed *infra*) acknowledging that “the concept of an excess of power that is not an excess of jurisdiction is not an easy one”. .

<sup>219</sup> See *Parsons & Whittemore Overseas v. Société Générale (RAKTA)*, 508 F.2d 969 (2d Cir. 1974).

commuter passing through the Paris Métro or New York's Grand Central Station. This distinction remains central to the degree of deference that courts should grant an award that appears to tread on jurisdictional matters.

While such extreme examples may be rare (due to the *in terrorem* effect of judicial scrutiny), they do exist. Until enjoined by a federal court, a Florida “arbitration service” recently conducted one hundred and fourteen (114) “arbitrations” against a bank. In each instance, a credit card holder received an “award” in the precise amount of the cardholder's outstanding debt, even though the bank had never signed an agreement authorized the arbitration service to decide these disputes.<sup>220</sup>

In the more normal line of cases, analysis is complicated by the different thresholds that exist for various types of consent. In some instances consent must be explicit or in writing. On other occasions, circumstances might permit consent to be inferred or presumed.

This should not be surprising, given the varying manifestations of consent in aspects of life other than arbitration. Only the most unromantic (or unrealistic) individual would argue that a woman's consent to be kissed by her boyfriend must be in writing. A glance or a phrase can supply the invitation. Her consent to be married, however, normally requires a higher degree of formality, evidenced by ceremony and explicit words of acceptance.

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<sup>220</sup> Chase Manhattan Bank v. National Arbitration Council, 2005 WL 1270504 (M.D. Fla. 2005). One Mr. Charles Morgan acted as sole arbitrator under the auspices of the National Arbitration Council (NAC), of which he was sole proprietor. The arbitration clause in the credit agreement listed three arbitral institutions: American Arbitration Association, JAMS and National Arbitration Forum. The court granted an injunction against NAC and Mr. Morgan from conducting arbitrations or issuing awards involving the bank (Chase), and from accepting any monies from Chase cardholders for arbitration services.

Similarly, in determining consent to arbitrate jurisdictional questions, the nature of the evidence required varies according to the character of the challenge. On one extreme, a company might say it never agreed to arbitrate anything at all. To meet this challenge, the other side would normally need to produce a written agreement of some sort. At the other end of the spectrum, the parties might differ over whether the arbitrator appointed to decide their dispute has power to award compound interest. Here, one might rely on inferences or presumptions drawn from generally accepted arbitral practice. In the middle might fall questions about the validity of an arbitration clause following an assignment, where the parties' intent can be ascertained by inferences in some situations but not others.<sup>221</sup>

In short, consent implicates a continuum of commitment. Once the major step (an agreement to arbitrate) has been taken, the details (arbitrator power on matters such as interest or assignment) might yield more easily to presumptions.<sup>222</sup>

#### 4. Public Policy

In order to reflect the interests of persons not party to the arbitration agreement, legal systems sometimes draw boundaries around an arbitrator's jurisdiction. Such "externalities" relate to sensitive public norms that affect all of society. The restrictions on arbitral power usually take the form of either limits on subjects that may be arbitrated (either in general or for a specific case) or refusal to give effect to awards whose content

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<sup>221</sup> See *AC Equipment Ltd. V. American Engineering Corp.*, 215 F. 3d 151 (2d Cir. 2003), where a subcontractor challenged the contractor's assignment of their agreement, arguing that the assignment invalidated the ad hoc arbitration clause. The court held that arbitration could be compelled, and an arbitrator appointed, without judicial hearings on the assignment's validity. The court distinguished the situation in which a subcontractor argues that it never agreed to arbitrate at all.

<sup>222</sup> For an exploration of consent as a series of concentric circles, see Alan Scott Rau, *Federal Common Law and Arbitral Power*, forthcoming 2007.

offends the recognition forum's most basic notions of morality or justice.

a) General Subject Matter Limits

An arbitrator's decision may be "out of bounds" not only because it lacks any foundation in the parties' mutual consent, but also due to the arbitration's legal framework applicable regardless of any agreements between the litigants.

Notwithstanding the protagonists' desires, arbitration has on occasion been limited for "public policy" (*ordre public*) reasons with respect to sensitive subject matters such as competition law, securities regulation or civil rights violations.<sup>223</sup>

An attempt to empower an arbitrator to hear a particular dispute might be impermissible because the state has taken a monopoly on implementation of the law in areas where arbitrators (much like foxes guarding a chicken coop) present too great a risk of getting it wrong. Public policy may be invoked as a catch-all prohibition on the arbitration of certain categories of disputes, as well as to protect the integrity of the arbitral process in matters such as arbitrator bias or lack of due process.

Public policy limits on arbitrability *per se* are less important than they used to be, in the sense that courts now tend to allow arbitration to proceed with respect to public law claims related to anti-trust, securities regulation, patents, bankruptcy and state franchise

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<sup>223</sup> It is important to distinguish between invocation of public policy as a bar to arbitration, and the imposition of public policy to limit the way an arbitrator can or must decide the case. In the latter connection, See *Eco Swiss China Time Ltd. V. Benetton International NV*, European Court of Justice, Case 126/97 (ECR I-3055, 1999), concerning an application to annul an award contrary to European Community competition law. On public policy in arbitration, see generally, HOMAYOON ARFAZADEH, *ORDRE PUBLIC ET ARBITRAGE INTERNATIONAL À L'ÉPREUVE DE LA MONDIALISATION* (2005) Chapter II, 79-128.

statutes.<sup>224</sup> Nevertheless, there still exist situations in which courts might feel it proper to deny arbitrators jurisdiction to hear questions relating to certain statutory claims, out of concern that the arbitrator might “get it wrong” in a way that injures vital public interests.

To revive an old metaphor, allowing deference to arbitrators’ determinations of acceptable public policy would be similar to leaving matters of war entirely to generals. In connection with vital public law claims, it would be hard to see how any submission of arbitrability to the arbitrator (regardless of whether it was in fact accepted by the parties) could be immune from independent judicial review.

Challenges to jurisdiction based on public policy do not yield to the same kind of analysis as jurisdictional limits based on the parties’ agreement. The parties cannot expect the state to respect a grant of arbitral power on a subject matter that the state deems non-arbitrable. Similarly, arbitrators would not normally be permitted to determine their jurisdiction in any final and binding way in an award that furthers the parties’ fraud.<sup>225</sup>

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<sup>224</sup> For examples of the abandonment of earlier judicial hostility to arbitration of statutory claims that implicate vital societal interests, see generally, William W. Park, *International Forum Selection* (1995), at 97-100.

<sup>225</sup> For example, a federal Court of Appeals in the United States upheld vacatur of an award in which the re-incorporation (“redomestication”) of a captive insurance company from Massachusetts to Bermuda was deemed to be a fraud on the public regulatory authorities. See in *Commercial Union v. Lines*, 378 F.3d 204 (2d Cir. 2004). A captive insurance company called EMLICO reinsured with Commercial Union a portion of its liability under policies that EMLICO issued to General Electric, its only policy holder. General Electric sought to recover asbestos clean-up costs from EMLICO, which in turn sought to recover these from Commercial Union. EMLICO allegedly had transferred its corporate domicile to Bermuda by deceiving the Massachusetts Insurance Commissioner about its solvency. The district court was directed to determine whether the Bermuda liquidation of EMLICO affected the results in the arbitration. The fraud at issue was not in the procurement of the re-insurance contract, nor in the procurement of the award (for example, by bribery), but rather fraud on a governmental body that potentially affected the outcome of the arbitration.

## b) Restrictions for Specific Cases

In some instances, public policy might limit arbitration of a particular dispute rather than an entire subject matter. The imposition of such jurisdictional restrictions can be illustrated by the decision in *United States v. Stein*.<sup>226</sup> Said to be the largest criminal tax case in American history, the case involves the indictment of former partners of the KPMG accounting firm, who were accused of conspiracy and tax evasion in connection with abusive tax shelters.<sup>227</sup> The partners asserted that by contract KPMG must advance the legal fees incurred for their defense. The firm argued that this “advancement claim” must be arbitrated pursuant to the terms of a partnership agreement

When the partners brought a court action to enforce their claim for the legal fees, the firm moved to dismiss the action on the basis of the arbitration clause. The court thus had to consider whether the dispute over the right to legal fees was itself subject to arbitration.

The case holds that arbitration of the legal fees issue would violate public policy even assuming the existence of a valid arbitration agreement.<sup>228</sup> The reasoning requires a bit of background. Federal prosecutors had been found to have violated the partners’ Constitutional rights to counsel by pressuring KPMG (under threat of indictment and destruction of its business) to refuse advancement of the legal fees.

Acknowledging the principle that ambiguity in the scope of an arbitration clause would normally be decided in favor of arbitration, the court nevertheless took jurisdiction

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<sup>226</sup> 2006 WL 2556076 (SDNY 2006); stay pending appeal denied, 2006 WL 2724079.

<sup>227</sup> Employees as well as partners were indicted. For ease of articulation, however, the term “partners” will be used for both categories of defendants.

<sup>228</sup> The decision also addresses rights of several allegedly “non-party” defendants who asserted that they had never agreed to arbitrate.

to decide on the question of legal fees. The policy in favor of arbitration was outweighed by a stronger federal policy in favor of prompt and fair criminal trials. The court considered arbitration of the legal fees issue would undermine this policy.

The court posited that arbitration involves “unpredictable timing and the likelihood of delay” and thus “would force the court to do violence to one important public interest or another.” The interest that tipped the scale was the prompt determination of whether the defendants had proper counsel, or rather needed appointment of a lawyer at public expense.

One might disagree with the court’s assumption about the delay occasioned by arbitration rather than litigation. However, it is not hard not to understand the concern that private arbitration should not derail a large criminal case, even if one does not accept the court’s suggestion that arbitration is slow and unpredictable.

c) Content of the Award

Questions related to subject matter arbitrability intersect with, but are distinct from, problem derived from awards that violate public policy by reason of their content. For example, an arbitrator might well have jurisdiction to decide an antitrust question. But he or she cannot ignore the relevant law and policies without risking having the award refused recognition on the grounds that it violates public policy<sup>229</sup> or gives effect

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<sup>229</sup> See *Mitsubishi Motors v. Soler Chrysler Plymouth*, 473 U.S. 614, 638 (1985), where the Court asserted (rightly or wrongly) that “having permitted the arbitration to go forward, the national courts of the United States will have the opportunity at the award-enforcement stage to ensure that the legitimate interest in the enforcement of the antitrust laws has been addressed [because the New York Convention] reserves to each signatory country the right to refuse enforcement of an award where the “recognition or enforcement of the award would be contrary to the public policy of that country.” While the efficacy of the arbitral process requires that substantive review at the award-enforcement stage remain minimal, it would not require intrusive inquiry to ascertain that the tribunal took cognizance of the antitrust claims and actually decided them.



to illegal conduct.<sup>230</sup>

Mandatory norms of the place of performance may limit an arbitrator's jurisdiction regardless of the applicable law. An arbitrator who ignores American antitrust laws, in connection with sales to New York consumers, can expect his or her award to be vacated (assuming an arbitral situs within the United States) even though the contract provides for Swiss law to be applicable.<sup>231</sup>

In this connection, arbitrators may find themselves in a double bind. In applying the mandatory norms of the place of performance, an arbitrator may exceed his or her jurisdiction under the law of a country called to enforce the award or monitor the integrity of the process. In the above example, the arbitrator who applied American antitrust rules even though the parties asked for a decision according to Swiss principles could expose the award to annulment for excess of authority in an arbitral situs that did not share the United States' perspective on the proper role of competition law.

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<sup>230</sup> Obvious examples include awards ordering payment for sales of slaves, heroine or illegal arms to terrorists. If an airline pilot is dismissed from employment for showing up drunk at the cockpit, courts can be expected to vacate an award reinstating the pilot. See *Delta Air Lines, Inc. v. Air Line Pilots Ass'n, Intern.*, 861 F.2d 665 (11th Cir. 1988), involving pilot who was intoxicated while flying a commercial plane from Bangor, Maine, to Boston, Massachusetts. Focusing on the regulations promulgated by the Federal Aviation Administration, the court consider the case non-arbitrable, stating the airline "was under a duty to prevent the wrongdoing of which its Pilot-In-Command was guilty, and it could not agree to arbitrate that issue." *Id.* at 674. This non-arbitrability approach denies effect to an arbitral finding on the facts that the pilot had not been drunk. Such violation of public policy in the process of performing employment duties was distinguished from situations in which public policy was violated outside employment, giving rise to no workplace violation of a duty. In such instances, an arbitrator might be given greater leeway with respect to bad behavior. See *United Paper Workers v. Misco*, 484 U.S. 29 (1987) (marijuana found in car) and *Florida Power Corp. v. IBEW*, 847 F. 2d 680 (11th Cir. 1988) (drunk driving on employee's own time).

<sup>231</sup> See footnote 19, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614 (1985). Pro-consumer usury prohibitions might also impose themselves on the arbitration of a loan transaction expressly made subject to the laws of a country without limits on interest rates.

#### IV. Items for Further Consideration

Inevitably, no matter how good a legal doctrine, questions arise about its application in specific situations. The devil always lurks in the details. The following discussion takes as its springboard several questions drawn from the French, German, English and American legal systems. Raising these queries in no way suggests that the legal systems mentioned have proven inadequate. Rather, the various lines of inquiry reflect a call for further dialogue.

##### A. “Manifestly Void” Clauses in France

As mentioned earlier, in French law the arbitrators’ power to decide on their own competence operates in tandem with an explicit provision that puts off jurisdictional challenges until after an award is rendered. The *Nouveau Code de Procédure Civile* provides that if a claim has already been presented to the arbitrators (literally, if the tribunal has been “seized” of a matter) courts must declare themselves without jurisdiction to hear the case. If arbitration has *not* yet begun, courts must also declare themselves lacking jurisdiction unless the arbitration agreement is “clearly void” (*manifestement nulle*).<sup>232</sup>

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<sup>232</sup> NCPC Article 1458. The full text reads as follows, “When a dispute for which an arbitral tribunal has been constituted [literally “seized” of the dispute] pursuant to an arbitration agreement is brought before a governmental court, the court must declare itself without jurisdiction. If the arbitral tribunal has not yet been constituted [literally “seized” of the dispute], the court must also declare itself without jurisdiction unless the arbitration agreement is clearly void.” Author’s translation. (In the original, “Lorsqu’un litige dont un tribunal arbitral est saisi en vertu d’une convention d’arbitrage est porté devant une juridiction de l’État, celle-ci doit se déclarer incompétente. Si le tribunal arbitral n’est pas encore saisi, la juridiction doit également se déclarer incompétente à moins que la convention d’arbitrage ne soit manifestement nulle.”) Although certain provisions of domestic French arbitration law do not apply to international arbitration, such is not the case for Article 1458, which falls within Title I of Book IV of the NCPC. See NCPC Article 1507 and Décret du 12 mai 1981, Articles 55 and 56, providing for non-application of certain provisions in Titles IV, V and VI.

The theory seems to be that a party wrongfully hindered in bringing its arbitration claim deserves more solicitude than does a party improperly joined to an arbitral proceeding. To deal with the former risk (dilatatory tactics to disrupt arbitration), courts are given only limited power to examine the validity of the arbitration clause before the arbitration has begun, and none at all after proceedings have started.

Following an award, however, judicial review will take place on the grounds provided by the French arbitration statute, which for international arbitration covers a number of jurisdictional defects: decision in the absence of an arbitration agreement, irregular composition of the arbitral tribunal, and failure to respect the mission given to the arbitral tribunal.<sup>233</sup>

This system conserves judicial resources by delaying review until the end of the process, when the parties may have settled or the arbitrator might have gotten it right. Some authors have called this sequence a “guarantee of good administration of justice”.<sup>234</sup>

One source of puzzlement to many non-French lawyers lies in the fact that the exception for clauses that are *manifestement nulle* applies only when the arbitration has

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<sup>233</sup> Nouveau Code de Procédure Civile Article 1502, for international cases. Review in domestic arbitration can be found in Articles 1483, which provides for annulment of an award containing analogous jurisdictional defects.

<sup>234</sup> Pierre Mayer, *L'autonomie de l'arbitre dans l'appréciation de sa propre compétence*, 217 RECUEIL DES COURS (Académie de droit international de La Haye) 321 (1989) at 350, suggesting, “L'examen successif est une garantie de bonne administration de la justice; le juge pourra s'inspirer de la motivation adoptée par l'arbitre, ou y trouver au contraire une faille révélatrice.” However, Mayer also argues that when a court action has been begun before arbitration, the judge should address the alleged jurisdictional defect without regard to whether “manifest” or not. *Id.* at 346. Moreover, good reason exists to suspect that Professor Mayer’s views may have evolved during the past few years, to the point that he would favor an immediately available summary court proceeding to decide whether an arbitration clause was clearly void.

not begun. Why should this be so? Faced with a clause that is clearly void, why should a court find its hands tied in declaring the nullity of the proceedings simply because a purported arbitration has already begun? Perhaps the answer lies in the fact that the parties are already before a judge, and thus the risk of delay is less than if no judicial action had yet begun.

A “manifestly void” clause would seem inoperative regardless of how far along the sham procedures had run. To some observers, it seems strange to delay judicial intervention in an arbitration with no consensual underpinning simply because someone has set a process in motion.

Perhaps, at the beginning of an arbitration, courts might limit their task to determining whether they can be *prima facie* satisfied that the arbitration clause exists, deferring an in-depth analysis of jurisdiction to the moment when the award itself must be reviewed. But why should *all* examination of jurisdiction be forbidden?

Since arbitration remains consensual at its core, one might even ask how a purported tribunal can be “seized” of any matter on the basis of a void clause. There exists a risk of loading the analytic dice by using the term “arbitration” to refer to a process that was never accepted by the two sides. As a definitional matter, when a signature on an alleged arbitration agreement was clearly forged, or signed with a gun at her head, to label someone an arbitrator would not provide decision-making authority any more than calling a dog’s tail a “leg” would give the animal five limbs instead of four.<sup>235</sup> Without a grant of authority from the litigants, a would-be arbitrator is no more than a shameless volunteer.

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<sup>235</sup> Abraham Lincoln once asked, “If I call a tail a leg, how many legs does a dog have? Five?” He then answered, “No. Four. Calling a tail a leg does not make it so.”

B. The New Approach in Germany

1. The *Kompetenz-Kompetenz* Clause<sup>236</sup>

Like the length of women's dresses, arbitration law often experiences its own fashion changes from one season to another. Perhaps the most radical of such style shifts can be found in the German approaches to arbitrators' jurisdictional determinations.

At one time, German courts recognized contract provisions that granted arbitrators a right to rule on their own authority in a final (rather than temporary) way.<sup>237</sup> In a landmark case arising from a charter party of a refrigerated transport ship, Germany's highest court admitted the possibility of an agreement on jurisdiction (*eine Kompetenz-Kompetenz-Klausel*). The arbitral tribunal was given power to render a jurisdictional decision on whether the charterer's agent was bound to arbitrate, subject to no judicial second-guessing.<sup>238</sup> The job of deciding whether in fact such a clause existed in the relevant freight contract (so as to bind the party resisting arbitration) was remanded to the lower court. This principle followed the lines of an earlier *Bundesgerichtshof* decision rendered almost a quarter century earlier,<sup>239</sup> and was confirmed in a case decided as late as 1991,<sup>240</sup> the same year the German Ministry of Justice established a reform commission whose work ultimately led to enactment of a new arbitration law.

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<sup>236</sup> For helpful comments on the German cases, thanks are due to Professor Peter Schlosser, Professor Klaus Peter Berger, and Dr. Ulrich Lohmann.

<sup>237</sup> See generally Peter Schlosser, *The Competence of Arbitrators and of Courts*, 8 *ARB. INT'L* 189 (1992), at 199-200. See also Klaus Peter Berger, *INTERNATIONAL ECONOMIC ARBITRATION* (1993) at 359; Klaus Peter Berger, *INTERNATIONAL WIRTSCHAFTSSCHIEDSGERICHTSBARKEIT* (1992) at 253.

<sup>238</sup> BGH, Urteil v. 5 Mai 1977, III ZR 177/74. Reported in 68 *BGHZ* 356, at 358. See discussion in Peter Schlosser, *DAS RECHT DER INTERNATIONALEN PRIVATEN SCHIEDSGERICHTSBARKEIT* (1989) at § 556.

<sup>239</sup> BGH II ZR 323/55, decided in 1953.

<sup>240</sup> BGH III ZR 68/90. See BGH *Neue Juristische Wochenschrift* (NJW) 1991, 2215.

## 2. The 1998 Reforms

In 1998 Germany adopted the UNCITRAL Model Arbitration Law.<sup>241</sup> During the drafting stage, the official commentary on Article 1040 *Zivilprozessordnung (ZPO)* (the equivalent of UNCITRAL Model Law Article 16) stated that courts would always have the last word on arbitral jurisdiction.<sup>242</sup> In essence, questions of arbitrator jurisdiction were shifted to the category of non-arbitrable subject matters. This principle has been affirmed by judicial pronouncements and authoritative commentary, asserting that *Kompetenz-Kompetenz* clauses are against public policy<sup>243</sup> and that courts may intervene at any time to decide arbitral competence.<sup>244</sup> As discussed below, it remains to be seen

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<sup>241</sup> On the 1998 German law, see Friedrich Niggemann, *Chronique de Jurisprudence Étrangère: Allemagne*, 2006 Rev. arb. 225; Otto Sandrock, *Procedural Aspects of the New German Arbitration Act*, 14 ARB. INT'L 33 (1998); Peter Schlosser ADR II, Institute of Comparative Law, Chuo University, Japan 335 (Takeshi Kojima, ed. 2004); Klaus Peter Berger, *Das neue Schiedsverfahrensrecht in der Praxis – Analyse und aktuelle Entwicklungen*, in RECHT DER INTERNATIONALEN WIRTSCHAFT (RIW), Heft 1 (2001).

<sup>242</sup> See ENTWURF EINES GESETZE ZUR NEUORDNUNG DES SCHIEDSVERFAHRENSRECHTS July 1995, at page 132 (draft commentary on German adoption of the UNCITRAL Model Arbitration Law).

<sup>243</sup> JOACHIM MÜNCH, MÜNCHENER KOMMENTAR ZPO, 2. Auflage, Band 3, § 1040 (München 2001), at 1183 (Rdnr. 26). This commentary argues that the interplay of § 1040 subsections 1 (tribunal may rule on its jurisdiction) and 3 (one month period for challenge of ruling) establish a mandatory character of judicial jurisdiction. Consequently, the commentary characterizes *Kompetenz Kompetenz* clauses as *unwirksam, weil gegen zwingendes Recht verstossend* (inoperative because they violate mandatory law). See also KLAUS-PETER BERGER, PRIVATE DISPUTE RESOLUTION IN INTERNATIONAL BUSINESS, Volume I (2006), at Question 7; Klaus-Peter Berger, *The Implementation of the UNCITRAL Model Law in Germany*, 13 INT. ARB. REP. 38 (January 1998).

<sup>244</sup> Peter Schlosser in STEIN/JONAS, KOMMENTAR ZUR ZIVILPROZESSORDNUNG, 22. Auflage, Band 9 (Tübingen 2002) § 1040, Rdnr. 2, at page 489, with cross-reference to Schlosser's own comments at § 1032, Rdnr. 11. Professor Schlosser writes, "Aus der vorläufigen Kompetenz-Kompetenz des Schiedsgerichts folgt auch nicht, dass es das 'erste Wort' bezüglich der Wirksamkeit der Schiedsvereinbarung erhalten hätte." ("It does not follow from the arbitrator's preliminary *Kompetenz-Kompetenz* that he has the "first word" regarding the validity of the arbitration agreement.") In referring to the "first word" on jurisdiction, Professor Schlosser sought to draw attention to the way Germany's

whether the logic of these commentators and judicial decisions will be pushed to cover even separate contracts on arbitral authority, rather than simple jurisdictional clauses contained a single commercial agreement.

Current case law has endorsed a prophylactic rule that seems to bars such clauses, regardless of what the evidence might show about the parties' intent. The prohibition on *Kompetenz-Kompetenz* clauses was confirmed clearly by a 2005 decision of the *Bundesgerichtshof*<sup>245</sup> which had followed a shift in approach announced three years earlier in a case expressing concern that a wrongful assertion of arbitral jurisdiction might results in deprivation of a party's "lawful judge" (*gesetzlich Richter*)<sup>246</sup>

The significance of the 2005 decision lies not only in its statements about

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practice (permitting courts to rule on jurisdiction before an arbitral award) differs from the legal position in France, where court review of jurisdiction generally waits until after the award has been rendered. German law provides that courts will always have the "last word" on jurisdiction, and in some instances may also have the "first word" as well.

<sup>245</sup> BGH, Urteil 13 Januar 2005, III ZR 265/03. Reported NJW 16/2005 at 1125. The case is also reported on the DIS database, with notes by Huber/Bach and Wagner/Quinke. An alleged loss on a brokerage account (typical in arbitration cases) brought a court action for recovery notwithstanding the arbitration clause. In the course of confirming the duty to arbitrate, the Court re-emphasized that any jurisdictional decision would be subject to review. On its facts, the BGH pronouncement gives little difficulty. There was in fact no award review at all, let alone a challenge to a first award establishing jurisdictional principles for a second arbitration. In Anglo-American legal thought, the court's decision might be labeled *dictum*. See also BGH decision of 23 February 2006 (III ZB 50/05), reported 2006 SCHIEDSVZ (May/June 2006) 161, reversing the Karlsruhe OLG refusal to recognize an award rendered in Minsk under the rules of the Byelarus (White Russia) Chambe of Commerce. Germany's highest court rejected the contention that international public policy (*ordre public international*) had been violated by an arbitral tribunal's jurisdictional ruling in a final award on the merits. According to the BGH, no policy violation occurs if the final jurisdictional ruling rested with the government courts, as was the case in Byelarus. 2006 SCHIEDSVZ 161, at 164.

<sup>246</sup> BGH, Urteil 6 Juni 2002, III ZB 44/01. This decision involved an arbitral tribunal's finding that it lacked jurisdiction. However, the court in *dictum* contrasted the facts of its case with the opposite scenario, where an arbitral tribunal wrongfully assumes jurisdiction thereby depriving a party of its "lawful judge" (*gesetzlich Richter*).

*Kompetenz-Kompetenz* clauses, but also in its affirmation that judges may provide jurisdictional input *before* an arbitrator's decision on the matter. Thus courts not only the "last word" on the arbitrator's jurisdiction, but in some instances the "first word" as well.

To a large extent, this new approach seems to derive from a fear of sloppy judicial decision-making. Rather than a rigorous analysis to determine the existence of a genuine agreement to arbitrate jurisdiction, judges were apparently inclined to leave jurisdictional issues to the arbitrators, almost automatically finding *Kompetenz-Kompetenz* clauses on scanty evidence. In the backlash, legislators and scholars expressed the opinion (rightly or wrongly) that the UNCITRAL Model Law was inconsistent with such a practice.<sup>247</sup>

In discussing the prior lack of analytic rigor, one of Germany's most eminent scholars suggests that prior to 1998 his country's judiciary had become inclined to find *Kompetenz-Kompetenz* clauses even where they did not exist, thus clearing the judicial dockets even as to a party that had no real intent to waive its right to a court hearing.<sup>248</sup> Professor Schlosser tells of a case in which a corporate liquidator had begun an action in Germany for a determination that certain goods were not the property of the respondent, a matter which arose by operation of law apart from the contract subject to arbitration. The parties to the relevant arbitration agreement had agreed as follows: "For all disputes arising out of this contract the contracting parties submit themselves to the Chamber of Commerce of Geneva." The *Bundesgerichtshof* instructed the lower court to verify the existence of an *oral* agreement to arbitrate by which the arbitral tribunal would have had

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<sup>247</sup> See BT-Drucksache 13/5274 at 26 & 44, cited by the *Bundesgerichtshof* in its decision of 13 January 2005, at 5 & 6. See also ENTWURF EINES GESETZE ZUR NEUORDNUNG DES SCHIEDSVERFAHRENSRECHTS July 1995, at 132 (draft commentary on German adoption of the UNCITRAL Model Arbitration Law), discussed *supra*.

<sup>248</sup> Peter Schlosser ADR II, Institute of Comparative Law, Chuo University, Japan (Takeshi Kojima, ed. 2004) 335, at 340.



jurisdiction to decide the scope of the written agreement to arbitrate.<sup>249</sup>

The German arbitration statute has an express provision permitting declaratory court judgments on the validity of arbitration clauses, provided application is made prior to constitution of the arbitral tribunal.<sup>250</sup> Moreover, German judges may examine fully the validity of the arbitration clause either in the context of a court action on the merits of a claim<sup>251</sup> or an annulment action of either an interim jurisdictional decision<sup>252</sup> or final award.<sup>253</sup>

It should be noted, however, that German scholars are not unanimous on all questions related to court review of arbitrators' jurisdiction. Some writers say that judicial review is mandatory, and thus the parties cannot by agreement create a de facto waiver of those provisions through an agreement giving a jurisdictional question to arbitrators.<sup>254</sup> Others, however, appear to accept that the parties may waive grounds for award vacatur that are designed to protect private interests,<sup>255</sup> as opposed to public

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<sup>249</sup> Schlosser, *id.* At 342-343, citing *Juristenzeitung* 1989, 201.

<sup>250</sup> ZPO Section 1032(2) which provides, *Bei Gericht kann bis zur Bildung des Schiedsgerichts Antrag auf Feststellung der Zulässigkeit oder Unzulässigkeit eines schiedsrichterlichen Verfahrens gestellt werden.* (“Prior to the constitution of the arbitral tribunal, an application may be made to the court to determine whether or not arbitration is admissible.”)

<sup>251</sup> ZPO Section 1032(1). Compare the practice obtaining in France under NCPC Article 1458, which allows pre-award court pronouncements on arbitration clauses only if the clause is “manifestment nulle” and only if the arbitration has not yet begun.

<sup>252</sup> ZPO Section 1040(3), analogous to UNCITRAL Model Law Article 16(3).

<sup>253</sup> ZPO Section 1059.

<sup>254</sup> Judicial review would normally occur under either under ZPO Section 1040(3) or ZPO Section 1059, depending on whether the award is interim or final.

<sup>255</sup> See Geimer in ZÖLLER, *ZPO*, 25. Aufl., 2005, § 1059, Rdnr. 2 and 80; SCHWAB & WALTER, *SCHIEDSGERICHTSBARKEIT*, 7. Aufl., 2005, Kap. 6, Rdnr. 10; Albers in BAUMBACH, LAUTERBACH, ALBERS & HARTMANN, *ZPO*, 64. Aufl., München 2006, § 1059, Rdnr. 2. See also GEIMER, *INTERNATIONALES ZIVILPROZESSRECHT* (5. Aufl., Köln

order.<sup>256</sup> The result of this latter approach would be that courts might give respect to agreements subjecting jurisdictional questions to final arbitration, provided such questions are clearly identified.

### 3. The Parties' Expectations

At the risk of appearing presumptuous (always a hazard for a foreign lawyer), one might ask whether a blanket denial of *Kompetenz-Kompetenz* clauses constitute an overreaction which might in some cases disregard the parties' legitimate expectations. The text of the law provides simply that arbitrators may rule on their own jurisdiction, that jurisdictional challenges must be raised in a timely fashion, and that the arbitrators' rulings on the matter would normally (*in der Regel*) take the form of an interim decision subject to judicial review on a request filed within thirty days of the ruling.<sup>257</sup>

These provisions say nothing about when or whether these arbitral decisions should be final. The statute here is silent about whether parties may create a special contractual regime submitting jurisdictional questions to final decision by an arbitrator. While such agreements may be rare in practice,<sup>258</sup> they might in some cases exist.

If the parties have two disputes (one related to the merits, and the other to

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2005) at 130-131 (notes 309-311), addressing procedural party autonomy in relation to foreign judgments. Geimer posits that parties should be able to waive grounds for non-recognition designed to protect one of the parties, as opposed to government interests (*unmittelbare Staatsinteressen*), and to create by agreement a reliable environment for the resolution of their dispute.

<sup>256</sup> Clearly the grounds for vacatur under ZPO 1059(2) (public policy and subject matter arbitrability) should not be waivable, since these matters directly implicate government (rather than private) interests.

<sup>257</sup> ZPO Section 1040

<sup>258</sup> In the adversarial context of preliminary jurisdictional rulings under ZPO § 1040 (UNCITRAL Model Article 16), parties rarely agree on very much, let alone a *Kompetenz-Kompetenz* clause.

jurisdiction), and wish to submit each to arbitration, it is hard to see why they should be prevented from doing so. Courts should, of course, have the opportunity to verify the reality of the alleged consent to arbitration. Judicial review would in all events involve examination of the validity of the initial agreement allegedly granting the arbitrators power on jurisdictional questions such as the scope of their procedural powers or the range of issues covered by the arbitration clause.

The grounds for judicial review envisaged in ZPO Sections 1040 (for interim decisions) or 1059 (for final awards) certainly remain matters of public policy, and include lack of arbitral authority.<sup>259</sup> However, it would seem an elevation of form over substance to suggest that a question of arbitral authority which relates only to what the parties agreed (bearing no relation to any issue of substantive *ordre public*) must remain non-arbitrable (thus eluding a final decision by the arbitrator) notwithstanding an express contractual stipulation to the contrary.

The matter may well turn out to be a question of what is meant by a decision on the “merits”. As suggested in the cautionary tale set forth earlier in this paper,<sup>260</sup> the parties may well wish, in some cases, to grant arbitrators power to decide a jurisdictional question in the same way they would decide some other questions of contract interpretation. If so, it would be unfortunate if the new German position on *Kompetenz-*

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<sup>259</sup> ZPO Section 1059, analogous to UNCITRAL Model Law Article 34, permits vacatur for invalid arbitration agreement, inability to present one’s case, an award that deals with a matter not falling within the arbitration submission, or improper constitution of the arbitral tribunal.

<sup>260</sup> See discussion *supra* in Part II. The time limits in that scenario, we remember, are restrictions on arbitral authority, not statutes of limitations. The latter remain substantive in German law. BGB §§ 195 et seq. The hypothetical presumes that the restrictions limit the right to arbitrate, not substantive recovery.

*Kompetenz* clauses applied to separate agreements on arbitral authority,<sup>261</sup> and indeed inconsistent with the goal of the UNCITRAL Model Law, to give binding effect to legitimate arbitral decisions.

Whether made in Germany or abroad, an award should be subject to challenge for jurisdictional infirmity.<sup>262</sup> However, neither side should be permitted to renege on a freely-accepted arbitration agreement followed by fair proceedings, even if the agreement covers matters relating to arbitral authority,.

#### 4. Avoiding Extremes

It is not difficult to sympathize with the concerns of German courts, legislators and scholars in connection with the confusion and potential abuse caused by earlier decisions. Loose talk about arbitrators determining their own jurisdiction can give rise to inappropriate overreaching. A contract's jurisdictional clause does not necessarily give the arbitrator competence, any more than pieces of paper can by themselves agree to anything.<sup>263</sup> Only individuals agree, whether in their own capacity or as agents for legally cognizable collectivities. Jurisdiction must be determined according to all the facts and circumstances, not simplistic recitals.

The prospect that a legal principle may be misused does not necessarily justify a

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<sup>261</sup> ZPO Section 1059(1)(c) (analogous to UNCITRAL Model Law Article 34) permits an award to be set aside if it deals with a dispute beyond the scope of the arbitration submission, and Section 1059(1)(d) permits setting aside of the arbitral award if the procedure is not in accordance with the parties' agreement.

<sup>262</sup> See discussion in Niggemann, *Chronique de Jurisprudence Étrangère*, *supra* at 235: "les tribunaux allemands constatent régulièrement que la décision du tribunal arbitral étranger sur sa compétence ne les lie pas". Niggemann goes on to cite New York Convention Article V(1)(a), related to absence of a valid arbitration agreement.

<sup>263</sup> See Judge Easterbrook's opinion in *Sphere Drake v. All American Insurance*, 256 F.3d 587 (7th Cir. 2001), at 590.

rule that leads to a different type of error. With respect to arbitral jurisdiction, risks exist at two extremes. On the one hand, courts should not assume the finality of an arbitrator's jurisdictional determination merely on the basis of contract recitals taken out of context. On the other extreme, no good reason has been advanced to prohibit genuine consent to arbitration on questions related to the existence of an arbitrator's power.

As a matter of policy, sophisticated business managers have long been permitted to agree on final decisions about contract liability and damages. Such decisions normally benefit from a presumption of deference to the parties' pre-dispute wishes. Likewise, business managers may agree to arbitrate such matters. No good reason seems to prevent similar agreements about the jurisdictional pre-requisites to such arbitration.<sup>264</sup>

If the "old style" German *Kompetenz-Kompetenz* was abused, the remedy might be better education of judges and lawyers about the dangers of overreaching arbitrators. With thoughtfulness and care, policy-makers should be able to avoid both extremes in the pursuit of reasonable counterpoise in the articulation and application of jurisdictional rules.

### C. Arbitral Jurisdiction and Contract Interpretation

#### 1. The Litigants' Role in Creating Arbitral Authority

In a commercial agreement, broadly drafted arbitration clauses often give the arbitrator authority to construe contract language as well as to establish the facts. In an international context, this interpretative function will occasionally involve determining which governing law applies.

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<sup>264</sup> In a consumer context, sound public policy might call for a higher level of judicial paternalism. See DAVID QUINKE, *BÖRSENSCHIEDSVEREINBARUNGEN UND PROZESSUALER ANLEGGERSCHUTZ* (Carl Heymans Verlag 2005). This question was expressly left open by the BGH above-cited decision of 13 January 2005.

On occasion, the parties may wish to be more explicit about either the powers granted, or the restrictions imposed, with respect to the arbitrator's powers. Sometimes this may be done through explicit contract language, and sometimes through incorporation of provisions in the relevant arbitration rules. For example, an arbitrator might be granted, or denied, the right to award attorneys' fees<sup>265</sup> or to permit third parties to intervene.<sup>266</sup>

What should happen when arbitrators misconstrue (in the eyes of the reviewing court) contract language relating to their authority? Challenges to an arbitrator's exercise

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<sup>265</sup> Article 31 of the AAA International Rules permits arbitrators to follow the European practice by awarding "the reasonable costs for legal representation of a successful party". By contrast, New York CPLR § 7513 endorses the so-called "American rule" by providing that attorneys' fees are permissible only if provided in the parties' agreement. At least one court has held that reference to the AAA Rules does not satisfy the requirements of New York law. See *CIT Project Finance v. Credit Suisse First Boston*, 799 NYS2d 159, 2004 WL 2941331 (2004). This slip opinion may be distinguished on its facts, given that the relevant clause was drafted restrictively, giving the arbitrator power to decide only a narrow question whose resolution did not dispose of the claim. The approach applied more generally permits arbitrators to determine the parties' intent with respect to legal fees. See *PaineWebber v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996). See also *Shaw Group v. Triplefine International Corp.*, 322 F.3d 115 (2d Cir. 2003) and *Stone & Webster v. Triplefine International Corp.*, 118 Fed.Appx. 546 (2d Cir. 2004), involving attorneys' fees in an ICC arbitration. The two *Triplefine* decisions related to the same dispute, although the first decision also included *Stone & Webster's* parent the Shaw Group. In the *Shaw* decision the Second Circuit vacated a lower court decision that had enjoined a party from claiming as contract damages attorneys' fees incurred in opposing motions to stay arbitration. In the *Stone & Webster* decision the court affirmed an award of attorneys' fees (for the arbitration and the court action) notwithstanding the argument that they were precluded by N.Y. P.P.L.R. § 7513, which imposes the so-called "American rule" of denying legal fees in breach of contract cases "unless otherwise provided in the agreement to arbitrate." The decision upheld the parties' right to waive the provisions of New York law by reference to institutional rules (such as those of the ICC) which provide for arbitrators to allocate legal expenses.

<sup>266</sup> See e.g., See Rules 22.1(h), LCIA Arbitration Rules, allowing a willing third person to be joined to a proceeding notwithstanding the objection of one of the parties.

of specific powers can set the stage for a battle between two equally important presumptions: (i) the last word on contract interpretation is normally for the arbitrator; but (ii) absent the parties' agreement otherwise, the final say on arbitral jurisdiction remains for the courts. As in so many other matters related to arbitral jurisdiction, the resolution of such conflicts will depend on the particular facts and circumstances of the case. Set forth below are two contexts in which courts have struggled with this tension.

## 2. Paradigm Cases: Foreign Currency and Punitive Damages

### a) The House of Lords in *Lesotho Highlands*

One distinctive feature of English arbitration law is its detail. The 1996 Act seems to contain more specific rules about particular arbitral or judicial powers than any other major arbitration statute.

Most of these rules, however, contain an important escape hatch: they apply unless the parties have otherwise agreed, which is entirely as it should be in a legal system that values party autonomy and flexibility. For example, arbitrators are given authority to order security for costs (Section 38), to dismiss a claim for inordinate delay by the claimant (Section 41), to make an award in "any currency" (Section 48), or to award compound interest (Section 49). In all cases, however, the relevant arbitral powers are circumscribed by the qualifier "unless otherwise agreed" by the parties.<sup>267</sup> Granting a

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<sup>267</sup> Similarly, courts are given powers subject to the parties' agreement otherwise. The most notable example can be found in Section 69, which gives courts the right to correct an error of law. The Act provides for appeal on question of law (defined as questions of English law) but permits appeal to be waived either before or after the dispute arises. This opportunity for waiver of merits review meets the goal of arbitral finality expected by those members of the international business community who arbitrate in London for reasons of convenience and expertise, rather than to hear high-priced QC's engage in clever courtroom debate of matters already decided by the arbitrators. As under prior law, exclusion of merits review can be made by reference to institutional arbitration rules providing for waiver of appeal.

“power” to an arbitrator constitutes another way of saying that the arbitral tribunal has jurisdiction to do something, whether order security for costs, award interest or make a decision denominated in a particular currency.

In connection with these jurisdictional grants, the question that then arises is, “Who decides whether the parties have otherwise agreed?” Who determines whether a particular form of authority has been taken from arbitrators? A mistake in contract interpretation should not normally be reviewable. The arbitrators’ job is to interpret the parties’ agreement. But what happens if the part of the contract they interpret relates directly to their powers?

On the one hand, an award might well be recognized even though arbitrators imperfectly exercised powers granted by the statute. If the contract says that an arbitral tribunal is authorized to award compound interest, there would normally be no cause for annulment simply because the chosen rate was different than the one that a reviewing court might have considered appropriate.

On the other hand, the principle that arbitrators interpret contract language cannot stand for the proposition that they can create their own jurisdiction *ex nihilo*. If a contract says that arbitrators have no authority to award treble damages, it is hard to see how they could interpret the limitation as a grant.

What an arbitrator might find, however, is that the ban on treble damages was void under the applicable law. If so, the award could award exemplary damages if justified by the portions of the contract that were not tainted by invalidity. Similar findings might be made with respect to other contract restrictions, such as a limitation of liability clauses that fixed a ceiling on recovery at a percentage of the price of goods sold,



or excluded consequential damages. In all cases, however, the finding would need to be made as a matter of contract construction (the task given to the arbitrator), not interpretation of the arbitration law.

The matter has sometimes been subject to a certain ambiguity. The principal speech by Lord Steyn in the House of Lords decision in *Lesotho Highlands* suggested that the Arbitration Act gave “unconstrained” power to make an award in any currency.<sup>268</sup> His colleagues disagreed, however.<sup>269</sup> Lord Steyn then went on to posit that the power was not unconstrained, and that arbitrators had erred in interpreting either the contract or the Arbitration Act. In either event, he said, the arbitrators would have done no more than commit error of law.<sup>270</sup>

The possibility of a mistake in the interpretation of the Arbitration Act, however, might be more troublesome. Interpretation of arbitration statutes normally falls to courts. Arbitrators cannot, simply by their own bare assertion, create powers they do not have. If an arbitration statute requires awards to be denominated in Sterling, it is hard to see how an arbitrator’s *ipse dixit* can generate authority to award Swiss Francs.

The difficulty arises because a decision on whether the parties have “agreed otherwise” amounts not only to an interpretation of the contract, but also to a *de facto*

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<sup>268</sup> *Lesotho Highlands Development Authority v. Impreglio SpA* [2005] UKHL 43 (30 June 2005), reversing the Court of Appeal decision found at [2004] All ER (Comm.) 97 (CA 2003). *Id.*, at Paragraph 22. See generally William W. Park, *The Nature of Arbitral Authority: A Comment on Lesotho Highlands*, 21 ARB. INT’L 483 (2005).

<sup>269</sup> Lords Hoffmann, Scott and Rodgers agreed that error of law does not equal excess of power. However, they disagreed with Lord Steyn’s construction of Section 48 concerning an arbitrator’s power to order payment of money in any currency. Lord Phillips (at paragraphs 43-54) went further and stated that the arbitrators had purported to exercise a discretion that the statute did not give them.

<sup>270</sup> Paragraph 23, HL decision of 30 June 2005.

construction of how the Arbitration Act should be applied in a particular circumstance. By deciding that the parties have or have not “agreed otherwise” the arbitrators expand or contract their own authority accordingly.

In *Lesotho Highlands*, Lord Steyn made clear that the most that might have occurred in the case at bar was an erroneous exercise of powers that actually existed.<sup>271</sup> An award of Swiss Francs might be an imperfect exercise of arbitral power, but would not be a jurisdictional invention.

The contours of arbitrator power, however, may be more difficult to ascertain in other situations. For example, a contractual choice-of-law clause might designate a legal system that prohibits arbitrators from awarding punitive damages.<sup>272</sup> But such a clause could perhaps be read to designate substantive only state contract law, not including arbitral procedure.<sup>273</sup> Moreover, as the United States Supreme Court has noted, it is not always obvious when damages are punitive rather than compensatory.<sup>274</sup> To what extent, then, do arbitrators have the power to confer on themselves, in a final and binding way, authority to grant punitive damages?

The decision in *Lesotho Highlands* cannot stand for the proposition that arbitrators may purposefully ignore their mandate. The arbitrators awarded currencies

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<sup>271</sup> Paragraph 24, HL decision of 30 June 2005.

<sup>272</sup> See, e.g., New York law as expressed in *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354 (1976).

<sup>273</sup> *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52 (1995), upholding an award for punitive damages in a dispute covered by a New York choice-of-law clause.

<sup>274</sup> See *Pacificare Health Systems v. Book*, 538 U.S. 401 (2002), where a unanimous Court upheld the right to compel arbitration of claims under the Racketeer Influenced and Corrupt Organizations Act, which provides for treble damages, notwithstanding a contractual prohibition on punitive damages. The Court suggested that treble damage awards sometimes serve “remedial purposes” that are compensatory in nature.

considered “appropriate in the circumstances” after having taken careful note of the contract stipulations<sup>275</sup> and looked only to currencies and exchange rates in the parties’ agreement. Nothing suggests that their award was a fig leaf to cover intentional disregard of the contract.

The risk of pernicious arbitrator willfulness was noted by one observer, whose comment on *Lesotho Highlands* raised the specter of arbitrators “misapplying the Arbitration Act”, “ignore[ing] the parties’ agreement as to applicable law” and “riding rough-shod through choice-of-law provisions”.<sup>276</sup> Beyond cavil, those who care for the health of arbitration must remain vigilant to such dangers, mindful of the difficulty in drawing the line between an arbitrator’s innocent misconstruction of the parties’ contract and a full-scale disregard of the arbitral mission.

That being said, the House of Lords decision in itself gives no mandate for such bad behavior. An arbitrator might well apply a power given to him or her by the Arbitration Act, but do so in an imperfect way. This might occur, for example, if the arbitrator applied interest or currency rates different from those that the reviewing judge would have considered appropriate. A wrong decision with respect to exercise of clearly-granted powers does not always equal an excess of authority.

b) Punitive Damages: The Supreme Court in *Pacificare*

In *Pacificare Health Systems v. Book*<sup>277</sup> a group of doctors had filed a nationwide

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<sup>275</sup> See portions of award cited in Paragraph 10, HL decision of 30 June 2005.

<sup>276</sup> See Adam Samuel, *Lesotho Highlands: Denaturing an Arbitration Statute and an Express Choice of Law does not Involve the Arbitrator Exceeding his Powers*, 23(3) J. INT’L ARB. 259 (2006), at pages 261, 262 and 263, respectively.

<sup>277</sup> 538 U.S. 401 (2003), reversing *In re Humana Inc. Managed Care Litigation*, 285 F. 3d 971 (11th Cir. 2002).

class action against several health maintenance organizations, alleging that the organizations had conspired to refuse proper reimbursement for services provided under the health plans accepted by the physicians. The legal basis for the doctors' action included claims under the Racketeer Influenced and Corrupt Organizations Act, commonly known as RICO.<sup>278</sup> This line of attack was attractive for the plaintiff physicians because the RICO statute allows awards of treble damages, amounting to three times any actual damage proven. There was a catch, however. The physicians had agreed to resolve disputes with the health care providers through arbitration. And some of the arbitration agreements to which they had agreed were explicit in prohibiting arbitrators from awarding punitive damages.<sup>279</sup>

The Supreme Court allowed the arbitrators themselves to determine, as an initial matter, whether they could grant treble recovery under the RICO, notwithstanding the contract limitation on punitive damages. While the case is sometimes presented as an example of judges deferring to arbitrators on jurisdictional matters, the court in fact followed a different (and rather murky) line by denying that it was engaged in

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<sup>278</sup> 18 U.S.C. § 1961-68. While some readers might be puzzled that a health care provider was influenced by racketeers, those familiar with RICO know that it has long been commonplace to include racketeering counts in ordinary business litigation. Section 1962 makes it unlawful to invest income derived from a "pattern of racketeering" in any business engaged in interstate or international commerce. Section 1961 defines racketeering to include not only acts and threats of things such as murder, kidnapping, arson, robbery and bribery, but also acts indictable under several sections of federal criminal law. Frequently RICO civil claims are based on alleged conspiracy to commit mail and wire fraud, as defined in 18 U.S.C. § 1341 & 1342. Section 1964 provides that persons injured by violations of RICO shall recover "threefold the damages he sustains" as well as attorney's fees.

<sup>279</sup> The various agreements provided either that (i) "punitive damages shall not be awarded [in the arbitrations], (ii) "arbitrators...shall have no authority to award any punitive or exemplary damages" or (iii) "arbitrators...shall have no authority to award extra contractual damages of any kind, including punitive or exemplary damages."

jurisdictional analysis at all. As discussed below, Justice Scalia asserted that it was not clear (at least to him) that the power to award punitive damages presented a gateway “arbitrability question”, which is to say, a jurisdictional issue.

The lower courts had refused to require the physicians to arbitrate, reasoning that if arbitrators could not award punitive damages this would deny meaningful relief for violations of RICO. Presumptively, RICO claims were of such public importance as to be non-waivable in a pre-dispute arbitration agreement. The health care organizations appealed.

In a relatively brief opinion by Justice Scalia, a unanimous Supreme Court upheld the health care organizations’ right to compel arbitration. The key to the Court’s reasoning lies in its assumption about the ambiguity of the term “punitive damages” and the nature of treble damages in the RICO statute. The Court suggested that some judicial decisions had given treble damage a compensatory character, “serving remedial purposes in addition to punitive objectives.”<sup>280</sup> Consequently, the Court expressed agnosticism about whether an arbitrator would or would not interpret the punitive damage prohibitions in a way that might cast doubt on the permissibility of treble damages. “We do not know how the arbitrator will construe the remedial limitations,” wrote Justice Scalia, and thus it would be “mere speculation” (using the vocabulary of an earlier decision<sup>281</sup>) to presume that arbitrators might deny themselves the power to grant punitive damages”. It was that very prospect (that treble damages might be found beyond the arbitrators’ jurisdiction) which had troubled the lower court, anxious to protect the

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<sup>280</sup> Referring to statutory remedies such as those at issue in RICO claims, Justice Scalia described treble damages as lying “on different points along the spectrum between purely compensatory and strictly punitive awards.” 538 U.S. 405.

<sup>281</sup> *Vimar Seguros y Reaseguros, S.A. v. M/V Sky Reefer*, 515 U.S. 528 (1995).

physicians' right to recovery. Consequently, the Court would not take upon itself the authority to decide "the antecedent question" of how the ambiguity concerning punitive damages is to be resolved.<sup>282</sup>

In essence, the Court decided not to decide, but to pursue a "wait and see" policy. On the theoretical level, therefore, the case cannot be said to give the arbitrators' power to make final a determination on the matter of their authority.

Justice Scalia added to the suspense with an intriguing footnote. "If the conceptual ambiguity [about what the prohibition on punitive damages might mean] could itself be characterized as raising a 'gateway' question of arbitrability," he reasoned, then "it would be appropriate for a court to answer it [the arbitrability question] in the first instance."<sup>283</sup> The Court then concluded, "Given our presumption in favor of arbitration ... we think the preliminary question whether the remedial limitations at issue here prohibit an award of RICO treble damages is not a question of arbitrability."<sup>284</sup>

What the Court seems to be saying is that arbitrators would construe a particular expression in the contract ("punitive damages") in the same way they interpret any other contract phrase, taking into account the context of the parties' relationship and other terms in the agreement. While the meaning given to these terms might affect one side's

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<sup>282</sup> 538 U.S. 407.

<sup>283</sup> 538 U.S. 407. But the footnote continues that the phrase "question of arbitrability" should be applicable only in the kind of narrow circumstance where contracting parties "would likely have expected a court to have decided the gateway matter, where they are not likely to have thought that they had agreed that an arbitrator would do so, and, consequently, where reference of the gateway dispute to the court avoids the risk of forcing parties to arbitrate a matter that they may well not have agreed to arbitrate." There are those who might observe, however, that the heart of arbitral jurisdiction turns on what the parties were "likely to have thought" about the decisions an arbitrator was supposed to make.

<sup>284</sup> 538 U.S. 407, at n. 2.

recovery, it would not enlarge arbitral authority, given that it is already broadly defined under the common arbitration clause which gives arbitrators the job of interpreting the language in the parties' agreement and the applicable law, even (and especially) in close cases.<sup>285</sup>

From one perspective, Scalia might be saying no more than that the matter is not ripe for determination until the court knows whether the arbitrators will in fact exceed their jurisdiction or violate public policy.<sup>286</sup> The troubling aspect of this decision lies in its susceptibility to misinterpretation, as in essence giving arbitrators *de facto* power to determine their own jurisdiction to award treble damages, simply by the way they would interpret the notion of punitive damages. If the arbitrators held that treble damages under RICO were not "punitive" in the context of the physicians' claims, then by definition these damages would be within their jurisdiction. Such a result may not be implausible under the circumstances. Arguments have been made that treble damages make "rough justice" compensation for the disruption that may result from contract breach but be difficult to quantify. The slope, however, does not continue indefinitely. At some point

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<sup>285</sup> Illustrations of this point arise in many interesting arbitrations. Here are a few. (1) Professional specialty. A statute might make limitation of liability clauses valid only in contracts between persons "in the same profession" (French law refers to contracts "entre professionnels de la même spécialité"). Since two professional lives are rarely completely alike, the arbitrator must determine how narrow to draw the concept of professional "specialty". (2) "Subject to..." A contract might make one obligation "subject to" a particular event. Does the expression mean "On condition that" or "Unless"? Both usages exist. "Bob must take the exam, subject to [unless] being excused by the Dean. But, "Christine will have dinner at home, subject to [on condition that] her plane lands on time. (3) A licensee might be entitled to sub-license to an entity that sells a "range" of the licensee's products. If the licensee sells three dozen products, how many constitutes a "range"? Presumably we need more than one, but not necessarily thirty-six.

<sup>286</sup> Of course, when arbitration award can be enforced against assets abroad, this may be of little consequence.

language ceases to be elastic, and the parties' words impose definite boundaries on what arbitrators can do.

D. The "Arbitrability Question" in the United States

1. Legal Framework

a) Overview

In the United States, questions otherwise be labeled "jurisdictional" often find themselves being classified as matters for the arbitrators to decide along with the merits of the dispute. As we shall see, this characterization exercise lies at the heart of judicial deference to the arbitral process.

Unlike the arbitration laws of France,<sup>287</sup> and to a lesser extent England,<sup>288</sup> the Federal Arbitration Act creates no statutory presumption that courts should await the award before pronouncing themselves on an arbitrator's authority to hear a dispute.<sup>289</sup> Early in the arbitral process, courts can decide whether a particular matter has been (or can be) submitted to arbitration, usually in the context of a motion to compel arbitration or to stay litigation.<sup>290</sup> Courts remain free to entertain motions related to arbitral jurisdiction at any moment from the start of proceedings onward. Moreover, when the

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<sup>287</sup> See NCPC Article 1458, discussed *supra*.

<sup>288</sup> See 1996 Arbitration Act, Section 72, discussed *supra*, which provides for the right to challenge the arbitration agreement or jurisdiction through a motion for declaration or injunction only when the person alleged to be a party to the arbitration "takes no part in the proceedings". See also Sections 70(2) (applications and appeals may be brought only after exhaustion of available arbitral process) and 73 (loss of right to object to lack of jurisdiction if a litigant takes part in an arbitration without raising the matter in the proceedings).

<sup>289</sup> For the German position on the matter, see BGH decision of 13 January 2005, discussed *supra*.

<sup>290</sup> FAA Section 3 provides that federal courts shall stay competing litigation "upon being satisfied that the issue involved in such [judicial] suit or proceeding is referable to arbitration ...."



existence of an agreement to arbitrate is open to doubt, courts may order the question resolved by a jury.<sup>291</sup>

In other ways, however, American arbitration law has been extremely generous in giving arbitrators both the first and the last word in determining their own authority. The statutory scheme for international arbitration has been integrated with a practice of sending jurisdictional questions to arbitrators if there is evidence that such is the path intended by the parties.<sup>292</sup>

The conceptual underpinning of this approach relies on a finding that “the parties intended that the question of arbitrability [used in the sense of jurisdiction] shall be decided by the arbitrator.”<sup>293</sup> With a different vocabulary, American courts have in essence adopted the old German concept of a *Kompetenz-Kompetenz* clause, by which the parties may agree to submit a jurisdictional matter to final and binding arbitration.<sup>294</sup> As

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<sup>291</sup> See *Sandvik AB v. Advent Int’l Corp* 220 F.3d 99 (3d Cir. 2000); *China Minmetals Materials Ltd. V. Chi Mei*, 334 F.3d 274 (3d. Cir. 2003).

<sup>292</sup> For a survey of cases along these lines, see Robert B. Davidson, *Recent U.S. Cases Affecting the Power of an International Arbitral Tribunal to Determine its own Jurisdiction*, in *THE SWEDISH ARBITRATION ACT OF 1999 FIVE YEARS ON: A CRITICAL REVIEW OF STRENGTHS AND WEAKNESSES* 61 (Lars Heuman & Sigvard Jarvin, eds. 2006; Symposium Proceedings, University of Stockholm, October 2004).

<sup>293</sup> See *PaineWebber Inc. v. Bybyk*, 81 F.3d 1192, at 1198-99 (2d Cir. 1996). See also *Alliance Bernstein Investments*, discussed *supra*. The principle has also been extended to class actions in *JSC Surgutneftegaz v. Harvard College*, 167 Fed.Appx. 266 (2nd Cir. 2006), 2006 WL 354282, affirming 2005 WL 1863676 (S.D.N.Y. 2005). Here investors brought a class action arbitration over dividend policy of a Russian company, whose shares were evidenced by American Depository Receipts (ADR’s) held in New York. The court found “the intent of the parties to commit the question of arbitrability to the arbitrator.” Slip opinion at 3. The contest was not about the existence of the arbitration clause (accepted by both sides) but rather about whether its scope was broad enough to cover the parties’ dispute.

<sup>294</sup> American courts are often unwilling to use the same vocabulary as other nations, preferring to talk of “the arbitrability question” rather than jurisdiction. See *First Options*

discussed more fully below, jurisdictional differences have been manipulated into the realm of substantive questions whose resolution the parties are deemed to have given to the arbitrators.

b) Void and Voidable Clauses

In the past, judicial decisions often distinguished between “void” and “voidable” clauses. Under this view, only courts may decide challenges based on allegations that the agreement is void *ab initio*, rather than simply voidable at one side’s election.<sup>295</sup>

The instinct behind such decisions is understandable. *Ex nihilo nihil fit*: nothing comes from nothing. Consequently, a void clause cannot serve as the source of authority for any putative arbitrator.<sup>296</sup>

However well-intentioned, the void/voidable distinction seems unnecessary. The better approach would be for courts to ask simply, “What did the parties intend?” If the arbitration clause was for some reason invalid, then there would be no party intent to arbitrate anything. In some cases the invalidity might taint the entire contract, as in the event of forgery or unauthorized signature. In other instances, the invalidity might touch

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of Chicago. v. Kaplan, 514 U.S. 938, 943 (1995); PaineWebber, Inc. v. Elahi, 87 F.3d 589, 596-98 (1st Cir. 1996).

<sup>295</sup> See Sandvik AB v. Advent Int’l Corp 220 F. 3d 99 (3d Cir. 2000); Three Valleys Mun. WaterDist. V. E.F. Hutton & Co., 925 F. 2d 1136 (9th Cir. 1991); Canada Life Ass. Co. v. Guardian Life Ins. Co., 242 F. Supp. 2d 344 (S.D.N.Y. 2003); Sphere Drake Ins. v. All American Ins. Co., 256 F.3d 587 (7th Cir. 2001).

<sup>296</sup> Pollux Marine Agencies v. Louis Dreyfus Corp., 455 F. Supp. 211 (S.D.N.Y. 1978). In this connection, analytic links are often between an arbitrator’s jurisdictional power and the separability (autonomy) in the arbitration clause. If the voidness or illegality of the main agreement does not strike the arbitration clause, the arbitrator continues to have power to make a jurisdictional determination. By contrast, if the invalidity does infect the agreement to arbitrate (as might happen in a forged document) the arbitrator would clearly lack authority. See Harbour Assurance Co. Ltd. v. Kansa General Int’l Ins. Co., [1993] Q.B. 701.

only the arbitration clause, and might be the result of fraudulent misrepresentations about the arbitral process which gave one side the right to rescind that aspect of the transactions.<sup>297</sup>

What should matter is simply that the arbitration clause was invalid, regardless of how that came to be.<sup>298</sup> Mercifully, the void/voidable distinction was finally laid to rest by the United States Supreme Court in its recent *Buckeye* decision.<sup>299</sup> An action against a check cashing service, accused of making illegal usurious loans, was brought by borrowers in derogation of the arbitration clause. The Court found that the allegation of “void loan agreement” did not deprive the arbitrators of the right to decide that very issue, as long as the arbitration clause itself remained sound.

## 2. The *Dictum* in *First Options*

To understand the “arbitrability question” approach, the most convenient starting point might be *First Options of Chicago v. Kaplan*.<sup>300</sup> In *dictum*, this U.S. Supreme

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<sup>297</sup> See *Engalla v. Permanente Med. Group*, 938 P.2d 903 (Cal. 1997), involving a malpractice claim against a health care provider in which habitual delays in arbitration were found to constitute fraud by the provider.

<sup>298</sup> For a view along these lines (albeit pursuant to a slightly different line of reasoning), see Robert H. Smit, *Separability and Competence-Competence in International Arbitration: Ex Nihilo Nihil Fit? Or Can Something Indeed Come From Nothing?*, 13 AM. REV. INT’L ARB. 19 (2002), at 34-36.

<sup>299</sup> *Buckeye Check Cashing, Inc. v. Cardegna*, 126 S.Ct. 1204 (2006), discussed *supra*.

<sup>300</sup> 514 U.S. 938, 943. See generally, William W. Park *The Arbitrability Dicta in First Options v. Kaplan: What Sort of Kompetenz-Kompetenz Has Crossed the Atlantic?*, 12 ARB. INT’L 137 (1996), reprinted 11 INT’L ARB. REP. 28 (Oct. 1996); William W. Park, *Determining Arbitral Jurisdiction: Allocation of Tasks Between Courts and Arbitrators*, 8 AM. REV. INT’L ARB. 133 (1997); reprinted in [2000] ADR LAW J.19 (March 2000). For an academic tourney on some of the issues raised in *First Options*, see Thomas Carbonneau, *Comment Upon Professor Park’s Analysis of the Dicta in First Options v. Kaplan*, 11 Int’l Arb. Rep. 18 (November 1996); Alan Scott Rau, *Arbitration As Contract: One More Word About First Options v. Kaplan*, 12 INT’L ARB. REP. 1 (March 1997); Thomas Carbonneau, *Le Tournoi of Academic Commentary on Kaplan: A Reply to*

Court decision supplied a verbal hook on which much subsequent case analysis has been hung. Almost invariably, these cases cite *First Options* for the dual proposition that (i) contracting parties may agree to arbitrate jurisdictional matters (questions about “arbitrability”) but (ii) such agreement must be founded on clear evidence.

Prior to that decision, general American contract principles certainly existed to provide a doctrinal foundation for deference to arbitrators’ decisions on their authority. *First Options*, however, supplied a high level of visibility and authoritative endorsement for such deference.<sup>301</sup>

In *First Options*, an arbitral award had been rendered against both an investment company and its owners with respect to debts owed to a securities clearing house. The owners (husband and wife) argued that they had never signed the arbitration agreement, and consequently were not bound by the award. The Supreme Court carefully distinguished between three questions: (i) did the Kaplans owe money? (ii) did the Kaplans agree to arbitrate? and (iii) who (court or arbitrator) should decide whether the Kaplans agreed to arbitrate?

On the facts of the case, the Supreme Court affirmed the lower court’s finding that the owners had not agreed to arbitrate, without any judicial deference to the

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*Professor Rau*, 12 INT’L ARB. REP 35 (APRIL 1997). See also, Shirin Philipp, *Is the Supreme Court Bucking the Trend? First Options v. Kaplan in Light of European Reform Initiatives in Arbitration Law*, 14 B.U. INT’L L. J. 119 (1996).

<sup>301</sup> See *A T & T Technologies v. Communications Workers*, 475 U.S. 643 (1986), discussed *infra*. See also Alan Scott Rau, *The Culture of American Arbitration*, *supra*, at 464, note 69, suggesting that the *dictum* of *First Options* can be “found fully developed in earlier Supreme Court decisions.” Not all observers have noticed such full development.

arbitrator's determination.<sup>302</sup> Whether Manuel and Carol Kaplan were bound to arbitrate by virtue of a clause signed by their investment company was a question for courts. It was for a judge, not arbitrator, to provide the ultimate determination on whether Mr. and Mrs. Kaplan were in fact bound to arbitrate by reason of the actions of their investment company, on theories such as agency, alter ego, or lifting the corporate veil.

Although unnecessary to the holding of the case, the Supreme Court's went further and suggested that in some situations (although not under the facts of *Kaplan*) "the arbitrability question itself" might be submitted to arbitration.<sup>303</sup> In such a situation, the courts must defer ("give considerable leeway") to arbitrators' decisions on the limits of their own jurisdiction. However, the burden of showing that a non-signatory intended to arbitrate remained with the party seeking arbitration.<sup>304</sup>

The *dictum*'s critical language (which in some situations may eclipse the holding of the case) reads as follows:

If [the parties agreed to submit arbitrability to arbitration] then the court's standard for reviewing the arbitrator's decision about the matter should not differ from the standard courts apply when they review any other matter that the parties have agreed to arbitrate.... That is to say, the court should give considerable leeway to the arbitrator, setting aside his or her decision only in certain narrow circumstances.<sup>305</sup>

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<sup>302</sup> The Supreme Court also dealt with the standard a court of appeals should apply when reviewing a district court decision relating to vacatur or confirmation of an arbitral award under Section 10 of the Federal Arbitration Act. The Court held that a district court's findings of fact should be accepted unless "clearly erroneous," but that questions of law should be decided *de novo*. The Third Circuit agreed with the owners that they were not bound by the arbitration agreement, and therefore had reversed the district court confirmation of the award against them.

<sup>303</sup> 514 U.S. 938 (1995).

<sup>304</sup> In the United States, given the absence of any federal common law, the bindingness of an arbitration clause would be a matter for state law principles.

<sup>305</sup> For the proposition that arbitrability can be submitted to arbitrators, the Court cited to alleged authority in labor arbitration: *A T & T Technologies v. Communications Workers*,

Given the longevity of Supreme Court *dictum* in the field of arbitration,<sup>306</sup> its teaching on “the arbitrability question” can be expected to weigh heavily on the future allocation of functions between courts and arbitrators. At the least, the *dictum* now requires judges to ask not only whether arbitrators exceeded their powers, but also whether the arbitrators were given authority to decide a jurisdictional matter in a way deserving deference.<sup>307</sup>

### 3. Possible Applications of the *Dictum*

#### a) Multiple Contexts of “Arbitrability”

The *dictum* may in some instances lend itself to mischief if applied by courts seeking to reduce their workload. Situations will certainly exist in which parties might agree to submit a particular question to binding arbitration, even though that question would normally be characterized as jurisdictional. However, awards may still be

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475 U.S. 643, 649 (1986) and *Steelworkers v. Warrior & Gulf Navigation*, 363 U.S. 574, 583, n. 7 (1960). Invocation of these labor cases must be approached with caution. In the United States, the statutory basis for labor arbitration lies in section 301 of the Labor-Management Relations Act of 1947 (commonly called the “Taft-Hartley Act”) rather than the Federal Arbitration Act. *See Textile Workers v. Lincoln Mills*, 353 U.S. 448 (1957). Admittedly, the law under the FAA and the LMRA has seen a convergence, with courts routinely citing cases decided under one statute in connection with another. Neither of the two cited cases actually found an agreement to arbitrate the question of arbitrability. In *AT&T Technologies* the Court held that the lower court’s decision to allow the arbitrator to decide arbitrability was error. *Warrior & Gulf* said that “it is clear...in this case [that] the question of arbitrability is for the courts to decide.” 363 U.S.583, n. 7.

<sup>306</sup> *See e.g.*, the Court's obscure pronouncement on arbitrator "manifest disregard" of the law in *Wilko v. Swan*, 346 U.S. 427 (1953), which has continued to be invoked long after the holding in the case was overruled.

<sup>307</sup> *See e.g.* *PaineWebber v. Elahi*, 87 F.3d 589 (1st Cir. 1996). For an early expression of scholarly concern over the potential for confusion, *see* Thomas Carbonneau, *Beyond the Trilogies: A New Bill of Rights and Law Practice Through the Contract of Arbitration*, 6 AM. REV. INT'L. ARB. 1 (1995). *See also* THOMAS E. CARBONNEAU, *CASES AND MATERIALS ON THE LAW AND PRACITCE OF ARBITRATION* (3d ed. 2002), at 20-21

reviewed for excess of authority under Section 10 of the Federal Arbitration Act. At some point in any chain of agreements, a consensual basis must exist for arbitral authority over those questions.

One difficulty with the *dictum* is that the term “arbitrability” can cover so many different matters: whether a person ever agreed to arbitrate at all; the scope of an admittedly valid arbitration clause; and public policy limits on what arbitrators can and cannot decide. Only the second of those issues (scope of the parties' agreement) would normally be capable of delegation to arbitrators in a single agreement. The third category (public policy) would never be capable of delegation.

b) Existence of Arbitration Clause

Perhaps the most serious challenge to the *dictum* arises in connection when a respondent in an arbitration asserts that it never agreed to arbitrate, or a respondent in a judicial action claims the benefit of an arbitration clause. Delegation of jurisdictional authority on that question would normally require a separate agreement. A contract clause purporting to give arbitrators power to determine their own authority does not, in itself, insulate from judicial review a decision to add a party that never agreed to arbitrate.<sup>308</sup> The mere narration or recital of the arbitrator's power on a printed form cannot be confused with a genuine grant of authority.

The suggestion that arbitrators can determine their own jurisdiction with respect to the identity of the parties, without a separate agreement submitting that question to

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<sup>308</sup> In some instances, of course, a person who did agree to arbitrate may be required, by the terms of the contract or agreed-upon arbitration rules, to accept joinder of a third party. See LCIA Rule 22.1(h), allowing a willing third party to be joined to a proceeding notwithstanding the objection of one of the existing litigants. In such a case, however, the objecting party has accepted the process for joinder by contracting for application of the LCIA Rules.

arbitration, brings to mind the picture of Baron Münchhausen pulling himself up by his own pigtail. In many cases such a principle will assume the very proposition (arbitral jurisdiction) that remains to be proven. In the absence of an arbitration agreement accepted by the person alleged to be bound with respect to the dispute in question, the person rendering the award would seem better characterized as a vigilante, intermeddler or imposter.

This does not mean that a contract may never be interpreted as giving the arbitrator power to determine whether a particular person agreed to arbitrate at all. Rather, such agreements must be truly distinct from, and chronologically subsequent to, the alleged principal agreement. For example, a buyer might sign a purchase contract with a seller corporation. When a dispute arises, the seller might allege that an arbitration clause in the contract bound not only the seller corporation, but also its parent entity. Or, the seller's parent might claim the benefit of the arbitration clause in attempting to avoid a court action brought against the parent by the seller. The theory might be advanced that the subsidiary had contracted as agent for the parent, or that the parent was the alter ego of the subsidiary.

After a dispute arises, nothing would prevent the parent from agreeing to ask an arbitrator to determine whether it was in fact bound by the arbitration clause. The arbitral tribunal to whose authority the parent has consented under the second agreement would be convened to determine whether the parent bound itself under the first agreement. In such a case, an arbitral tribunal so constituted would do no more than decide the merits of a question of fact and/or law about whether the initial agreement empowered the



arbitrator to the extent asserted.<sup>309</sup>

c) Scope

Questions related to the scope of an arbitration clause lend themselves more easily to application of the “arbitrability question” *dictum*. Depending on the facts and circumstances evidencing the parties’ intent, an arbitration agreement might permit arbitrators to decide what controverted questions are covered by the clause, or to interpret the extent of their powers.

Not all contract terms, however, lend themselves to such final interpretation by arbitrators. For instance, courts presumably would not accept an arbitrator’s erroneous finding that a contracting party named Alpha Corporation really referred to Omega Limited when the two entities were in fact completely unrelated to one another. An arbitrator’s construction of contract terms cannot change the parties’ identity.<sup>310</sup>

4. Broad and “Open Ended” Clauses

In practice, courts often address jurisdictional questions by reference to the nature of the arbitration clause itself. A “broad” arbitration clause will be seen as evidence of an intent to submit many (albeit not all) jurisdictional questions to the arbitrator. Such expansive, widely-drafted clauses often talk about “all controversies, disputes and questions” that might be “related to or arising out of” the parties’ agreement.<sup>311</sup>

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<sup>309</sup> This is exactly what happened in *Astro Valiente Compania Naviera v. Pakistan Ministry of Food & Agriculture (The Emmanuel Colocotronis No. 2)*, [1982], 1 W.L.R. 1096, 1 All E. R. 578. Buyers of wheat at first refused to arbitrate a dispute with the shipper over demurrage, on the theory that the arbitration clause in the charter party had not been incorporated in the bill of lading which by the charter party’s terms was to “supersede” the charter party. The parties submitted to ad hoc arbitration the question of whether the arbitration clause had been incorporated into the bill of lading.

<sup>310</sup> See discussion of the Scalia opinion in *Pacificare*.

<sup>311</sup> See e.g., *Fraternity Fund Ltd. v. Beacon Hill Asset Mgt.*, 371 F. Supp. 2d 571 (SDNY

While many contracts do contain such broadly drafted clauses, they are not universal.<sup>312</sup> On occasion, the parties may submit to arbitration only a single narrow question of fact, reserving the rest of the dispute to the competent courts.<sup>313</sup> Consequently, scholars, judges and policy-makers must be careful about presuming their own conclusion on what arbitration clauses do and do not cover.

In disputes where challenges to an arbitrator's jurisdiction do *not* implicate the existence of the arbitration clause, intriguing questions arise with respect to broadly drafted clauses that might give arbitrators absolute power to determine their own jurisdiction. Such "open-ended" clauses might cover "all disputes ever arising between

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2005); Ryan Beck & Co. v. Fakh, 268 F. Supp. 2d 210 (EDNY 2003).

<sup>312</sup> For an example of a narrow clause, see *Bristol-Myers Squibb v. SR International Business Insurance Co. Ltd.*, 354 F.Supp.2d 499 (SDNY 2005), which held that an arbitration clause making reference to "any dispute or difference arising under" the insurance policy did not cover fraud. The insurer sought to rescind policies and the policyholder sought a declaratory judgment that the question of fraud was outside the scope of the arbitration. The court felt bound by the earlier precedent of *In Re Kinoshita*, 287 F.2d 951 (2d Cir. 1961), which while out of step with modern law still controlled on narrow facts. For a case distinguishing *Kinoshita* (rightly or wrongly) see *S.A. Mineracao da Trindade-Samitri v. Utah Int'l, Inc.*, 745 F.2d 190 (2d Cir. 1984)(words "whenever any question or dispute shall arise or occur under" the agreement held broad enough to include claims of fraudulent inducement to contract). Compare *Louis Dreyfus Negoce S.A. v. Blystad Shipping & Trading Inc.*, 252 F.3d 218, 223 (2d Cir.2001). *ACE Capital Re Overseas Ltd. v. Central United Life Insurance Co.* 307 F.3d 24 (2d Cir.2002).

<sup>313</sup> See e.g., *CIT Project Finance v. Credit Suisse First Boston*, 799 NYS2d 159, 2004 WL 2941331 (2004), holding that arbitrators may not grant attorneys' fees. The court reached this somewhat surprising conclusion notwithstanding Article 31 of the AAA International Rules, which provides that arbitrators to follow the European "loser pays" practice of awarding "reasonable costs for legal representation of a successful party". The court relied on N.Y. CPLR § 7513, permitting an award of attorneys' fees only if provided in the parties' agreement. The arbitration clause at issue gave the arbitrators power only over a specific issue of fact, reserving most of the dispute to courts. By contrast, when the contract contains a broad clause, courts allow arbitrators to address the parties' intent on legal fees. See *PaineWebber v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996); *Shaw Group v. Triplefine International Corp.*, 322 F.3d 115 (2nd Cir. 2003); *Stone & Webster v. Triplefine International Corp.*, 118 Fed.Appx. 546 (2d Cir. 2004).

the parties” and would not include the typical language requiring that arbitration arise from or be related to a particular contractual relationship. A related problem might derive from a master agreement subject to an arbitration provision, followed by several more limited contracts that do not themselves contain arbitration clauses.

While such open-ended language would reduce the prospect of judicial second guessing of the arbitrator, the situation would not always be problem-free. Imagine that a university president asks a lawyer to represent his wayward child in litigation arising out of an auto accident. A retainer agreement signed by the president includes an arbitration clause stating that the arbitral tribunal will have power to decide questions relating to its own jurisdiction. After a dispute about the number of hours spent on the accident case is referred to a properly constituted arbitral tribunal, the lawyer (who is also an adjunct member of the university's law faculty) includes in her submission to the arbitrator a claim for a substantial salary increase for the course she teaches. Must a judge defer to an arbitral tribunal's decision to hear the salary claim as well as the retainer disagreement? Normally one would think not, at least if the president was contracting in a personal capacity (as parent) rather than as an academic administrator.

##### 5. Judicial Deference toward Contract Recitals

Even before the U.S. Supreme Court decision in *First Options v. Kaplan*, some American judicial decisions gave evidence of deference to contract recitations which suggested (either explicitly or by reference to arbitration rules) that arbitrators were able to rule in a final and binding way on their own jurisdiction.<sup>314</sup> One problematic example

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<sup>314</sup> Instances in labor arbitration have already been mentioned. See *A T & T Technologies v. Communications Workers*, 475 U.S. 643 (1986), discussed *infra*.

can be seen in the decision by the Court of Appeals in *Apollo Computer v. Berg*.<sup>315</sup>

A contract between a Massachusetts computer company and a Swedish distributor was terminated and the rights of the bankrupt Swedish distributor were assigned to a third party. The Massachusetts company claimed that the non-assignment clause in the contract covered the arbitration clause itself, which became void as a consequence of the assignment.

The court held that the arbitrators' jurisdiction over the claims was a question for arbitrators themselves to decide. The arbitral tribunal was appointed pursuant to the Arbitration Rules of the International Chamber of Commerce, which calls for the ICC to refer to the arbitrators any objections to the validity of an arbitration agreement, as long as the ICC is *prima facie* satisfied that an arbitration agreement may exist.<sup>316</sup> On this basis the American court reasoned that the parties had agreed to submit the arbitrability question to the arbitrators.

On closer examination the reasoning in *Apollo* might reveal itself as an exercise in presuming a conclusion. The problem is not that the parties lacked the power, as a matter of contract law, to submit the jurisdictional question to arbitration. Rather, it is simply not certain that they actually did so.

If a full examination of the facts reveals that the arbitration agreement was in fact automatically terminated by the assignment, then ICC Arbitration Rules become relevant.

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<sup>315</sup> 886 F. 2d 469 (1st Cir. 1989), at 473. *See also* sequel to *Apollo* in *Hewlett Packard, Inc. v. Berg*, 61 F.3d 101 (1st Cir. 1995), vacating a confirmation order and remanding for further proceedings the award confirmed in 867 F. Supp. 1126 (D. Mass. 1994). Similar questions were discussed in *S.G.S. v. Raytheon*, 643 F. 2d. 863 (1st Cir. 1981).

<sup>316</sup> ICC Rules, Article 6(2) (1998 Version). At the time, the applicable rule was found in Article 8, and referred to the “*prima facie* existence” of the arbitration agreement, rather than the ICC Court being *prima facie* satisfied.

This would be relatively evident had the arbitration clause contained a proviso, typed in large bold letters, to the effect that “The Arbitration clause is void after assignment”. In such circumstances, it is hard to imagine that any arbitrators could accord themselves jurisdiction in a final and binding way. A similar result would seem to obtain if the parties’ had evidenced their intent through selection of an applicable law that yielded the same result.

A better approach might have been simply to make a finding about the effect of the assignment under Massachusetts law, which seemed to provide that a general non-assignment clause bars the delegation of duties, but not the assignment of rights, including the right to arbitrate. Indeed, such was the approach of the federal district court in this case.<sup>317</sup> For better or for worse, the Court of Appeals refused to address the issue, instead resting its decision on the principle that the effect of the assignment was a question for the arbitrators.

For a private arbitral institution like the International Chamber of Commerce to leave the difficult issues to the arbitrator may be acceptable as an efficiency device if national courts later exercise a fuller control over the clause's validity.<sup>318</sup> However, the aggregate social and economic consequences of such a *prima facie* approach are likely to be less acceptable when a judge imposes state power to enforce an arbitral award without an independent examination of the authenticity and scope of the alleged arbitration

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<sup>317</sup> 886 F. 2d at 407. For a general discussion of the assignment of rights under UNICROIT principles, see Wolfgang Wiegant & Corinne Zellweger-Gutknecht, *Assignment*, in UNICROIT PRINCIPLES: NEW DEVELOPMENTS AND APPLICATIONS 27 (ICC Bulletin, Court of Arbitration, 2005 Special Supplement).

<sup>318</sup> Even for arbitral institutions, however, this approach may not be free from problems. An arbitration agreement with a forged signature, or a real signature forced by a gun at the head, ought to be no less a complete nullity because it gives the appearance of being valid.

agreement. The result may well be a loss of confidence by the business community in both the arbitral system and the judiciary that enforces arbitration agreements and awards.

#### 6. Amplifying *First Options* in Subsequent Case Law

Recent decisions of the United States Supreme Court provide a perspective on how American jurisdictional methodology plays itself out in practice. The following two cases, *Howsam* and *Bazzle*, address which threshold preconditions for arbitration are to be determined by judges and which are for arbitrators.<sup>319</sup>

##### a) Time Limits

Securities arbitration has been a particularly fruitful ground for jurisdictional conflict with respect to time limits. The investor generally tells of a “nest egg” lost due to a financial adviser’s misconduct, with golden retirement years turned into a financially harsh old age due to unsuitable investments. The adviser, of course, replies that the customer was well aware of the risks and pushed hard for aggressive growth stocks.<sup>320</sup>

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<sup>319</sup> See generally William W. Park, *The Contours of Arbitral Jurisdiction: Who Decides What?*, 3 INT’L ARB. NEWS 2 (ABA, Summer 2003), reprinted in 18 INT’L ARB. REP. 21 (August 2003). A third Supreme Court opinion in *Pacificare Health Systems v. Book* is often discussed in connection with *Howsam* and *Bazzle*. In a puzzling footnote the Court stated that the question at issue was “*not* a question of arbitrability.” 538 U.S. 407 at n.2. (Emphasis added.) In light of its somewhat different rationale (courts wait to see how the arbitrators will decide) *Pacificare* has been discussed earlier, along with *Lesotho Highlands*, in relation to the impact of contract interpretation on arbitral jurisdiction.

<sup>320</sup> The so-called “Seven Deadly Sins” of securities transactions are hardly as exciting as the classic offenses: lust, gluttony, sloth, anger, envy, pride and greed – although the last of these often plays a role in broker misbehavior. The catalogue of common transgressions includes (i) churning, (ii) unauthorized trading, (iii) unsuitable trading, (iv) intentional misrepresentation, (v) broker ignorance, (vi) misappropriation and (vii) outside business activities of the employee relating to investment marketing that is attributed to the employer. See David E. Robbins, *Seven Deadly Sins that Lead to Arbitration Disaster*, 820 PLI/Corp 489, Practising Law Institute, Corporate Law and Practice Course Handbook Series (July-August 1993).

The reason time bars are so frequently invoked in brokerage disputes is that the investor is a bit like a casino gambler: happy when winning, but likely to complain in the event of a loss.<sup>321</sup> If stock rises in value, there would be no loss, and thus no grumbling that the investment advice was “unsuitable.” Only when things later go sour will the broker be accused of misbehavior, even though the purchase of securities might be many years in the past.<sup>322</sup>

For decades, the question of what jurisdictional determinations could be made by an arbitrator was moot, since the basic distrust of arbitrators (the foxes who would guard the chicken coop) generally meant there was no arbitration of securities transactions. Except in international cases,<sup>323</sup> courts traditionally refused to enforce arbitration clauses that implicated either the 1933 Securities Act or the 1934 Securities Exchange Act.<sup>324</sup> Interpreting these two pieces of legislation was considered too important for the private sector. Therefore, since most investment portfolios contain stocks and bonds, accusations of misfeasance by financial advisers generally ended up in court.

In 1989 the situation changed due to liberalization of limits on subject matter

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<sup>321</sup> While the investment in *Howsam* had occurred sometime between the account opening in 1986 and its closing in 1994, the arbitration was begun only in 1997.

<sup>322</sup> One recalls the vignette from the 1942 movie *Casablanca*, starring Humphrey Bogart and Ingrid Bergman. The French police captain, played by Claude Rains, closed down Rick’s Café because he was “shocked” to find gambling going on – all the while being quite happy to take his winnings.

<sup>323</sup> See *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) (securities disputes arbitrable in a German-American contract at a time when prohibited in a domestic contract).

<sup>324</sup> See *Wilko v. Swan*, 346 U.S. 427 (1953), overruled in *Shearson/American Express v. McMahon*, 482 U.S. 220 (1987) (fraud claims under Exchange Act §10b). Ironically, *Wilko* has lived on in its *dictum* which posited “manifest disregard of the law” as an extra-statutory ground for judicial review.

arbitrability by the U.S. Supreme Court.<sup>325</sup> In part the attitude shift may have been due to the SEC playing a more active role in supervising the self-regulatory organizations (such as the National Association of Securities Dealers), under whose auspices securities arbitration proceeded. And in part the change in attitude might have been related to the perceived need to relieve congestion in judicial dockets.

In any event, the result was a wholesale adoption of arbitration by the securities industry to a point where many securities law questions are no longer addressed by courts at all. Much of the law has thus been frozen during the past dozen years, with few judicial precedents to fertilize legal development.

In *Howsam v. Dean Witter*<sup>326</sup> the drama played itself out through an investment in limited partnerships whose performance proved unsatisfactory, causing the investor to allege broker misrepresentation of the investment's quality. The brokerage firm then filed suit in federal court requesting an injunction against the arbitration on the ground that the original investment advice was more than six years old, and thus barred by the NASD "eligibility rule" requiring that any claim be brought within six years of the relevant occurrence.<sup>327</sup> The Supreme Court gave the arbitrators a green light to determine whether their power to hear the case was affected by time limits contained in the arbitration rules.

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<sup>325</sup> See *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989), concerning Securities Act §12(2) claims.

<sup>326</sup> 537 U.S. 79 (2002). The unanimous decision was written by Justice Breyer. A concurrence by Justice Thomas rested solely on the basis that New York law (applicable to the contract in question) had held that time bars under the NASD Rules are for arbitrators to decide.

<sup>327</sup> NASD Code of Arbitration Section 10304 (formerly Rule 15), states that no dispute "shall be eligible for submission to arbitration ... where six (6) years have elapsed from the occurrence or event giving rise to the ... dispute."



Resolving a split among the circuits over who (judge or arbitrator) decides on “eligibility” requirements, the U.S. Supreme Court in *Howsam* held that time limits were for the arbitrator. An opinion by Breyer paid lip service to the principle that judges would normally decide gateway jurisdictional matters unless the parties clearly provided otherwise. However, the Court presumed (rightly or wrongly) the parties’ intent that the NASD Rules be construed by the arbitrators themselves, who were supposed to possess (according to the Court) special familiarity and expertise in interpreting these rules.<sup>328</sup>

b) Class Actions

A plurality of the Court followed a similar line of reasoning in *Green Tree Financial Corp v. Bazzle*,<sup>329</sup> which involved an attempt at class action arbitration of disputes arising from consumer loans used to purchase mobile homes and finance residential improvements.<sup>330</sup> Once again, the Supreme Court punted the question to the

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<sup>328</sup> The court also noted that § 10324 of the NASD Rules (formerly Rule 35) gave arbitrators power to “interpret and determine the applicability of all provisions under the [NASD] Code.” For other cases on time limits, see *MCI Telecommunications Corp. v. Exalon Industries, Inc.*, 138 F. 3d 426 (1st Cir. 1998) (time limits for challenging award do not apply when existence of an arbitration agreement is challenged). But *contra* see *MBNA America Bank v. Hart*, 710 N.W.2d 125 (N.D. 2006); *MBNA America Bank v. Swartz*, 2006 WL 1071523 (Del. Ch) (time bar for challenging clause).

<sup>329</sup> 539 U.S. 444 (2003). The interesting plurality decision split 4-1-3-1. Four Justices concluded that it was for the arbitrator to decide whether the contracts allowed class action arbitration. One concurred in the judgment although he would have preferred to affirm the South Carolina decision that ordered arbitration to proceed as a class action. Three Justices dissented on the basis that any imposition of class-wide arbitration contravened the parties’ contract, and one dissented on the ground that the FAA should not apply in state courts.

<sup>330</sup> In federal court, class actions would be permitted under FRCP Rule 23. Several arbitral institutions (including the American Arbitration Association) have established rules for class action arbitration patterned on these provisions.

arbitrator himself.<sup>331</sup>

In violation of South Carolina's Consumer Protection Code, the lender allegedly neglected to give borrowers notice about the right to name their own lawyers and insurance agents. Two groups of borrowers filed separate suits in the South Carolina state courts seeking class certification of their claims against the lender. The first court certified the class and compelled class arbitration pursuant to the loan agreement's arbitration clause. The second court initially denied the lender's motion to compel arbitration, but was reversed and the case proceeded to arbitration before the same arbitrator.

After the arbitrator awarded the two classes \$10.9 million and \$9.2 million (respectively) plus attorney's fees, the South Carolina Supreme Court consolidated the lender's appeals and ruled that the relevant loan contracts permitted class actions in arbitration.<sup>332</sup> The U.S. Supreme Court granted certiorari to determine whether the state court holding was consistent with the Federal Arbitration Act. The plurality opinion by Justice Breyer announced that the permissibility of class action arbitration was a matter of contract interpretation for the arbitrator, not the courts. For Justice Breyer and his plurality, the question was "what kind of arbitration proceeding [had] the parties agreed

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<sup>331</sup> Commentary on this case includes Hans Smit, *Class Actions and Their Waiver in Arbitration*, 15 AM. REV. INT'L ARB. 199 (2004); Bernard Hanotiau, *A New Development in Complex Multiparty-Multicontract Proceedings: Classwide Arbitration*, 20 ARB. INT'L 39 (2004)

<sup>332</sup> The South Carolina Supreme Court had determined that the loan contracts were silent in respect of class action. By contrast, on the U.S. Supreme Court the dissenting opinion by Justice Rehnquist found that that the contracts forbid class arbitration, while the opinion by Justice Breyer delivered for the Court essentially ducked the issue and held that it was for the arbitrator to determine whether the contract allowed class arbitration.

to?” If the contract is silent, the question was for the arbitrator, they said.<sup>333</sup> The state court decision was vacated and remanded for further consideration.<sup>334</sup>

It is of course possible that litigants might agree to give an arbitrator broad power to determine whether an arbitration clause includes the possibility of class action, as suggested by the Breyer opinion in *Bazzle*. However, such a conclusion is by no means obvious from the language of the relevant contracts, each of which was accepted by an individual borrower and provided for an arbitrator to be selected for all disputes arising from “this contract” – a reference to the singular, not plural. In commercial arbitration, the normal presumption has always been that parties agree to arbitrate with particular claimants or respondents, not with the whole world. Prior to *Bazzle*, the FAA did not authorize forced joinder of different arbitrations arising out of related claims<sup>335</sup> except as agreed by the parties<sup>336</sup> or when conducted pursuant to a statute that explicitly so

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<sup>333</sup> With respect to the implications of silence, one is reminded of the playful comparisons of European legal systems. In Germany, all which is not permitted is forbidden. In France, all which is not forbidden is permitted. To which some add that in Italy all which is forbidden is also permitted.

<sup>334</sup> A dissent by Chief Justice Rehnquist (joined by Justices O’Connor and Kennedy) argued that any imposition of class-wide arbitration contravened the parties’ contract as a matter of law. Justice Thomas dissented on the ground that the Federal Arbitration Act should not apply in state courts. Justice Stevens concurred in the judgment but dissented from its reasoning. Believing that the state court was correct as a matter of law that class action arbitration was permitted, Stevens would have affirmed the South Carolina decision. However, to avoid the absence of any controlling majority (only three out of nine Justices agreed with Rehnquist) Stevens concurred with Breyer in the judgment.

<sup>335</sup> See *Government of U.K. v. Boeing Co.*, 998 F.2d 68 (2nd Cir. 1993) (denying consolidation of arbitrations with Boeing and Textron, Inc. relating to contract with the British Ministry of Defense to develop an electronic fuel system).

<sup>336</sup> As between the same parties, Article 4(6) of the ICC Rules permits the Court to join claims until the signing of the Terms of Reference. Thereafter, addition of any new claim must be authorized by the arbitral tribunal. Compare Article 22(h) of the Arbitration Rules of the London Court of International Arbitration, permitting the arbitral tribunal to

provides.<sup>337</sup>

In passing, one might ask to what extent the result in *Bazzle* was influenced by the somewhat unusual language in the arbitration clause. Arbitration was to resolve not only contract-related disputes, claims or controversies, but also controversies arising from or relating to “the relationships that result from this contract.”

In one post-*Bazzle* case (on appeal as of this writing), a federal district court vacated an arbitral award that had interpreted a maritime transport contract to include a class action stipulation.<sup>338</sup> In finding “manifest disregard of the law” the court stressed both the maritime nature of the contracts (as to which expert testimony established a clear presumption against class actions) and the principle of New York law that when contracts are silent on an issue no agreement has been reached.<sup>339</sup>

As to the parties’ intent, the court might well have reached the right result. Given the long tradition of non-consolidation for international maritime arbitration, something quite special would be needed to justify a determination that the litigants granted the arbitrators authority to create a class action process.<sup>340</sup>

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allow third persons to be joined in an arbitration provided the third person has consented in writing to joinder.

<sup>337</sup> For example, Massachusetts Gen. Laws, c. 251, § 2A, calls for consolidation as provided in the Massachusetts Rules of Civil Procedure, which in Rule 42 permits joinder of actions “involving a common question of law or fact.” *New England Energy, Inc. v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988) has held that a federal court sitting in Massachusetts may order consolidation of related arbitrations pursuant to state statute. Compare California Code of Civil Procedure, § 1281.3.

<sup>338</sup> *Stolt-Nielsen S.A. v. Animalfeeds Int’l Corp.*, 435 F. Supp. 2d 383 (S.D.N.Y. 2006).

<sup>339</sup> *Id.* 387.

<sup>340</sup> In some instances (not applicable in *Animalfeeds*) a state statute might provide otherwise. See *New England Energy v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988), applying Massachusetts law. On the law concerning consolidation before *Bazzle*, see *United Kingdom v. Boeing*, 998 F.2d 68 (1993), discussed *supra*.

Even if the court might have been correct on contract interpretation, it is by no means certain that the arbitrators' mistake (if it was one) could be characterized as "manifest disregard" of law. The job of interpreting the parties' intent falls to the arbitrators. This task, which implicates mixed questions of fact and law, as well as evaluation of industry custom and practice, has always been entrusted to the arbitrators.<sup>341</sup>

A new twist was added by a Court of Appeals decision arising from customer disputes with a cable television provider. *Kristian v. Comcast Corp.*<sup>342</sup> held that a ban on class actions would invalidate the arbitration agreement,<sup>343</sup> but for the possibility of severing the class action prohibition. In an action for antitrust violations under both state and federal law, the Court applied a consumer protection rationale to conclude that the validity of the ban on arbitrability of the class action should be decided by courts rather than arbitrators. The Court allowed the arbitration to proceed only after striking down and severing this prohibition.

## 7. Consumer Transactions

### a) Legal Framework: Justice Astbury's Ghost

Unlike most of Europe, the United States provides no statutory scheme of general

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<sup>341</sup> Perhaps the court believed the arbitrators to have concluded that *Bazzle* dictated an interpretation of the contract which favored class arbitration. While this would indeed be a misreading of *Bazzle*, it seems more than unlikely that this particular panel (Gerald Aksen, Kenneth Feinberg and William Jentes) could have made that mistake. The court itself seems to have misstated *Bazzle*, suggesting that the interpretation of the agreement was for the arbitrator only "in the first instance" rather than as a final matter. *Id.* At 384.

<sup>342</sup> 2006 Westlaw 1028758 (1st Cir. 2006). See also *Discover Bank v. Superior Court*, 113 P. 3d 1100 (2005), declaring a class action waiver to be unconscionable and *Strand v. U.S. Bank N.A.*, 693 N.W.2d 918 (N.D. 2005), upholding such waivers.

<sup>343</sup> The arbitration clause itself provided (in bold face capitals!) that "there shall be no right or authority for any claims to be arbitrated on a class action or consolidated basis."

application to protect the interests of ill-informed consumers and employees who may be dispatched by an arbitration clause to seek uncertain remedies at inaccessible locations. For the past eighty years, a venerable but antiquated federal arbitration statute has stubbornly resisted distinctions between business and consumer arbitration, and has pre-empted state law that tried to protect the so-called little guy.

This does not mean, however, that courts cannot reach the same result (protecting consumer against abusive clauses) through ordinary contract principles. On a case-by-case basis, doctrines such as “unconscionability”, “excessive cost” and “mutuality of remedy” have been pressed into service to safeguard the interests of weaker parties to adhesion contracts.<sup>344</sup> Indeed, in one Alabama case the court found a loan agreement’s *Kompetenz-Kompetenz* clause in itself to indicate unconscionability.<sup>345</sup>

To a large extent, this American exceptionalism finds its roots in yet another national idiosyncrasy: the role of the civil jury in deciding contract claims, often beginning with a bias in favor of the consumer or employee (the proverbial “little guy”)

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<sup>344</sup> See e.g. *Kloss v. Jones* (discussed *infra*); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 891-92 (9th Cir. 2002) (limitation of damages and unilateral nature of the clause found unconscionable). See also *Ting v. AT&T*, 182 F. Supp. 2d 902, 927-36 (N.D. Cal. 2002). For a view questioning mainline consumer protectionist thought, see Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreements – With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251 (2006). For a contrasting view, see Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial*, 38 U. SAN FRANCISCO L. REV. 17 (2003). See generally, Edward Brunet, Richard Speidel, Jean Sternlight & Stephen Ware, *ARBITRATION LAW IN AMERICA: A CRITICAL ASSESSMENT* (2006), Chapter 5 (Consumer Arbitration).

<sup>345</sup> *American General Finance v. Branch*, 793 So. 2d 738 (2001). The in question provided, “Borrower and Lender further agree that all issues and disputes as to the arbitrability of claims must b of Such authority of the arbitrator to determine its [sic] own authority may also be resolved by the arbitrator”. *Id.*, 741. Other indicia of unconscionability included the breadth of the arbitration clause (applicable to every dispute or controversy) and the lender’s exemption from arbitration in certain cases.

against the manufacturers and employers. Concerned about the lack of rationality in jury verdicts, the business community sees arbitration as a more reasonable alternative to court litigation. This legal oddity has given to arbitration law in the United States an evolutionary path distinct from that of most of its trading partners.

Resistance to reform has come largely from arbitration's institutional establishment, which (perhaps understandably) perceives itself as providing a bulwark of adjudicatory evenhandedness. The fear is often expressed that any move toward a more modern arbitration law might open a Pandora's Box of upheaval, led by an unholy alliance of consumer advocates and plaintiffs' lawyers who see arbitration as a scam to protect crooked finance companies and abusive bosses.<sup>346</sup>

The institutional establishment's opposition to change brings to mind remarks attributed to Sir John Astbury, the English judge who declared the 1926 British General Strike to be illegal. As mobs took to the streets and workers rioted throughout Britain, some political leaders talked of conciliation and change. To which Astbury reportedly replied, "Reform? Reform? Are things not bad enough already?"<sup>347</sup>

#### b) Jurisdiction in Credit and Securities Operations

For better or for worse, the absence of any federal consumer protection regime for arbitration has engendered reactions at the state level. Two cases merit special attention, each one relating to a financial transaction in which the arbitration clause played a role in a scheme to take advantage of a relatively unsophisticated party.

One of the most creative efforts to protect weaker parties came out of Montana,

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<sup>346</sup> See e.g., John M. Townsed, *The Federal Arbitration Act is Too Important to Amend*, 4 INT'L ARB. NEWS 19 (ABA, Summer 2004).

<sup>347</sup> Attributed to Mr. Justice Astbury (1860-1939), who sat on the Chancery Bench from 1913 to 1929, and was elevated to the Privy Council in 1929.

which in *Kloss v. Jones*<sup>348</sup> attempted to impose public policy limits on the entirety of an arbitrator’s jurisdiction. In refusing to compel arbitration against a financial adviser accused of negligence and breach of fiduciary duty, the Montana Supreme Court held the arbitration clause to be an impermissible attempt to waive basic rights guaranteed by the Montana constitution.

*Kloss* bears out the adage that “hard facts can make difficult law” – or at least problematic rules. After a 95-year-old widow had been persuaded by her investment adviser to create a trust, the adviser proceeded to fund the trust by selling assets from her personal brokerage account. When the widow’s nephew learned of the sell-off, he helped her begin litigation against the adviser for fraud, breach of fiduciary duty and deceptive business practices. The adviser invoked the arbitration clauses contained in the account-opening documents, likely fearing a less than sympathetic hearing before a jury.

The Montana Supreme Court found that the arbitration clause involved a waiver of rights guaranteed by the Montana Constitution: access to courts and trial by jury. The arbitration clause, contained in a contract of adhesion, had purported to waive these “sacred” and “inviolable” rights.<sup>349</sup> This waiver was not within the weaker party’s “reasonable expectation” and thus was held to be unenforceable.

This avenue of attack is significant. The state court addressed waiver of

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<sup>348</sup> 310 Mont. 123, 54 P.3d 1 (2002), on reh’g 57 P.3d 41, cert. denied, 538 U.S. 956 (2003). For a rather harsh critique of *Kloss*, see Carroll E. Neesemann, *Montana Court Continues its Hostility to Mandatory Arbitration*, ABA DISPUTE RESOLUTION J. 22 (February/April 2003), suggesting that the decision “makes the failure to read a provision (any provision, not just an arbitration clause) in an adhesion contract a complete defense to enforceability.” Of course, in fact the Montana decision did not refer to “any provision” but concerned only waiver of constitutional rights not within the weaker party’s “reasonable expectation.”

<sup>349</sup> *Id.*, Special Concurrence by Nelson, at paragraph 55.



constitutional rights in general, rather than saying that an arbitration clause was *per se* unconscionable, thus running less risk of conflict with the Federal Arbitration Act (FAA). While the FAA implements a policy favorable to arbitration, it contains a significant (albeit unintended) escape hatch by providing that arbitration clauses are enforceable except “on such grounds as exist at law or in equity for the revocation of any contract.”<sup>350</sup> Since the United States has no general federal law of contracts,<sup>351</sup> one must look to state law for the basic common law grounds for contract revocability.

Some states have attempted to push revocability beyond classic common law defenses such as fraud and duress, and occasionally impose special grounds for revocability of arbitration clauses, usually within the context of consumer or employee protection legislation. Such legislation has been held invalid, however, to the extent the state targets arbitration for special burdens that would defeat the policy of the FAA.<sup>352</sup> In other words, a state might say that all contracts must be in capital letters, but could not say that only arbitration clauses must be in capital letters.<sup>353</sup>

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<sup>350</sup> 9 U.S.C. § 2.

<sup>351</sup> Sixty-five years ago in *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), the U.S. Supreme Court (attempting to prevent forum shopping between state and federal fora) stated, “Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state.” *Id.* at 78.

<sup>352</sup> For example, at one point Montana passed a law stating that an arbitration clause was revocable unless in capital letters and underlined. See *Doctor's Associates v. Casarotto*, 517 U.S. 681 (1996). Massachusetts also attempted (unsuccessfully) a similar restriction on securities arbitration. See *Securities Industry Assoc. v. Connolly*, 883 F.2d 1114 (1st Cir. 1989). For other attempts to rationalize the role of state arbitration law, see *Mastrobuono v. Shearson Lehman*, 514 U.S. 52 (1995); *Allied-Bruce v. Dobson*, 513 U.S. 265 (1995); *Volt v. Stanford*, 489 U.S. 468 (1989).

<sup>353</sup> The U.S. Congress, however, can and has passed legislation limiting arbitration on behalf of special interest groups. See *Motor Vehicle Franchise Contract Act*, § 11028, Pub. L. No. 107-273, 116 Stat. 1758 (enacted as 15 U.S.C. § 1226), sometimes known as the Bono Bill in recognition of its original sponsor the late Sonny Bono.

Here we return to our nonagenarian widow in Montana. When the court in *Kloss v. Jones* struck down the arbitration clause, it did not single out arbitration itself for attack. Rather the court applied principles of law “generally applicable to all contracts” in order to protect citizens against waiver of constitutional rights. Arguably, therefore, the refusal to enforce the arbitration clause did not run afoul of federal arbitration policy. *Kloss* serves as a reminder that an arbitrator’s power to address jurisdictional matters will be limited by public policy, which can always circumscribe the type of disputes that may be sent to arbitration.

A much less digestible decision recently came out of Kansas. Although the state Supreme Court had its heart in the right place (if courts have hearts anywhere), the reasoning remains highly problematic as a guide for the adjudication of future cases.

In *MBNA America Bank v. Credit*,<sup>354</sup> the Court vacated an arbitration award used to collect on a credit card debt of one Ms. Loretta K. Credit. The Bank had been unable to produce an arbitration agreement, and reason existed to suspect that the arbitration service provider might have been showing a systematic sympathy to financial institutions inconsistent with the impartiality one expects of arbitral institutions.

To reach its decision, the Court need only have noted that the bank had provided no evidence of an agreement to arbitrate. Unfortunately, however, the court added dictum stating, “When the existence of the [arbitration] agreement is challenged, the issue must be settled by a court before the arbitrator may proceed.” The assertion has no

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<sup>354</sup> 281 Kan. 655 (2006), 132 P.3d 898 (2006). To avoid reader confusion, it should be mentioned that “Credit” was the name of the individual borrower. See generally Christopher Drahozal, *Jurisdiction of Arbitrators to Decide Their Own Jurisdiction*, 17 WORLD ARBITRATION & MEDIATION REPORT 296 (September 2006).

foundation in logic, policy or law.<sup>355</sup>

While it would have been outrageous for the bank to have the award confirmed without producing the arbitration clause, a court can always address this matter at the award enforcement stage. Or, the question could be raised earlier, in the context of a motion to compel arbitration (by the bank) or to stay court proceedings (by the borrower). However, to require an arbitration to stop merely because arbitral jurisdiction has been challenged departs from the very fundamentals of sound arbitration law and practice.

#### 8. The Next Step

Where these cases leave us for the future is not entirely certain. The decisions in *Howsam* and *Bazzle* (like the decision in *Pacificare* discussed earlier) are plausible. However, the presumptions about the parties' intent may not be self-evident. If a case is not eligible for arbitration later than six years following the broker's misbehavior, can one even speak of an "arbitrator" for an arbitration begun in the seventh year? If a contract prohibits arbitrators from awarding the two-thirds part of treble damages that most people consider punitive, can arbitrators give themselves this power merely by saying that these damages are really compensatory? If an agreement to arbitrate is intended to provide bilateral dispute resolution, can an arbitrator turn the proceedings into a multilateral process? Do the cases presume their own conclusions and imply that arbitrators can create authority simply by defining contract terms that accord with the desired scope of arbitral power?

The heart of the jurisdictional dilemma is that language, while often ambiguous, is not infinitely plastic. Some contract terms with a jurisdictional significance may well fall

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<sup>355</sup> Had the court purported to apply a Kansas statute, the matter might have been less serious. The Federal Arbitration Act, however, provided the applicable procedural law.

within the spectrum of matters the parties intended the arbitrator to interpret. Others, however, do not. Much depends on the precise context of the jurisdictional issues, which are increasingly (and unfortunately) called “arbitrability questions” in many decisions.<sup>356</sup>

To illustrate, the Second Circuit has held that an ICC arbitrator may address claims for costs incurred in a court action allegedly brought in breach of an arbitration clause.<sup>357</sup> This is hardly remarkable. In reaching the conclusion that the parties bargained to arbitrate “questions of arbitrability,”<sup>358</sup> the Court simply noted that the parties had signed a broad arbitration clause, which would be given effect under the ICC Rules.<sup>359</sup>

Let us change the facts a bit, however, and return to our earlier scenario about the constitution of the arbitral tribunal by an improper appointing authority. Imagine that a contract provides for arbitration under the rules of the American Arbitration Association, but the claimant files its request for arbitration with the International Chamber of

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<sup>356</sup> American courts often use “arbitrability” interchangeably with “jurisdiction.” This is regrettable, since it blurs useful distinctions between an arbitrator who may not hear a case because of the parties’ drafting choice, and an arbitrator lacking power because non-waivable legal norms prohibit him to consider the disputed subject matter. It is true that when arbitrators lack jurisdiction, a dispute is not arbitrable. However, the term would be better reserved to instances where the subject matter of a dispute has been declared off limits by the relevant legal system. In this sense, antitrust and securities disputes were traditionally non-arbitrable in the United States, and employment and consumer controversies remain non-arbitrable in many parts of Europe, at least under pre-dispute arbitration agreements.

<sup>357</sup> *Shaw Group v. Triplefine International Corp*, 322 F. 3d 115 (2d Cir. 2003); *Stone & Webster v. Triplefine International Corp.*, 118 Fed.Appx. 546 (2d Cir. 2004). The arbitration clause at issue covered disputes “concerning or arising out of [the parties’] Agreement.”

<sup>358</sup> *Id.* At 125.

<sup>359</sup> In light of the Court’s citation to Article 6(2) of the ICC Rules, there may have been some confusion in the court about the difference between the ICC Court and the arbitrators themselves. The former has power only to make a preliminary (*prima facie*) determinations of jurisdiction, while the in-depth decisions are reserved for the arbitrator.

Commerce, which it perceives as likely to appoint an arbitrator predisposed to claimant's case. It is difficult to see how an ICC arbitrator could render a final and binding award, absent modification of the parties' agreement.<sup>360</sup>

Or, to invoke another example, let us envisage two merchants who agree to arbitrate disputes arising out of the sale of fruit. The arbitrators might rule on whether "fruit" was used in the botanical sense (the contents of any developed seed plant ovary) to include pecans as well as apples.<sup>361</sup> However, it is not at all evident that a court, when asked to enforce an award or compel arbitration, should accept an arbitrator's determination that "fruit" includes typewriters.

The matter would not be so serious if the arbitrators' jurisdictional decision was only preliminary, subject to a clearly understood right of post-award judicial review. Unfortunately, the recent Supreme Court decisions on arbitration do not make clear (at least to this author) that a second look by the judiciary is in all events guaranteed.

Much of the work in allocating tasks between courts and arbitrators will turn on characterization of the analytic task. One formulation might ask, "May persons who call

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<sup>360</sup> The hypothetical is presented only by way of illustration, the author being well aware that the ICC's excellent personnel and efficient internal controls would make such an attempt at fraud highly unlikely.

<sup>361</sup> In this connection, one remembers a late 19th century customs case in which the U.S. Supreme Court held that in common parlance tomatoes were vegetables rather than fruit, and thus not free of import duty under a free list for "fruits," but taxed at 10 % ad valorem under a tariff on "vegetables." See *Nix v. Hedden*, 149 U.S. 304 (1893). Justice Gray noted that "botanically speaking tomatoes are the fruit of a vine, just as are cucumbers, squashes, beans and peas." However, in a breathtaking culinary excursion that makes one hungry just to read it, he continued that "in the common language of the people, whether sellers or consumers of provisions, all these are vegetables which are grown in kitchen gardens and which, whether eaten cooked or raw, are, like potatoes, carrots, parsnips, turnips, beets, cauliflower, cabbage, celery and lettuce, usually served at dinner in, with or after the soup, fish, or meats which constitute the principal part of the repast, and not, like fruits generally, as dessert." *Id.*

themselves arbitrators determine their jurisdiction free from judicial review?” An affirmative answer would be conceptually problematic, implying that a piece of paper labeled “award” could be enforced without regard to the legitimate mission of the alleged arbitrator.

An alternate phraseology could pose the jurisdictional question differently: “By agreeing to arbitrate, did the parties intend to waive their right to have courts determine a particular jurisdictional precondition to arbitration (such as time bars) or a particular substantive question (such as liability for costs of litigation begun in breach of the arbitration agreement)?” Answering the latter question would require a factual inquiry into the parties’ true intent. In some instances the consent may reveal itself only through an explicit agreement. In other circumstances, presumptions and inferences might suffice. On this matter, considerable analytical toil remains.

### **Conclusion: Costs and Benefits**

The principle known as *Kompetenz-Kompetenz* addresses a very narrow issue, albeit one of critical importance. The question is not whether the arbitrator possesses authority to decide the merits of a particular matter, but *who* (judge or arbitrator) gets to answer that preliminary question.

Most legal systems seem to accept that arbitrators may rule on their own jurisdiction and continue the proceedings, provided no court of competent jurisdiction tells them to stop. Far less consensus exists on the effect that an arbitrator’s jurisdictional ruling will have in court, when judges can be asked to vacate an award, to enjoin an arbitral proceeding or to hear a case notwithstanding an allegedly valid arbitration clause. For example, judges might be asked to vacate an award, or to declare an arbitration clause invalid before proceedings begin.

The various ways that different countries address the matter contain their own relative costs and benefits. In all events, two issues lie in most challenges to an arbitrator's jurisdiction: (i) the timing of judicial intervention to address questions related to arbitral jurisdiction; and (ii) the effect of any jurisdictional rulings that arbitrators might make.

The first inquiry concerns the moment for the judicial consideration of jurisdictional questions. Some point (or points) must be fixed in the arbitral process for courts to entertain motions concerning arbitral authority, with a view to preventing or to correcting an excess of jurisdiction. The second question relates to whether courts should ever defer, and if so in what circumstances, to arbitral determinations related to matters and parties subjected to arbitration. The analysis is one of contract, with a focus on the basics of party intent.

On the matter of timing, there is much to commend the French rule, which leaves most judicial intervention until after the award, when the arbitrator's decision is known. The "delayed review" principle limits opportunities for dilatory measures that might derail or sabotage an arbitration. Moreover, postponing jurisdictional motions may preserve judicial resources. Judges need not get involved if the case is settled or decided in a way acceptable to both sides. If the case does not settle, judges may receive the benefit of an arbitrator's discussion and findings on the jurisdictional questions, particularly for international cases where reasoned awards remain the norm.

The French rule has its cost, however. A person who never agreed to arbitrate may need to hedge bets by taking part in a bogus arbitration, at substantial cost of time and money. Herein lies the proverbial fly in the Gallic ointment: innocent respondents

must wait until the end of proceedings to challenge even the most obvious jurisdictional defects.

While frivolous attacks on arbitral authority are sometimes used as a delaying tactic, unwarranted arbitrations also pose their own risk. Believing its chances better in arbitration than in court, a claimant playing hard ball might bring an arbitral proceeding with weak jurisdictional foundation, hoping for an easy win that will exert undue settlement pressure.

Out of fairness, a rapid and summary mechanism should exist to permit courts to halt proceedings when the arbitration clause is manifestly void or clearly against public policy.<sup>362</sup> Without some evidence of a valid arbitration agreement, the respondent's burden of costly hearings (a possible default award being the only alternative) usually outweighs any societal benefit from reducing dilatory tactics in other cases. An arbitration would go forward only if a court has been *prima facie* satisfied of the validity and application of the arbitration clause (no forgery or gun at the head during signing), subject to more extensive review at the award stage.<sup>363</sup>

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<sup>362</sup> The suggestion here is for something equivalent to the summary process (*examen sommaire / summarische Prüfung*) of a Swiss court when asked to appoint an arbitrator. See LDIP, Article 179(3).

<sup>363</sup> For a somewhat contrasting view, see Pierre Mayer, *L'Autonomie de l'arbitre dans l'appréciation de sa propre compétence*, 217 RECUEIL DES COURS 320 (Académie de droit international de La Haye 1989), at 346, suggesting that courts seized of a case prior to commencement of arbitration should address jurisdiction fully, not limiting the review to determining if the clause is “manifestly” void. *Id.*, para. 15. (*On se demandera s'il est très logique pour le droit français d'obliger le juge étatique, saisi d'une demande au fond par une partie au mépris d'une convention d'arbitrage, à se déclarer incompétent sans pouvoir constater, sauf si elle est 'manifeste', la nullité de la convention.*) Professor Mayer takes a different view when the arbitration has already begun, expressing concern that the greater risk remains dilatory actions (*Id.*, at 347, para. 17).



Such a process could be combined with greater use of court-imposed sanctions (monetary penalties) to discourage frivolous jurisdictional challenges, an option increasingly considered by American judges frustrated with groundless motions to vacate awards.<sup>364</sup> No good reason exists why, as a matter of policy, similar measure should not be available to moderate improper motions to compel litigation or to stay arbitration.

Addressing the second matter (judicial deference to arbitrators' rulings on their own authority) calls for considerable nuance and balance. In considering what to do with *Kompetenz-Kompetenz* clauses, legal system must navigate between two extremes. One is a lack of judicial rigor in examining the validity of such agreements. The other is a blanket over-inclusive rejection of all such clauses, no matter how clearly the evidence might support their validity in a given factual context.

Alleged grants of jurisdictional power to arbitrators must be considered with caution. A danger always exists that judges lacking analytic rigor will be tempted to clear their dockets through sloppy interpretation of the parties' intent, thereby denying one side its day in court. Arbitrators should never be given jurisdiction on the basis of a mere contract recital (such as "the arbitrator has jurisdiction over all questions") without verifying the true consent of the party sought to be bound. Even the best of rules may be misunderstood. Recitation of a "pro-arbitration" mantra often leads to cloudy thinking.

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<sup>364</sup> *Dominion Video v. Echo Star Satellite*, 430 F.3d 1269 (10th Cir. 2005) (sanctions imposed on party bringing baseless challenge to award confirmation); *Harbert International v. Hercules Steel Co.*, 441 F.3d 905 (11th Cir. 2006) (motion to vacate for "manifest disregard of the law" led to stern warning that the court was "ready, willing and able" to impose sanctions on parties who "attempt to salvage arbitration losses through litigation that has no sound basis in the law applicable to arbitration awards."); *CUNA Mutual Insurance Society v. Office & Professional Employees Int'l Union*, 443 F.3d 556 (7th Cir. 2006) (warning that courts will not permit "spinning out the arbitral process unconscionably through the filing of meritless suits and appeals.")

Such potential misapplication must be considered in balancing the costs and the benefits of any legal rule.

That being said, the concern that contracts will be misinterpreted need not lead to a public policy that bans all forms of jurisdictional clauses in arbitration. Legitimate bargains should not be trumped by fears of occasional abuse. From a commercial perspective, business managers may wish to reduce the prospect of judicial intervention (particularly for international transactions) by giving an arbitral tribunal the final say on a jurisdictional issue. Respecting such agreements furthers fundamental respect for the parties' legitimate expectations.

While not entirely free from doubt, the American cases are probably getting things more right than wrong. While exceptions exist, judges in the United States seem to be asking the correct question: what did the litigants actually agree to arbitrate? On public policy issues, of course, arbitrators can never be empowered to make binding determinations.

Judicial review will in all events involve examination of the validity of the initial agreement, allegedly granting the arbitrators power on questions related to their authority. Such agreements will be most plausible when related to jurisdictional matters such as the time limits, scope of procedural powers and range of issues submitted to arbitration.

When one side challenges the very existence of an arbitration clause, the arbitrators' authority does not always yield to routine presumptions. Many cases present their own peculiar facts and issues. Was the arbitration clause forged or signed with a gun at the head? Did the corporate officer who executed the contract have power to commit the company? With respect to such questions, arbitrators can make binding

rulings only if the supervisory court has been satisfied of the parties' informed and explicit consent (normally in the form of a distinct second agreement) to submit the precise jurisdictional question to arbitrator.

In all these lines of inquiry, legal maxims and phrases on arbitral jurisdiction can facilitate analysis by communicating general norms quickly. The expressions lose their value, however, if pressed into service with excessive formalism, or pursuant to the type of thoughtless mimicry that parrots perform. When lawyers invoke contract recitals divorced from context, much as wizards incant magic words, the result is a voodoo jurisprudence that has no place in a healthy legal framework for arbitration.

As in most areas of the law, the articulation of specific standards that work in practice will require thoughtful analysis by policy-makers and practitioners alike. The goal of such efforts remains an arbitral system that gives effect to the parties' legitimate expectations about what questions are subject to final and binding private adjudication.

## Appendix: Jurisdiction in Practice: Selected Scenarios

1. A claim against a “non-signatory” company<sup>365</sup> might be brought on the basis of an arbitration clause signed by a corporate affiliate, either offensively (to reach assets of the corporate parent) or defensively (to permit a parent corporation to avoid jury trial), on theories such as agency (express or implied), alter ego, or piercing the corporate veil.<sup>366</sup>

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<sup>365</sup> The term “non-signatories” remains useful shorthand to describe persons whose relationship to the arbitration is unclear at first blush. The term can be misleading, however, in its implication that a duty to arbitrate must derive from signed documents. Better taxonomy might classify such cases as involving “un-mentioned” parties. Unsigned arbitration agreements can be valid, *inter alia* under New York Convention Article II (exchanges of letters), as well as agreements subject to the procedural law of countries that dispense with a signature requirement, including England (Arbitration Act of 1996 § 5) and the United States (FAA § 2, which refers only to a “written provision”). See generally, James M. Hosking, *Non-Signatories and International Arbitration in the United States: The Quest for Consent*, 20 ARB. INT’L 289(2004).

<sup>366</sup> For theories used to bind “non-signatories” see Thomson-CSF v. American Arbitration Association, 64 F. 3d 773 (2d Cir. 1993). See also Intergen v. Grina, 344 F. 3d 134 (1st Cir. 2003), in which Judge Selya noted the “abecedarian tenet that a party cannot be forced to arbitrate if it has not agreed to do so.” Unlike many other cases involving corporate affiliates (where either claimant or respondent will have agreed to arbitrate), Intergen involved litigation between two parent entities, neither of which had signed an arbitration clause. Compare *Bridas v. Turkmenistan*, 447 F.3d 411 (5th Cir. 2006), finding that government manipulation of an oil company made it the state’s alter ego. By contrast, in *Sarhank v. Oracle Corp.*, 404 F.3d 657 (2d Cir. 2005) the Court of Appeals decided that a parent should not answer for the obligations of its subsidiary pursuant to an arbitration clause signed by the latter. Citing “customary expectations of experienced business persons” the Court vacated a decision recognizing the Egyptian award and remanded the case for a finding on whether, as a matter of fact, the parent’s actions or inactions had given the subsidiary apparent or actual authority to consent to arbitration on its behalf. For reasons not fully explained, the Court assumed such determination would be made under “American contract law or the law of agency.” Similarly, an English court rejected piercing the corporate veil in *Republic of Kazakhstan v. Istil Group*, 2006 WL 1020597 (2006), [2006] EWHC 448 (Comm.) QBD, applying the 1996 Arbitration Act, § 67, to vacate an award against Kazakhstan for lack of substantive jurisdiction. For a related problem involving the overlap between the Russian Federation and the Russian Government, see *Compagnie Noga v. Russian Federation*, 361 F. 3d 676 (2d Cir. 2004).

2. Assertions of arbitral jurisdiction might invoke principles of estoppel.<sup>367</sup>
3. A duty to arbitrate might be based on trade usage, absent an explicit agreement,<sup>368</sup>
4. Corporate affiliates might be joined to an arbitration under what has been called “group of companies” doctrine.<sup>369</sup>
5. An award might be rendered by an arbitral tribunal whose appointment contained irregularities.<sup>370</sup>
6. An employer might assert the right to arbitrate on the basis of an “exchange” of letters, contested by the employee.<sup>371</sup>

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<sup>367</sup> *JML Industries v. Stolt-Nielsen*, 387 F. 3d 263 (2d Cir. 2004). Charterers brought anti-trust action against owners of “parcel tankers” used in chemical transport. Owners permitted to invoke so-called “ASBATANKVOY” arbitration clause (used in affreightment of liquefied products) contained in charter contracts signed by owners’ subsidiaries, given intertwining of issues to be resolved in arbitration and issues in agreements containing arbitration clause; *Fluor Daniel Intercontinental v. General Electric Co.*, 1999 WL 637236 (SDNY, 20 August 1999), invoking estoppel principles to hold that signatories of arbitration clauses were estopped from refusing to arbitrate with GE entities that sought to arbitrate issues intertwined with the contracts containing the arbitration clause;. In *Re Vesta Insurance Group*, Supreme Court of Texas No. 04-0141 (17 March 2006) (dispute between insurance company and its agent; arbitration of tortious interference claims between signatory to arbitration agreement and affiliates of another signatory).

<sup>368</sup> See BGH, Urt. V. 3.12.1992, III ZR 30/91, discussed in 1993 *DEUTSCHE ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT* 465 (commentary, Klaus Peter Berger) where the *Bundesgerichtshof* said that a duty to arbitrate might be implied through custom in the sheepskin trade.

<sup>369</sup> See *Isover St. Gobain v. Dow Chemical France et al.*, ICC Case 4131 (1982), ICC COLLECTION OF ARBITRAL AWARDS, Volume I: 1974-85 (Sigvard Jarvin & Yves Derains, eds., 1990), upheld by the Paris Cour d’appel, 21 October 1983, 1984 *REV. ARB.* 98; English language extracts in 9 *ICCA YEARBOOK COMMERCIAL ARBITRATION* 132 (1984). English law has rejected the “group of companies” doctrine, and requires evidence of agency before joinder of related companies. See *Peterson Farms Inc. v. C&M Farming Ltd.*, [2004] EWHC 121, [2004], 1 *Lloyd’s Rep* 603, 2004 WL 229138 (4 February 2004, Q.B. Div., Commercial Court).

<sup>370</sup> See *Encyclopaedia Universalis S.A. v. Encyclopaedia Britannica*, 2003 WL 22881820 (SDNY, December 2003). The tribunal’s presiding arbitrator had been appointed by the Tribunal de commerce in Luxembourg, as provided in the arbitration clause. However, this Luxembourg appointment was not preceded by an attempt to select a chairman by the party-nominated arbitrators, which was another requirement of the parties’ agreement.

<sup>371</sup> See *Dynamo v. Ovechkin*, 412 F. Supp 2d 24 (D.D.C. 2006), involving hockey prodigy Alexander Ovechkin who had played with the Dynamo Club in Moscow before

7. After an insurance company and its policyholder settle a dispute that had been subject to arbitration, they disagree on implementation of the settlement agreement. Whether the arbitrator has power to decide the subsequent quarrel will depend on the terms of the settlement's dispute resolution clause.<sup>372</sup>
8. If a dispute among law partners is submitted to arbitration, does the arbitrator have authority to declare forfeiture of the withdrawing partner's capital interest?<sup>373</sup>
9. Does an arbitrator might lack jurisdiction because the matter has already been decided by another arbitral tribunal?<sup>374</sup> When an arbitration clause gives rise to multiple arbitrations, will principles of *res judicata* and issue preclusion bar later arbitrators from deciding particular questions?<sup>375</sup>

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signing with the Washington Capitals to play in the National Hockey League. In the United States, the federal district court refused to recognize an award by the Arbitration Committee of the Russian Ice Hockey Federation that prohibited Ovechkin him for playing for the American team. No arbitration agreement resulted from the Russian Club's offer that failed to elicit any "matching letter" from the player.

<sup>372</sup> For example, arbitrators with power to decide controversies arising from one specific transaction would not necessarily have authority to decide disputes arising from a prior or subsequent commercial relationship between the same parties.

<sup>373</sup> See decision by Judge Mosk in *O'Flaherty v. Belgum*, 11 Cal. App. 4th 1004, 9 Cal. Rptr. 3d 286 (2004), holding that an arbitrator exceeded his authority (as granted in the partnership agreement) by declaring forfeiture of a withdrawing partner's capital account.

<sup>374</sup> Determinations about *res judicata* and issue preclusion (what the French might call *force de chose jugée* and *opposabilité* and the Germans *Rechtskraft*) do not yield to facile analysis. In the real world, difficult factual nuances often arise with respect to (i) identity of parties and (ii) identity of action, both prerequisites to preclusion. On the one hand, a losing party should not be permitted to begin another arbitration in the hope of getting a better result. On the other hand, due process requires that one company should not be denied an opportunity to vindicate a claim simply because similar issues were litigated by another entity. Particularly difficult issues arise when the same arbitration clause gives rise to multiple proceedings, or when in the middle of an arbitration one party sells a business unit that might later find itself seeking to assert related claims.

<sup>375</sup> For an example of multiple arbitrations arising from a single clause, see *Admart AG v. Stephen & Mary Birch Foundation*, 457 F. 3d 302 (3d Cir. 2006). A court in the United States was asked to enforce an award rendered ten years earlier in a matter where a second arbitral tribunal was deciding questions related to the same parties and the same dispute, left open by the prior award. In the initial arbitration, the buyer of an open air art exhibition was denied the right to rescind the purchase. The second tribunal was asked to ascertain alleged damage to the purchased art works, which damage would have reduced the price ultimately borne by the buyer. Determining damage, however, implicated an examination of the art work which the first award had purported to preclude, at least as a precondition to payment of the price.

10. A breach of contract action asserts recovery of punitive damages. The arbitrator's power to include a non-compensatory element in the award could depend on the terms of the parties' agreement,<sup>376</sup> the applicable law<sup>377</sup> or a combination of both as seen through the lens of the applicable institutional arbitration rules.<sup>378</sup> The same might be said of claims for compound interest or for an award denominated in a currency other than the one of the controverted transaction.<sup>379</sup>
11. If a court in Country X has already begun to hear a matter when an arbitration begins in Country Y, does the arbitral tribunal have the authority to proceed? Or do notions of *lis pendens* require the work to be suspended.<sup>380</sup>
12. Is an arbitrator deprived of authority because the stronger party, in order to maximize its litigation options,<sup>381</sup> has imposed an arbitration clause that binds one side only to arbitrate?<sup>382</sup> What role does "mutuality of remedy" play in arbitral jurisdiction?<sup>383</sup>

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<sup>376</sup> See *Pacificare Health Systems v. Book*, 538 U.S. 401 (2002).

<sup>377</sup> *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52 (1995), interpreting the New York state rule in *Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354 (1976).

<sup>378</sup> The AAA International Arbitration Rules exclude punitive damages unless the applicable statutes "requires" that the compensatory damages be increased in a specified manner. Arguably, adoption of the AAA International Rules might be deemed a waiver of the right to request punitive damages in jurisdictions that permit parties to enter into such exclusions. See e.g., *Drywall Systems v. ZVI Construction*, 435 Mass 664 (2002) (relating to the consumer protection provisions of M.G.L. Ch. 93A § 11), in which the court stated that "[p]arties who prefer to exclude multiple damage claims ... from arbitration may do so by the terms of their agreement to arbitrate, or they may elect to waive them entirely." *Id.* At 671, n. 5. In the instant case (a domestic construction dispute) no such waiver was found.

<sup>379</sup> *Lesotho Highlands Development Authority v. Impreglio SpA* [2005] UKHL 43 (30 June 2005).

<sup>380</sup> See *Fomento de Construcciones y Contrats S.A. v. Colon Container Terminal S.A.*, Swiss Tribunal fédéral, 14 mai 2001 (1e Cour Civile), BGE 127 III 279/ATF 127 III 279; discussed *supra*.

<sup>381</sup> From the perspective of litigation strategy, an institution would normally want to reserve an option either to elect arbitration or to go to court. A unilateral right permits significant flexibility with respect to hard-to-forecast elements such as whether extensive document discovery (available in court to a greater extent than in arbitration) will be beneficial in a particular dispute.

<sup>382</sup> See *Circuit City v. Adams*, 279 F. 3d 889 (9th Cir. 2002) (arbitration clause "unconscionable" for "unilaterally" forcing employee to arbitrate). By contrast, when employees and consumers (rather than employers and manufacturers) benefit from a right to opt-out of arbitration (through signing a form within thirty days of being hired),

13. If arbitrators are asked to consolidate arbitration of claims arising from separate contracts or transactions, the power to do so may depend on what the parties' agreement or the applicable arbitration rules say on the matter.<sup>384</sup> A similar question may arise prior to the commencement of the proceedings, with courts asked to make a declaratory pronouncement about whether the arbitrators will have authority to consider the matter at all.<sup>385</sup> Sometimes arbitration rules will address the matter, at least in part,<sup>386</sup> but in most cases remain silent on the matter.<sup>387</sup>

14. May an arbitrator award attorneys' fees? Does the answer depend on the applicable

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arbitration obligations have been upheld. See *Circuit City v. Ahmed*, 283 F. 3d 1198 (9th Cir. 2002); *Circuit City v. Najd*, 294 F. 3d 1104 (9th Cir. 2002).

<sup>383</sup> Some courts invoke the principle of "mutuality" (of remedy or of obligation) to invalidate arbitration agreements. The theory is that if both parties are not bound, then neither is bound. See *Hull v. Norcom, Inc.*, 750 F.2d 1547 (11th Cir. 1985) (employer retained right to go to court). Other courts have enforced optional clauses. See *Pittalis v. Sherafettin* [1986] 1 QB 868, [1986] (landlord/tenant rent review); *Law Debenture Trust Corp. v. Elektrim*, [2005] 1 All E.R. 476; 2005 WL 1630790; *Sablosky v. Gordon*, 73 N.Y.2d 133, 138-39 (N.Y. 1989). American financial institutions have used unilateral clauses to enhance litigation flexibility and reduce the prospect of what they perceive as biased jury proceedings. See generally William W. Park, *Arbitration in Banking and Finance*, 17 ANN. REV. BANKING L. 213, 251-253 (1998); William W. Park, *Jurisdictional Issues in Financial Arbitration*, Festschrift für Otto Sandrock zum 70. Geburtstag 745 (Klaus Peter Berger, ed. 2000).

<sup>384</sup> See *Shaw's Supermarkets v. United Food*, 321 F. 3d 251 (1st Cir. 2003), a union grievance arbitration (concerning whether union members should take leaves of absence when on a negotiation committee) in which arbitrators were given the right to consolidate three collective bargaining arbitrations brought by the same union.

<sup>385</sup> See *Employers Insurance Company of Wausau v. Century Indemnity Company*, 2006 WL 851643 (7th Cir. 2006). Allstate Insurance and Employers Insurance had entered into reinsurance contracts with Century Indemnity, which requested a consolidated arbitration of its claims against Employers and Allstate, as well as several other companies. Although holding that the question of consolidation was for the arbitrators, the Court of Appeals also determined that each side would appoint only one arbitrator, thus giving a substantial practical nudge to consolidation. Had the Court ordered constitution of two or more tribunals, it would not have been self-evident which would have ceded its work to the other.

<sup>386</sup> See LCIA Rules 22.1(h).

<sup>387</sup> There may, of course, be institutional practices (ICC practice) or rules with respect to judicial consolidation. See *New England Energy v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988) (allowing consolidation under Massachusetts law). Compare *United Kingdom v. Boeing*, 998 F. 2d 68 (2nd Cir. 1993) (consolidation denied).



law, the norms of the arbitral situs, arbitration rules, or some combination thereof?<sup>388</sup>

15. Related to consolidation, arbitrators in the United States sometimes face the question of whether they are authorized to direct “class action” proceedings for similar claims arising that would normally yield individual recoveries too small to make arbitration economically viable.<sup>389</sup>

16. Arbitration under investment treaties might raise the following jurisdictional issues.<sup>390</sup>

- A foreign investor might bring an arbitration claiming indirect expropriation by a country whose courts allegedly denied the investor a fair trial. In order for the arbitrators to hear the case, the alleged judicial misbehavior will need to fit within the definition of governmental “measures” covered by the relevant investment treaty.<sup>391</sup>

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<sup>388</sup> See e.g., *CIT Project Finance v. Credit Suisse First Boston*, 799 NYS2d 159, 2004 WL 2941331 (2004), discussed *supra*, holding arbitrators without power to grant attorneys’ fees notwithstanding application of Article 31 of the AAA International Rules, which provides for “the reasonable costs for legal representation of a successful party”. See also *PaineWebber v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996); *Shaw Group v. Triplefine Int’l Corp.*, 322 F.3d 115 (2d Cir. 2003); *Stone & Webster v. Triplefine International Corp.*, 118 Fed.Appx. 546 (2d Cir. 2004). For another aspect of the problem of attorneys’ fees in arbitration, see Christopher R. Drahozal, *Arbitration Costs and Contingent Fee Contracts*, 59 VAND. L. REV. 729 (2006)

<sup>389</sup> See *Green Tree Financial v. Bazzle* 539 U.S. 444 (2003) discussed *supra*. A recent Court of Appeals decision held that a ban on class actions would invalidate the arbitration agreement but for the possibility of severing the class action prohibition. See *Kristian v. Comcast Corp*, 2006 Westlaw 1028758 (1st Cir. 2006), an action for antitrust violations under both state and federal law arising from customers’ dispute with a cable television provider. Under what might best be called a public policy (consumer protection) analysis, the decision concluded that the validity of the ban on arbitrability of the class actions should be decided by courts rather than arbitrators. The Court struck down and severed the ban, and only then permitted arbitration to proceed. See also *Discover Bank v. Superior Court*, 113 P. 3d 1100 (2005), declaring a class action waiver to be unconscionable and *Strand v. U.S. Bank N.A.*, 693 N.W.2d 918 (N.D. 2005), upholding such waivers.

<sup>390</sup> See generally, Pierre Lalive, *Some Objections to Jurisdiction in Investor-State Arbitration*, in INTERNATIONAL COMMERCIAL ARBITRATION: IMPORTANT CONTEMPORARY QUESTIONS 376 (2002 ICCA Congress, London). Professor Lalive lists a half dozen categories for jurisdictional challenge in investor-state arbitration: nationality, the nature of an “investment”, assignment, absence of prior “friendly negotiations”, non-exhaustion of local remedies, and a fork in the road between a local and international forum.

<sup>391</sup> *Loewen Group, Inc. v. U.S.A.*, ICSID Case No. ARB (AF)/98/3, Interim Award on Jurisdiction, 5 January 2001.

- A host state might bring a counterclaim against the foreign investor or a company related to the investor. Would the arbitral tribunal constituted to hear the claim have authority to hear the counterclaim as well?<sup>392</sup>
- There might be an issue related to the nationality of the claimant. Does the arbitral tribunal have jurisdiction to hear the claim when an investor possesses dual nationality, including citizenship in the host state?<sup>393</sup> What is the arbitrator's power when the surviving entity in an investor's reorganization is incorporated in the host state?<sup>394</sup>
- A host state might assert that the treaty's definition of "investment" excludes certain categories of property (contract rights to build a factory), or requires that the original investor continue to hold shares of a company whose property was expropriated (rather than sell in order to mitigate damages). Or there may be a question of whether the arbitrator's jurisdiction covers disputes in which the state acts as a contracting party.<sup>395</sup>
- A host state might assert that the treaty's jurisdiction does not cover tax claims.<sup>396</sup>

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<sup>392</sup> *Saluka Investments B.V. v. Czech Republic*, Decision on Jurisdiction (UNCITRAL Rules, Netherlands-Czech BIT, 7 May 2004), rejecting jurisdiction over counterclaim without deciding on the relationship between claimant Saluka and another company of the Japanese merchant banking group (Nomura) with which it was affiliated.

<sup>393</sup> Decision on Jurisdiction in the case of *Champion Trading Company, Ameritrade International Inc., James T. Wahba, John B. Wahba, Timothy T. Wahba v. Arab Republic of Egypt*, Case No. ICSID ARB/02/9 (21 October 2003). On nationality in investment arbitration, see generally, Robert Wisner and Nick Gallus, *Nationality Requirements in Investor-State Arbitration*, 5(6) J. WORLD INVESTMENT AND TRADE 927 (2004); Anthony Sinclair, *Nationality of Individual Investors in ICSID Arbitration*, [2004] INT. A.L.R. 191. See also decision in *Wena Hotels v. Egypt*, Award (2000) reproduced 41 I.L.M. 896 (2002); Annulment Decision reproduced 41 I.L.M. 93 (2002). In *Sedelmayer v. Russia*, a tribunal constituted under the German-Russian BIT addressed the question of whether the corporate veil should be pierced when investor and owner had different nationalities.

<sup>394</sup> *The Loewen Group, Inc. & Raymond L. Loewen v. U.S.A.*, ICSID Case No. ARB (AF)/98/3, Final Award 26 June 2003.

<sup>395</sup> Sophie Lemaire, *Treaty Claims et Contract Claims: La Compétence du CIRDI à l'épreuve de la dualité de l'état*, 2006 REV. ARB. 353 (2006).

<sup>396</sup> See e.g., *Ecuador v. Occidental Exploration & Production Co.* [2006] EWHC 345 (English High Court), 2006 Westlaw 690585; UNCITRAL arbitration (LCIA Administered Case No. UN 3467), 1 July 2004 (Value Added Tax payments subject of investment dispute; taxpayer prevailed in arbitration). For a case in which the taxpayer did not prevail see *EnCana v. Ecuador*, UNCITRAL Arbitration (Final Award, 3 February 2006; dissenting opinion by Horacio Grigera Naón).

17. An arbitral tribunal is asked to decide a dispute between a consumer and a manufacturer in different countries. Two different arbitration statutes may be applicable. One expressly prohibits arbitration of consumer disputes. The other impliedly allows arbitration of cross-border contracts regardless of any consumer element. The arbitrators' power to hear the case will depend on which regime applies.<sup>397</sup>
18. Do arbitrators have authority to decide a dispute on the basis of on the basis of an arbitration clause contained in Terms and Conditions of Sale appearing through a hyperlink on a manufacturers' website shopping page?<sup>398</sup>
19. Will a buyer of goods be bound to arbitrate on basis of an arbitration clause in a contract between a manufacturer and a distributor.<sup>399</sup>
20. The parties to a contract provide for arbitration in a particular city, but under non-existent rules and without any identifiable appointing authority. To what extent may an arbitral institution in the chosen local confer upon itself power to constitute a tribunal.<sup>400</sup>
21. Does an arbitrator lack jurisdiction because the arbitration clause lacks

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<sup>397</sup> French *Cour de cassation*, May 21, 1997, *Meglio v. Société V2000*. Cass, *1e civ.*, May 21, 1997, 1997 REV. ARB. 537 (note Gaillard); *see also* Cass, *1e civ.*, May 21, 1997, 1998 REV. CRIT. DR. INT'L PRIVÉ 87 (note Heuzé). The *Cour de cassation* upheld the validity of an arbitration clause in an agreement for the purchase of a limited series Jaguar, finding that the contract implicated international commerce by virtue of a transfer of goods and funds between France and the United Kingdom.

<sup>398</sup> See *Dell Computer Corp v. Union des Consommateurs & Olivier Dumoulin*, Appeal to Supreme Court of Canada, S.C.C. File 31067, Leave to Appeal, 19 January 2006 (Docket: 31067), 2006 CarswellQue 84, appeal from 2005 CarswellQue 3270, Cour d'appel du Québec, 2005.

<sup>399</sup> For an answer in the affirmative, see *International Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411 (4th Cir. 2000), concerning sale of an industrial saw. When the buyer sought to enforce guarantees and warranties contained in the contract between the manufacturer of the saw and one of its distributors, the doctrine of equitable estoppel precluded the buyer's assertion that it was not bound by the arbitration clause in contract manufacturer – distributor agreement.

<sup>400</sup> See *Marks 3-Zet-Ernst Marks GmbH v. Presstek, Inc.*, 455 F.3d 7 (1st Cir. 2006), in which an arbitration clause between a German company and a Delaware corporation provided only for "arbitration in the Hague under the International Arbitration rules." The Permanent Court of Arbitration (PCA) in the Hague found no agreement to apply the UNCITRAL Arbitration Rules so as to permit the arbitration to go forward under its auspices. A request to compel arbitration made to a court in the United States was subsequently dismissed.

consideration?<sup>401</sup>

22. Arbitrators award monetary sanctions for one side's failure to comply with discovery orders. The award is challenged on the basis that the tribunal lacked authority to impose such a penalty.<sup>402</sup>

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<sup>401</sup> See *Douglass v. Pflueger Hawaii, Inc.*, 135 P. 3d 129 (Hawaii 2006), holding that an arbitration clause failed for lack of "bilateral consideration" when included in an employee handbook which the employer could change at will.

<sup>402</sup> *Superadio Ltd. Partnership v. Winstar Radio Productions*, 446 Mass. 330, (2006), permitting arbitrators' imposition of sanctions for violation of discovery orders. In a case arising from an agency for sale of advertising on radio (each side accusing the other of failing to turn over advertising revenues), the court upheld the tribunal's interpretation on the AAA rules, which in Rule 23(c) authorize arbitrators "to resolve any disputes concerning the exchange of information" As a matter of contract interpretation, the arbitral power to award sanctions may or may not be misplaced. However, the court's analytic methodology seems sound, in its attempt to discern what authority the parties granted the arbitrator. For a contrasting perspective, see Philip J. O'Neill, *The Arbitrator's Power to Award Monetary Sanctions for Discovery Abuse*, 60 DISPUTE RES. J. 60 (Nov. 2005/Jan. 2006); *Update: Massachusetts Allows Arbitrators to Award \$\$ Sanctions to Remedy Discovery Abuse*, 61 DISPUTE RES. J. 8 (May-August 2006). Mr. O'Neill suggests it might be best for American judges and arbitrators simply to look to institutional (AAA) interpretation of rules, rather than exercising independent judgment. Decided under Massachusetts Arbitration Act rather than the FAA, *Superadio* also refused to vacate the award on the ground that one side's attorney was not admitted to practice in Massachusetts.