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William W. Park

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# **AMENDING THE FEDERAL ARBITRATION ACT**

Boston University School of Law  
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Adapted as *The Specificity of International Arbitration: The Case  
for FAA Reform*, 36 VANDERBILT J. TRANSNATIONAL L. 1241  
(2003)

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Adapted from a paper delivered as part of a colloquium sponsored by the Institute of Judicial Administration, New York, September 2002.

## Amending the Federal Arbitration Act

*William W. Park\**

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## I. INTRODUCTION

If a pollster asked a random selection of Americans for a one-line verbal portrait of arbitration, common responses might include the following: (i) private litigation arising for construction and business disputes; (ii) a mechanism to resolve workplace tensions between management and labor; (iii) a process by which finance companies and stock brokers shield themselves from customer complaints; (iv) a way to level the playing field in deciding commercial controversies among companies from different parts of the world; (v) the way big corporations use NAFTA to escape regulation. To some extent all would be correct.<sup>1</sup>

Unfortunately, these different varieties of arbitration have all been squeezed into the same antiquated arbitration statute. Enacted 75 years ago as a simple procedural device to enforce arbitration in federal courts, the Federal Arbitration Act (FAA) has now been pressed into service as a body of substantive law that binds state courts as well, requiring that arbitration agreements be enforced on the same footing as other contracts.<sup>2</sup> The Act is as ill-suited to such use as an all-terrain vehicle. As drafted, the FAA ignores critical distinctions in the level of judicial supervision suitable to different types of cases. The *laissez-faire* court scrutiny appropriate to an international proceeding, between sophisticated business managers with access to competent counsel, may be quite misplaced in a consumer case, where an arbitration clause might require an ill-

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1. Divergent portrayals of arbitration bring to mind the John Godfrey Saxe poem *The Elephant*, about six sightless men describing a pachyderm. Having touched only one part of the anatomy (side, tusk, trunk, knee, ear, and tail), each respectively thought the elephant to be like a wall, spear, snake, tree, fan, and rope. The verses conclude, "And so these men of Indostan disputed loud and long, each in his own opinion exceeding stiff and strong, though each was partly in the right, and all were in the wrong." John Godfrey Saxe, *The Blind Man and the Elephant*, in *THE POEMS OF JOHN GODFREY SAXE* 135 (J.R. Osgood ed., 1873).

2. See discussion *infra* Section V.B (discussing *Doctor's Assocs. v. Casarotto*, 517 U.S. 681 (1996)).

informed individual to seek uncertain remedies at an inaccessible venue.<sup>3</sup> Moreover, basic arbitration notions are hidden in a maze of inconsistent cases that are anything but user friendly: they disorient and confuse litigants from abroad, adding significant transaction costs to the choice of arbitration in the United States.<sup>4</sup>

The time has come to consider amending the FAA to provide greater clarity for international arbitration. One springboard for reform can be found in the UNCITRAL Model Arbitration Law,<sup>5</sup> which has already engendered a rich case law that could serve as a prism to separate and identify many of the interrelated themes in cross-border arbitration.<sup>6</sup> The Model Law, however, should not be imported wholesale.<sup>7</sup> Any amendment of the Federal Arbitration Act must take account of home grown arbitration concerns and precedents.<sup>8</sup> Part of the peculiar U.S. genius has been our ability to adapt (rather than adopt) inventions from abroad.<sup>9</sup>

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3. See generally *id.*

4. The transaction costs to the parties (including attorneys fees for appellate review) are different from those incurred by society, which must pay judges to decide cases. For both the parties and society there may be costs resulting from the risk of an incorrect result which would constitute one factor weighing in favor of judicial review.

5. United Nations Commission on International Trade Law, Model Law on International Commercial Arbitration, adopted June 21, 1985. As of the end of 2002, the Model Law had been adopted by more than fifty jurisdictions, including four U.S. states (California, Connecticut, Oregon, and Texas) and all of Canada's provinces.

6. See generally HENRI C. ALVAREZ, NEIL KAPLAN & DAVID RIVKIN, MODEL LAW DECISIONS: CASES APPLYING THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION (2003).

7. One commentator has described the UNCITRAL Model Act as "an ersatz statute divorced from the rich and distinctively American federal experience with arbitration" and suggested that what is needed is "a work of renovation, the dusting of an antique, not a revolution." Joseph D. Becker, *Fixing the Federal Arbitration Act by the Millennium*, 8 AM. REV. INT'L ARB. 75, 75 (1997).

8. For a more ambitious proposal on adoption of the UNCITRAL Model Law, see Jack J. Coe, *A Critical Appraisal of the Federal Arbitration Act 1925 and of the Suitability of the Model Law as Its Replacement for International Commercial Disputes* (1999) (unpublished Ph.D. dissertation, London School of Economics) (on file with author). Compare the more cautious alternative advocated in William W. Park, *The Interaction of Courts and Arbitrators in England: The 1996 Act as a Model for the United States?*, 1 INT'L ARB. L. REV. 54, 67 (1998). For commentary positive to the Model Law, see James Carter, *Federal Arbitration Act Seen as Out of Step with Modern Laws*, 5 NEWS AND NOTES FROM INSTITUTE FOR TRANSNATIONAL LAW 1 (1990) (criticizing utility of UNCITRAL Model law for U.S.); *Report of the Committee on State International Arbitration Statutes* (ABA Subcommittee, Section on International Law and Practice, March 1990). Compare the less favorable evaluations in David Rivkin & Frances Kellner, *In Support of the FAA: An Argument Against U.S. Adoption of the UNCITRAL Model Law*, 1 AM. REV. INT'L ARB. 535 (1990); *Report of the Washington Foreign Law Society on the UNCITRAL Model Law on International Commercial Arbitration*, reprinted in 3 OHIO ST. J. ON DISP. RESOL. 303 (1988); *Report of the Committee on Arbitration and Alternative Dispute Resolution, Association of the Bar of the City of New York*, reprinted in 1988-89 ARBITRATION AND THE LAW 250 (1989).

9. For comparative studies of the various options available as legal frameworks for arbitration in several major arbitral centers, see JEAN-FRANÇOIS POUURET & SÉBASTIEN BESSON, DROIT COMPARE DE L'ARBITRAGE INTERNATIONAL (2002); JULIAN D.M. LEW, LOUKAS A. MISTELIS & STEFAN KRÖLL COMPARATIVE INTERNATIONAL ARBITRATION (2003).

The most critical need is for limitations on judicial review of international arbitration awards, permitting international arbitration law to evolve free from whatever paternalistic measures might be appropriate to domestically cultivated concerns.<sup>10</sup> Such reform would facilitate efficient and neutral dispute resolution by keeping judges from second guessing arbitrators on the merits of a dispute, while still permitting courts to support arbitration by enforcement of agreements and awards, as well as through interim measures in aid of arbitration.<sup>11</sup>

It is well known, of course, that certain arbitration service providers and industry groups oppose change.<sup>12</sup> They justify their reform-phobia by reference to the vagaries of the U.S. legislative process.<sup>13</sup> Once Congress goes into motion (so some fear), a Pandora's Box of special interests will open to unleash forces that would eviscerate arbitration's effectiveness.

Such skepticism of the democratic process is misplaced. There is no reason to think that Americans today are less capable of intelligent legislation than they were in the past. Moreover, the winds

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10. A separate set of provisions for review of international awards is not the only task confronting those hoping to enhance the quality of American arbitration law. For a European perspective on U.S. arbitration law reform, see Pierre-Yves Tschanz, *International Arbitration in the United States: The Need for a New Act*, 3 *ARB. INT'L* 309 (1987). On FAA reform, see generally authorities cited in note 8. See also Charles A. Hunnicut et al., *Report to the Washington Foreign Law Society on the UNCITRAL Model Law on International Commercial Arbitration*, 3 *OHIO ST. J. ON DISP. RESOL.* 303, 303 (1988); American Arbitration Association, Office of the General Counsel, *Adoption of the UNCITRAL Model Law on International Commercial Arbitration as Federal or State Legislation*, *ARBITRATION AND THE LAW* 250, 250-62 (1988); André J. Brunel, *A Proposal to Adopt UNCITRAL's Model Law on International Commercial Arbitration as Federal or State Legislation*, 25 *TEX. INT'L L. J.* 43 (1990); A Report of the New York State Bar Association International Litigation Committee, Commercial and Federal Litigation Section, *The UNCITRAL Model Law on International Commercial Arbitration*, 23:87 *N.Y.U. J. INT'L L. & POL.* 87, 87-88 (1990-1991); Daniel M. Kolkey, *Reflections on the U.S. Statutory Framework for International Commercial Arbitrations: Its Scope, its Shortcomings, and the Advantages of U.S. Adoption of the UNCITRAL Model Law*, 1 *AM. REV. INT'L ARB.* 491, 491 (1990).

11. Some cynics might question whether U.S. courts would in fact pay attention to an amendment of the FAA. See, e.g., comments of Richard W. Hulbert, Proceedings of The Institute of Judicial Administration Conference on Arbitration, NYU (Sept. 19, 2002). In a case confirming application of the FAA in state courts, Justice O'Connor expressed similar disenchantment with judicial interpretation of federal arbitration law, suggesting that "over the past decade the Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation." *Allied-Bruce Terminix v. Dobson*, 513 U.S. 265, 283 (1995).

12. See generally Hulbert, *supra* note 11.

13. At a recent colloquium in New York, the General Counsel of an important arbitrator service provider referred to the "shivers down the spine" produced by mention of FAA amendment.

of change are already blowing, and the question is no longer *if* but *how* reform will occur.<sup>14</sup>

## II. THE ARCHITECTURE OF AMERICAN ARBITRATION LAW

### A. *Scope of the Federal Arbitration Act*

The Federal Arbitration Act (FAA) subjects most arbitration in the United States to a single standard for judicial review,<sup>15</sup> regardless of whether the dispute is big or small, domestic or international, and notwithstanding state attempts to create a more nuanced framework for arbitration.<sup>16</sup> As a consequence, international arbitration unfolds haunted by the specter of anti-abuse measures intended to protect consumers and employees,<sup>17</sup> relying on the exercise of judicial discretion in an inefficient, case-by-case fashion.<sup>18</sup>

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14. A more practical concern relates to the difficulty of obtaining reform. Certain fatalists suggest that time and energy would be wasted in advancing a proposal which the American Arbitration Association and industry groups would seek to torpedo. This is an odd objection. The urge to improve, one would hope, remains valid notwithstanding opposition from entrenched interest groups. History is full of intelligent propositions (whether economic, political, social or religious) that were once fiercely contested by established orthodoxy.

15. The U.S. Supreme Court has construed narrowly the FAA exclusion of “contracts of employment” to cover only contracts for “transportation workers” such as seamen and railroad employees who provide services directly in foreign or interstate commerce. Collective bargaining agreements, however, rest on a separate statutory foundation with an ill-defined relationship to the FAA. *See* Taft-Hartley Labor-Management Relations Act § 301, 29 U.S.C. § 185 (2003); *see also* Textile Workers Union of America v. Lincoln Mills of Ala., 353 U.S. 448, 451 (1957) (holding that federal courts may fashion a body of federal law specifically for enforcement of collective bargaining agreements).

16. *See* CAL. CODE CIV. PROC. § 1297.11; CONN. GEN. STAT. § 50a-100; FLORIDA STAT. § 684; OR. REV. STAT. § 36.450; TEX. CIV. PRAC. & REM. CODE § 172.001 (exemplifying state initiatives inspired by or incorporating principles of the UNCITRAL Model Arbitration Act). However, the preemptive effect of federal law relegates state arbitration statutes to gap-filling on ancillary matters, thus giving state statutes only marginal impact. For example, an arbitrator’s authorization to administer oaths derives from UNIFORM ARBITRATION ACT § 7. The validity of a state rule depends on its perceived harmony with the policies underlying federal law.

17. *See, e.g.*, discussion of “manifest disregard of the law” *infra* Section IV.A. For judicial agonizing over how to treat arbitration agreements in employment contracts, *see generally* Circuit City Stores, Inc. v. Adams, 532 U.S. 105, 123 (2001). *See* discussion *infra* notes 211-13 and accompanying text; Wright v. Universal Maritime Services, 525 U.S. 70, 76 (1998); Gilmer v. Interstate/Johnson Lane, 500 U.S. 20 (1991); Stephen J. Ware, *Employment Arbitration & Voluntary Consent*, 25 HOFSTRA L. REV. 83 (1996). For similar concerns about consumer and small business arbitration, *see generally* Badie v. Bank of Am., 79 Cal. Rptr. 2d 273 (1998); ITT Cons. Fin. Corp. v. Patterson, 18 Cal. Rptr. 2d 563 (1993); Teleserve Sys. v. MCI, 659 N.Y.2d 658 (N.Y. App. Div. 1997); Brower v. Gateway 2000, 676 N.Y.S.2d 569 (A.D. 1st Dept. 1998). *See generally* *Symposium on Arbitration in the Securities Industry*, 63 FORDHAM L. REV. (1995).

18. In one case the court ordered costly discovery on the very fairness of institutional arbitration. *See* Rosenberg v. Merrill Lynch Pierce, 965 F. Supp. 190, 192 (D. Mass. 1997), *aff’d on other grounds*, 170 F.3d 1 (1st Cir. 1999); *see also* Specht v.

Understanding the American framework for arbitration requires a brief look at the Second Circuit decision in *Alghanim v. Toys 'R' Us*,<sup>19</sup> which held that domestic judicial review standards applied to awards rendered in international arbitrations with a U.S. situs.<sup>20</sup> The case, which involved a \$46 million award rendered in New York in favor of a Kuwaiti licensee of a U.S. toy store,<sup>21</sup> was challenged for alleged “manifest disregard of the law” by the arbitrator—a ground for vacatur under domestic law but not under the New York Arbitration Convention.<sup>22</sup>

One must remember that when adopting the 1958 New York Arbitration Convention, the United States accepted its application not only to awards rendered abroad, but also to so-called “non-domestic awards.”<sup>23</sup> The award in *Toys 'R' Us* fell under the latter category (“non-domestic”) and thus was subject to the Convention. Two of the three parties were non-American, and the underlying agreement involved performance in the Middle East.<sup>24</sup>

Convention awards would normally be subject to FAA § 207, which provides that a court “shall confirm the award” unless it finds one of the defenses to recognition contained in Convention Article V.<sup>25</sup> These defenses essentially supply escape hatches related to

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Netscape Communications Corp., 306 F.3d 17, 40 (2d Cir. 2002), refusing to enforce arbitration clause included in downloaded software. In action for alleged violations of federal privacy laws; the Court held that reasonably prudent internet users would not have learned of arbitration before downloading software, since agreement to arbitrate presented at bottom of scroll-down screen; cf. *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1452 (7th Cir. 1996) (enforcing arbitration clause in shrinkwrap license included with software).

19. *Yusuf Ahmed Alghanim & Sons v. Toys 'R' Us, Inc.*, 126 F.3d 15, 23-25 (2d Cir. 1997).

20. Domestic arbitration is covered by Chapter 1 of the FAA. *See* 9 U.S.C. (2000). Chapters 2 and 3 are designed principally to address recognition of awards made under the New York and Panama Conventions, which covers principally foreign awards.

21. The Hong Kong affiliate of Toys 'R' Us was also implicated in the arbitration. *Toys 'R' Us*, 126 F.3d at 15.

22. *Id.*

23. Foreign awards are described as “made in the territory of a State other than . . . where the recognition and enforcement of such awards are sought,” while non-domestic awards are defined to include “awards not considered as domestic awards in the State where recognition and enforcement are sought.” New York Convention, art. I(1) (June 10, 1958). By contrast, the United Kingdom took a different approach in a reservation applying the Convention “only to . . . awards made in the territory of another Contracting State.” British arbitration legislation limits the scope of the New York Convention to awards made in the territory of a state “other than the United Kingdom.” Arbitration Act, 1996, § 100(1) (Eng.). The United States took no such reservation. 9 U.S.C. § 202 (2000) (including within the scope of the Convention even arbitration agreements entirely between American citizens as long as related to property, performance or enforcement abroad, or bearing some “reasonable relation” to a foreign country).

24. *Id.*

25. New York Convention, art. I(1) (June 10, 1958, art).



procedural due process, public policy, and vacatur at the place where an award is made.<sup>26</sup>

Drawing what seems to be a distinction between motions to confirm and motions to vacate awards, and notwithstanding the language of FAA § 207, the Court in *Toys 'R' Us* found that a non-domestic award made in the United States would be subject to vacatur “in accordance with its domestic arbitration law and its full panoply of express and implied grounds for relief” including “manifest disregard of the law.”<sup>27</sup>

Not all jurisdictions follow the *Toys 'R' Us* approach. The Eleventh Circuit has held that the New York Convention’s grounds for refusal to confirm foreign awards were also the exclusive bases on which to review a “non-domestic” award made in the United States.<sup>28</sup> A federal district court in Miami came to the same result with respect to a motion to confirm an award among foreign parties made in Florida.<sup>29</sup>

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26. *Id.* Article V permits non-recognition in the event of (i) invalid arbitration agreement, (ii) lack of proper notice, (iii) arbitrator excess of authority, (iv) irregular composition of the arbitral tribunal, (v) award vacatur at the place where (or under the law of which) made, (vi) non-arbitrable subject matter or (vii) violation of public policy. *Id.* art. V.

27. *Toys 'R' Us*, 126 F.3d at 23. The court in *Toys 'R' Us* held that the award in question did not constitute “manifest disregard of the law.” For other cases in which federal courts have been asked to subject international awards to domestic vacatur standards, including “manifest disregard of the law,” see *Lummus Global Amazonas, S.A. v. Aguaytra Energy de Peru*, 2002 WL 31401996 (S.D. Tex. 2002) (vacating in part and confirming in part an award arising from construction of a natural gas pipeline in Peru; modified to incorporate the parties’ joint stipulation on construction credits), *Westinghouse Int’l Serv. Co. v. Merilectrica*, D. Mass., C.A. No. 00-11832 (Sept. 27, 2001) (upholding an award in a South American power plant construction dispute). See also discussion of *Westerbeke v. Daihatsu Motor Co., Ltd.*, 304 F.3d 200, 220-23 (2d Cir. 2002) *infra* notes 40-49 and accompanying text. See also *Industrial Risk Insurance v. M.A.N. Gutehoffnungshutte G.m.b.H.*, 141 F.3d 1434 (11th Cir. 1998); *Four Seasons Hotels and Resorts B. V. v Consorcio Barr S.A.* 267 F. Supp. 2d 1335 (S.D. Fla. 2003).

28. *Industrial Risk Insurance*, 141 F.3d 1434, 1441-42 (11th Cir. 1998) (involving a AAA arbitration in Florida between a German corporation and an U.S. insurer). The dispute arose from malfunction of a “tail gas expander,” a turbine generating electricity from waste gasses in nitric acid manufacture. *Id.* Giving a broad scope to the concept of “non-domestic” arbitration award, the court held that an award made in the United States falls within the purview of the New York Convention, and is thus governed exclusively by Chapter 2 of the FAA. *Id.* at 1441.

29. *Four Seasons Hotels*, 267 F. Supp. 2d 1335, 1335-37 (S.D. Fla. 2003) (applying the New York Convention as the exclusive grounds for considering confirmation of a AAA award rendered in Miami). The dispute between two foreign corporations concerned a hotel operation in Caracas, which the parties had subjected to Venezuelan law. The court also found that the New York Convention trumped the Inter-American Arbitration Convention, since not all parties to the relevant agreements were from countries that had adhered to the latter treaty. The court clearly distinguished between an enforcement action and an action to vacate. By virtue of the Miami situs of the proceedings, U.S. rather than Venezuelan courts were found to be the competent authority to vacate the award. Personal jurisdiction over the Venezuelan party was found by virtue of its participation in the Florida-based arbitration. The court also gave an interesting analysis of personal jurisdiction under the federal “long-arm statute” contained in Rule 4(k)(2) of the Federal Rules of Civil Procedure. *Id.*

## B. *The Need for a New Statute*

Such conflation of domestic and international arbitration is a bad idea as a matter of both sound policy and national self-interest. Rather than a hospitable climate for international arbitration, the business community is left with little clear guidance to predict how courts will react to allegations of arbitrator error. Diverse cases call for different levels of judicial review, with the least interventionist role assumed in arbitration between sophisticated business entities from different countries.

The United States remains a victim of a self-inflicted competitive disadvantage imposed by its single legal framework for arbitration. The spillover of domestic precedents into international cases will inevitably chill selection of U.S. cities for arbitration (with fewer fees to arbitrators and counsel) by foreign parties understandably hoping to avoid excessive judicial interference.

The FAA should be amended to provide a separate framework for international arbitration that would contain default rules limiting judicial review of awards to the narrowest grounds. In addition, parties might be given appropriate options to select greater judicial scrutiny. Such reform would keep courts away from arbitration except to support the process by enforcing agreements and awards and supplying interim measures in aid of arbitration.

Reform could be accomplished either through tinkering with the existing FAA Chapters 2 and 3 or by adding a new chapter which would cover all international proceedings in the United States, regardless of whether they fit within these two treaties. The latter approach, casting a wide net, might be the preferred avenue, since it could help limit misguided judicial inventions to fill either real or perceived gaps in the coverage of international arbitration.<sup>30</sup>

Some might observe that good arguments also exist for broader gauge change to protect all business arbitration, domestic as well as international, from excessive judicial review on grounds such as “manifest disregard.” The proposal in this paper is intentionally more modest, however, stemming from a concern that wider modifications of the FAA would meet more significant political impediments, thus reducing the prospect of reform in the international arena, where the

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30. For example, the U.S. Supreme Court decision in *Cortez Byrd*, which justified expansive venue for award vacatur as a way to permit American courts to “vacate awards rendered in foreign arbitrations not covered by either convention.” *Cortez Byrd Chips, Inc. v. Bill Harbert Const. Co.*, 529 U.S. 203, 203 (2000) (discussed *infra* notes 203-05 and accompanying text).

special need for neutrality makes arbitration's efficiency particularly vital. As Voltaire observed, the best is often the enemy of the good.<sup>31</sup>

### C. Manifest Disregard of the Law

#### 1. The *Wilko* Dictum

By statute, courts have been given power to vacate awards for defects in the basic procedural integrity of the arbitration,<sup>32</sup> but not with regard to either vague notions of public policy<sup>33</sup> or the merits of a dispute. Fifty years ago, however, this statutory scheme was amplified by *dictum* in a U.S. Supreme Court case prohibiting securities arbitration. In *Wilko v. Swan*, the Court added “manifest disregard of the law” as a basis for award vacatur.<sup>34</sup> This power to set

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31. See generally, VOLTAIRE, LES OEUVRES COMPLETES DE VOLTAIRE, Oxford (2000). *Le mieux est l'ennemi du bien*. Voltaire himself was apparently adapting an old Italian proverb, *Le meglio è l'inimico del bene*.

32. 9 U.S.C. § 10(a) provides for vacatur (i) for award procurement by corruption, fraud or undue means, (ii) evident partiality or corruption in the arbitrators, (iii) arbitrator misconduct in refusing to postpone the hearing or in refusing to hear evidence pertinent and material to the controversy, and any other “misbehavior by which the rights of any party have been prejudiced,” (iv) where the arbitrators exceeded their powers or “so imperfectly executed” their powers that a final award upon the subject matter was not made. For a survey of these grounds for vacatur, see generally Stephen L. Hayford, *A New Paradigm for Commercial Arbitration: Rethinking the Relationship Between Reasoned Awards and the Judicial Standards for Vacatur*, 66 GEO. WASH. L. REV. 443 (1998). See also Stephen L. Hayford & Scott Kenigan, *Vacatur: The Non-Statutory Grounds for Judicial Review of Commercial Awards*, 50 DISPUTE RESOLUTION J. 22 (Oct. 1996); Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 GA. L. REV. 731 (1996).

33. Although labor cases permit an award to be set aside for contravention of public policy, *United Paperworkers Int'l Union v. Misco, Inc.*, 484 U.S. 29, 47 (1987), the FAA contains no reference to public policy as a ground for vacatur of an award. It is uncertain whether in commercial arbitration violation of substantive public policy constitutes a ground for vacatur. See *Northrop Corp. v. Triad Int'l Mktg.*, 811 F.2d 1265, 1266-67 (9th Cir. 1987) (implicating alleged illegal commissions to intermediaries in armament contracts). After an arbitral tribunal had interpreted the governing law (California) as permitting such commissions, a federal district court vacated the award as “contrary to law and public policy,” only to be reversed by the Court of Appeals, which held that U.S. policy was too ill-defined to justify annulment of the award.

34. *Wilko v. Swan*, 346 U.S. 427, 436-37 (1953). See generally Noah Rubins, “*Manifest Disregard of the Law*” and *Vacatur of Arbitral Awards in the United States*, 12 AM. REV. INT'L ARB. 363 (2002). *Wilko* was overruled in *Shearson/American Express v. McMahon*, 482 U.S. 220, 224-25 (1987) (fraud claims under Exchange Act § 10b and Rule 10b-5) and *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477, 477 (1989) (Securities Act § 12(2) claims). Ironically, when the *Wilko* Court invented “manifest disregard of the law,” it considered the concept as unduly restrictive of judicial review. The fact that a finding of “manifest disregard” was the only way courts could address a mistake was seen as evidence of the need to nip securities arbitration in the bud by declaring the topic non-arbitrable. The Court stated:

[I]nterpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation. The United States Arbitration Act contains no

aside awards provides perhaps the most compelling motive for FAA reform.

Some interpretations of this concept take a restrictive view, building on notions of “excess of authority”<sup>35</sup> to limit the principle to decisions that ignore the contract or require parties to violate the law.<sup>36</sup> Other courts, however, have taken a more expansive view, effectively including mistakes of law<sup>37</sup> and moving well beyond the consumer and employment context for which the doctrine had been conceived.

Yet another approach to “manifest disregard” has been suggested in *Williams v. CIGNA Financial Advisors Inc.*<sup>38</sup> and *Bridas S.A.P.I.C. v. Government of Turkmenistan*.<sup>39</sup> In these decisions, the Fifth

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provision for judicial determination of legal issues such as is found in the English law. [Apparently a reference to the “case stated” provision abolished in 1979.] As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended [Section 14 of the Securities Act, forbidding waiver of securities laws] to apply to waiver of judicial trial and review.

*Wilko*, 346 U.S. 427, 431 (1953).

35. See 9 U.S.C. § 10(4) (2003).

36. See, e.g., *Advest, Inc. v. McCarthy*, 914 F.2d 6, 10-11 (1st Cir. 1990) (Selya, J.) (affirming a lower court’s refusal to vacate an award in a case wherein an investor alleged that a broker wrongfully liquidated his holdings). The Court held that an honest failure of interpreting the law is not enough to justify vacatur, which requires a decision “contrary to the plain language” of the agreement or an indication that the arbitrator “recognized the applicable law and then ignored it.” *Id.* at 8. *Cf. Watt v. Tiffany & Co.*, 248 F.3d 577, 580 (7th Cir. 2001). In *Watt*, Judge Easterbrook (for better or for worse) aligned the concept with public policy, which in an international context might diverge from applicable law. For example, an employment agreement to be performed abroad might discriminate on the basis of gender or religion in a way acceptable under the applicable foreign law. The court stated, “If manifest legal errors justified upsetting an arbitrator’s decision, then the relation between judges and arbitrators . . . would break down.” *Id.* at 579. Judge Easterbrook interpreted the test for vacatur as simply that “an arbitrator may not direct the parties’ to violate the law.” *Id.* at 580.

37. See *Halligan v. Piper Jaffray*, 148 F.3d 197, 203-04 (2d Cir. 1998), *cert. denied*, 526 U.S. 1034 (1999) (reversing decision that refused to vacate award denying age discrimination claim). See also *Westerbeke v. Daihatsu*, 304 F.3d 200 (2d Cir. 2002) (discussed *infra* notes 40-49 and accompanying text). Only a few years ago one of the finest U.S. arbitration scholars described the elements that a losing party must prove to demonstrate “manifest disregard,” and then concluded, “[t]his will never happen in our lifetimes.” Alan Scott Rau, *The New York Convention in American Courts*, 7 AM. REV. INT’L ARB. 214, 238 (1996). Professor Rau not only feels that “manifest disregard” is a dead letter, but “in operation the review standards of the Convention and the FAA will be identical.” *Id.* at 236.

38. *Williams v. CIGNA Financial Advisors Ind.*, 197 F.3d 752, 760-61 (5th Cir. 1999). *Williams* involved an age discrimination employment case arbitrated under NASD rules. See generally Noah Rubins, “*Manifest Disregard of the Law*” and *Vacatur of Arbitral Awards in the United States*, 12 AM. REV. INT’L ARB. 363 (2001).

39. *Bridas S.A.P.I.C. v. Government of Turkmenistan*, 2003 WL 22077651 (5th Cir. 2003). Here, an Argentinean corporation sought to confirm an ICC award rendered

Circuit followed a two-prong inquiry in which it determined first whether it was manifest that the arbitrators disregarded applicable law. Thereafter, the court considered whether the award would result in “significant injustice” under the circumstances of the case. Even if there was “manifest disregard,” an award would be upheld as long as no injustice resulted.

The problem is not necessarily in the “manifest disregard” doctrine itself, which properly applied may have a salutary effect where a special need exists for greater judiciary supervision. Rather, the difficulty lies in the doctrine’s potential for mischief and misuse in large international cases, when zealous litigators may be tempted to press “manifest disregard” into service as a proxy for attack on the substantive merits of an award.

## 2. *Westerbeke v. Daihatsu*

The risks of subjecting international cases to domestic grounds for vacatur are illustrated in *Westerbeke v. Daihatsu Motor Co., Ltd.*,<sup>40</sup> involving breach of a distribution agreement by a Japanese manufacturer. A Japanese manufacturer had given a U.S. company an exclusive right to sell certain contractually defined categories of engines. If the manufacturer wanted to market a new line of products, the sales agreement gave the distributor a right of first refusal during a period of six months.<sup>41</sup>

Ultimately, the deal went sour over a new product line that the manufacturer began offering through another North American distributor. The parties ended up in arbitration pursuant to provisions of the 1952 Japan-U.S. Trade Arbitration Agreement referenced in their contract.<sup>42</sup>

The arbitrator awarded the distributor more than \$4 million, having found the sales agreement to constitute a binding contract with a condition precedent in the form of a requirement that new lines of engines were subject to a right of first refusal. The manufacturer brought a motion to vacate the award, arguing that the parties had reached only a “preliminary agreement to agree.”<sup>43</sup>

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in Houston (the parties having agreed to abandon Stockholm, the contractually stipulated situs) under English law against the government of Turkmenistan and a government-owned oil company. Not only did it refuse to vacate find any “manifest disregard” of the law, the court also refused to vacate the award for excess of jurisdiction and held that the government itself could not be forced to arbitrate as the oil company’s alter ego. *Id.* at \*13-14.

40. *Westerbeke*, 304 F.3d 200 (2d Cir. 2002), *rev’g* 162 F. Supp. 2d 278 (2001). See also *Hoelt v. MVL Group Inc.*, 242 F.3d 57 (2003), reversing lower court decision vacating an award for “manifest disregard” in an arbitration arising from a dispute over a purchase price adjustment in the sale of a corporation engaged in market research.

41. *Id.* at 204-05.

42. *Id.* at 205.

43. *Id.* at 206.

Without a binding contract, the manufacturer argued, there could be no recovery for expectancy damages (purchase of substitution goods and lost profits), which was exactly what had been granted in the arbitration.<sup>44</sup>

To complicate matters, the arbitration had been bifurcated. A liability phase addressed whether the new product was indeed an engine within the terms of the contract. Then a subsequent stage assessed the claimant's damages. Unfortunate language in the Interlocutory Award on liability (which arguably had *res judicata* effect when it came time to draft the final decision) gave rise to an argument that the arbitrator had decided the manufacturer owed no more than a duty to negotiate in good faith.<sup>45</sup>

The district court disagreed and vacated the award, holding that the arbitrator had misapplied the New York law on damages. As an additional ground for vacatur, the court held that the theory of liability expressed in the first stage of the proceedings differed from that articulated in the damages stage.<sup>46</sup>

A year later the Second Circuit reversed, upholding the award of lost profits. In deciding whether there had been "manifest disregard," the Court of Appeals announced a two prong test. An objective element required inquiry into whether the relevant law was "well defined, explicit and clearly applicable." A subjective component of the test involved examination of whether the arbitrator intentionally ignored the law.<sup>47</sup>

Applying this approach, the Court of Appeals looked first at New York law on damages, which it found consistent with the arbitrator's award on the facts of the case. The court then proceeded to examine the arbitrator's intent, and found no evidence of knowing refusal to apply the governing law. Finally, the court addressed the alleged inconsistency between the Interlocutory and Final Awards. Giving the arbitrator the benefit of the doubt, the court interpreted ambiguous language in the Interlocutory Award in light of what the court called a "clarification" in the Final Award, which had found the sales agreement to constitute a contract with conditions precedent rather than simply an "agreement to agree."<sup>48</sup>

Although the case itself had a happy ending for the arbitration's prevailing party, the process involved costly appellate briefing and argument. The Court of Appeals had to examine the New York law on calculation of damages, as well as the difference between a

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44. By contrast, "reliance damages" would have been limited to amounts actually expended by reason of depending on the seller's promise, rather than the "benefit of the bargain" of expected profits. *Id.* at 223.

45. *Id.* at 212.

46. *See id.*

47. *Id.* at 216.

48. *Id.* at 212.

“preliminary agreement” on one hand and a binding contract with condition precedent on the other.<sup>49</sup> The court also had to explore the very nature of “manifest disregard” and other domestically nurtured defenses to award enforcement,<sup>50</sup> and investigate the facts that might give an indication of the arbitrator’s state of mind when deciding the case.

The very existence of the right to have judicial review on the substantive merits of the case (particularly on a ground for challenge as vague as “manifest disregard”) hangs over international arbitration like a sword of Damocles, to be grasped by litigators and judges alike. In principle, there would be nothing wrong with having these questions decided in court. However, the parties had by contract agreed to have the merits of their dispute decided by arbitrators, not judges. The prospect of such judicial meddling in the arbitral process can only alarm foreign enterprises contemplating arbitration in the United States. The procedural and political neutrality of international dispute resolution is compromised each time a local judge intervenes in response to aggressive litigation strategies that invoke precedents from domestic contexts.

Such temptations should be placed out of reach through a new chapter in the FAA, expressly foreclosing back door judicial interference with the merits of international cases. Giving litigants from abroad a measure of confidence that the U.S. judiciary will not unduly meddle in the substance of the case, such an amendment would promote efficient international dispute resolution and would make the United States a more user-friendly place to arbitrate.

### III. THE SPECIFICITY OF INTERNATIONAL ARBITRATION

#### *A. Arbitration’s Role in Cross-Border Transactions*

The need for special deference to arbitration and forum selection clauses in international business was articulated thirty years ago in a decision by the U.S. Supreme Court. Addressing the problematic nature of international litigation, the Court stated:

Much uncertainty and possibly great inconvenience to both parties could arise if a suit could be maintained in any jurisdiction [where personal or *in rem* jurisdiction might be established]. The elimination of all such uncertainties by agreeing in advance on a forum acceptable to

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49. *Id.* at 202.

50. For example, the Court had to consider the “essence of the agreement” arguments derived from collective bargaining decisions rendered more than forty years earlier in the so-called “Steelworkers Trilogy” cases. *See* *United Steelworkers v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 597 (1960); *see also* *Steelworkers v. American Mfg. Co.*, 363 U.S. 564, 568 (1960); *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 581-85 (1960). Under this line of cases courts may vacate an award that does not “draw its essence” from the contract.

both parties is an indispensable element in international trade, commerce, and contracting.<sup>51</sup>

While the adjectives “all” and “indispensable” may constitute a bit of hyperbole, the basic point seems beyond cavil. In a world lacking any neutral courts of mandatory jurisdiction over transactions that cross national borders,<sup>52</sup> arbitration usually does impose itself on international transactions *faute de mieux*, bringing to mind Churchill’s famous observation about democracy.<sup>53</sup> Courts have enforced arbitration agreements in international cases involving subjects that could not have been arbitrated in a single country context, including securities,<sup>54</sup> antitrust<sup>55</sup> and bankruptcy.<sup>56</sup>

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51. See *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 13-14 (1972) (addressing the need for certainty in the context of court selection clauses). Similar principles were adopted for arbitration in *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 522 (1974) and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631-33 (1985).

52. While a court in the United States exercising jurisdiction over a foreign respondent might appear neutral to the U.S. side, the perception from abroad might be quite different. The jurisdiction of the International Court of Justice (I.C.J.) is limited to state-to-state claims. A government must espouse the cause of its national, which is rare with respect to private investment. Moreover, when the I.C.J. has heard investment claims during the past thirty years, the private investor has lost. See *Elettronica Sicula SPA (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15, 28 I.L.M. 1109 (1989) (finding that there was no illegal taking when Italy requisitioned U.S.-owned plant to prevent liquidation, and discussing in paragraph 48 the terms of Article 36 of the 1948 FCN Treaty between Italy and the United States); see also *Barcelona Traction (Belgium v. Spain) (2d Phase)*, 1970 I.C.J. 3, 9 I.L.M. 227 (1970) (not permitting Belgium to bring claim of Belgian-owned Canadian company effectively dispossessed by Franco of profitable Spanish assets). See generally F.A. Mann, *Foreign Investment in the International Court of Justice*, 86 AM. J. INT’L L. 92 (1992).

53. Many forms of government have been tried, and will be tried in this world of sin and woe. No one pretends that democracy is perfect or all-wise. Indeed it has been said that democracy is the worst form of government except all those other forms that have been tried from time to time.

3 WINSTON S. CHURCHILL, COMPLETE SPEECHES (1897-1963) 7566 (Robert Rhodes James ed., 1974). The great statesman made the comment in the context of a House of Commons debate on changes to the so-called Parliament Act on November 11, 1947.

54. See *Scherk*, 417 U.S. 506, 511-13 (1974) (securities disputes arbitrable in a German-American contract, at a time when the doctrine in *Wilko v. Swan* banned such arbitration domestically).

55. See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631-33 (1985) (anti-trust disputes arbitrable in a Japanese-American contract, at a time when the *American Safety* doctrine banned arbitration of Sherman Act claims in contracts entirely among U.S. residents). Much of the reasoning of *Mitsubishi* might apply equally to domestic as well as international arbitration. Some observers feel that the international focus of the decision was a way to make the result easier to swallow by the public. See Jill A. Pietrowski, Comment, *Enforcing International Commercial Arbitration Agreements—Post Mitsubishi Motors Corp. v. Soler-Chrysler Plymouth, Inc.*, 36 AM. U.L. REV. 57, 85 (1986) (critiquing the Court’s decision).

56. For an example of a case in which an American company in search of the home court advantage in Massachusetts bankruptcy court attempted to use the bankruptcy laws to renege on its commitment to arbitrate, see *Soci t  Nationale Alg rienne pour la Recherche, le Transport, la Transformation et la Commercialisation des Hydrocarbures (SONATRACH) v. Distrigas Corp.*, 80 B.R. 606, 613 (D. Mass. 1987).



Not everyone sees a need to give special treatment to international arbitration.<sup>57</sup> Some countries have retreated from divergent treatment of domestic and international arbitration, due to concern that distinctions based on nationality might conflict with international commitments.<sup>58</sup>

There should be no mystery about the justification of a special status for international arbitration. The goals that lead business managers to insert arbitration clauses in cross-border contracts have a different focus than those that drive domestic arbitration.

All forms of arbitration usually implicate perceptions about cost, efficiency and expertise. International arbitration, however, involves greater emphasis on foreclosing the gamesmanship of parallel foreign litigation in each side's home courts.<sup>59</sup> Arbitration clauses in cross-border contracts are usually prompted by apprehension about the real or imagined bias of foreign judicial proceedings.<sup>60</sup> When a dispute has

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In deciding that the federal arbitration laws prevailed over the Bankruptcy Code, the court noted:

It is important and necessary for the United States to hold its domiciliaries to their bargains and not allow them to escape their commercial obligations by ducking into statutory safe harbors. Rather, our country should take special pains to project those qualities of honesty and fairness which are essential parts of the traditional American character.

*Id.* at 614.

57. No less a scholar than Michael Mustill once wrote that he had “never understood why international arbitration should be different in principle from any other kind of arbitration.” See Michael Mustill, *Cedric Barclay Memorial Lecture*, ARB. 159, at 165 (Aug. 1992).

58. Under the now superseded 1979 English Arbitration Act, pre-dispute waiver of appeal on points of law was not allowed between or among residents and/or citizens of the United Kingdom. See generally English Arbitration Act, 44 Eliz. 21 (1979) (Eng.). The 1996 Arbitration Act contained similar provisions, which never entered into force due to a perceived conflict with obligations within the European Union. See discussion of *Philip Alexander Securities & Futures Ltd. v. Bamberger infra* Section IV.B (interpreting Article 12 of the Treaty Establishing the European Community (EC Treaty), as amended by the Single European Act, the Treaty on European Union (Maastricht) and the Treaty of Amsterdam). There have also been reports that France is reconsidering the current distinction between domestic and international arbitration. See discussion of debate in meeting of *Comité français de l'arbitrage* held on June 19, 2002, reported in 13 WORLD ARB'N & MED. REP. 266, at 266 (October 2002).

59. For Americans, analogous concerns over neutral dispute resolution are expressed in the U.S. Constitution itself, which gives federal courts power over cases “between citizens of different states” on the assumption that a Massachusetts respondent facing an Alabama claimant (or vice versa) will feel more comfortable in federal court than before the other side's state judges. U.S. CONST. art. III, § 2, cl. 1; see 28 U.S.C. § 1332 (2002) (codifying such “diversity jurisdiction”). In a related connection, Alexander Hamilton argued that the “peace of the whole ought not to be left at the disposal of a part.” THE FEDERALIST NO. 80, at 476 (Alexander Hamilton) (Clinton Rossiter ed., 1961), quoted in GARY BORN, INTERNATIONAL CIVIL LITIGATION IN UNITED STATES COURTS 11 (3d ed. 1996).

60. For analogous principle, see 28 U.S.C. § 1332 (2003) (setting out that U.S. federal courts, under “diversity” jurisdiction, can remedy disputes between citizens of different states provided amount in dispute exceeds a certain threshold).

contacts with multiple countries, the parties may seek a playing field that is more neutral (procedurally, politically, and linguistically) than national courts.<sup>61</sup>

Absent reliable arbitration, judicial proceedings might go forward in a foreign language and perhaps before a xenophobic judge in a country lacking a tradition of judicial independence.<sup>62</sup> In an international contract, the value of a reliable dispute resolution clause may rise to a considerable percentage of the amount of the contract value.<sup>63</sup>

The special *raison d'être* of international arbitration means that the parties often place a premium on freedom from the type of judicial scrutiny that would impinge on procedural neutrality. For many wealth-creating transactions, the prospect of foreign court intervention will chill cross-border economic cooperation, causing productive transactions to falter or become more expensive.<sup>64</sup> Without predictability about applicable substantive and procedural norms, business managers may hesitate to consummate transactions or charge greater prices to cover the risk of uncertainty in the event of dispute.<sup>65</sup> Although the perception of litigation bias against foreigners is sometimes more significant than the reality of prejudice,

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61. Occasionally national courts of third countries might fill this role. However, limits related to subject matter jurisdiction and *forum non conveniens* often make this option problematic as a practical matter. See generally WILLIAM W. PARK, INTERNATIONAL FORUM SELECTION (1995).

62. Although a Massachusetts company might not relish having to go to court in Atlanta, relatively familiar procedural norms would still be applied in some variant of the English language. However, proceedings in Algiers would involve the tongue of Mohammed rather than Shakespeare, with local counsel required to advise on an unfamiliar code of civil procedure. Consequently, in such cases, the parties might choose ICC arbitration in Geneva, providing a greater sense of fairness *ex ante* (whatever the parties' second thoughts after the dispute arises) than the vision of U.S. juries or Algerian judges. Dispute resolution could proceed in a mutually accessible country by a tribunal chaired by someone of a nationality different from the parties, in a common language and according to procedural principles that give neither side an unfair advantage.

63. For a charming illustration of this principle, see Emmanuel Gaillard, *The Economic Value of an Arbitration Clause*, N.Y.L.J., Oct. 7, 1999, at 3. Professor Gaillard posits a construction company owed \$100 million by a foreign customer that refuses to pay. *Id.* Although the builder's case is well founded, bias in host country courts causes the builder to settle for half the claimed amount. *Id.* Thus the economic value of a well drafted arbitration clause would be \$50 million. *Id.*

64. On the effect of litigation risk aversion in international business, see generally William W. Park, *Neutrality, Predictability and Economic Cooperation*, 12 J. INT'L ARB. 99 (1995).

65. Greater risks require greater returns. To illustrate, imagine two potential investments, one in Country A presenting an opportunity for a large profit, but with a good chance that local courts will be biased against a foreign party, and another in Country B yielding a smaller profit, but with fair dispute resolution. Depending on how large the disparity between the expected returns, many risk-averse foreign merchants will choose the lower return coupled with the fairer legal system.

the consequences will be the same in that some transactions will not go forward without a reliable alternative to judicial litigation.<sup>66</sup>

It is often difficult for Americans to understand how disagreeable our civil justice system appears to foreigners. A recent article by a German scholar referred to U.S. litigation as a “procedural monster” that is feared because of its “appetite, sharp teeth and capriciousness.”<sup>67</sup>

Since contracts do not enforce themselves, but need flesh and blood adjudicators, *who* interprets an international agreement has often been more significant than *what* the applicable law says about its construction. Large portions of international arbitration procedure can be explained as an attempt to maximize the legitimacy of a process detached from the normal sources of authority.<sup>68</sup>

The specificity of international transactions has led many countries to adopt separate statutes for international arbitration. Belgium,<sup>69</sup> France,<sup>70</sup> and Switzerland,<sup>71</sup> as well as places that have

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66. A recent study found evidence that in federal civil actions in the United States, foreigners actually fare better than domestic parties, due in part to a fear of the American civil justice system that causes foreign litigants to continue to final judgment only when they have particularly strong cases. See Kevin Clermont & Theodore Eisenberg, *Xenophilia in American Courts*, 109 HARV. L. REV. 1120, 1122 (1996) (analyzing cases decided from 1986-94).

67. Rolf Stürner, *Why are Europeans Afraid to Litigate in the United States?*, in CONFERENCE SERIES OF CENTRO DI STUDI E RICERCHE DI DIRITTO COMPARATO E STRANIERO 15 (M.J. Bonnell ed., 2001). Stürner, who teaches in Fribourg, Germany, examines discovery, juries, costs rules (with each side bearing its own legal costs), extraterritorial jurisdiction, and direct service of process rather than through Hague Convention. See *generally id.*

68. For example, the practice of constituting an arbitral tribunal with each side making a nomination gives parties a measure of comfort that someone they trust will be on the inside to keep the adjudication honest. By contrast, for domestic transactions, the individuals who will decide cases are selected either by a government (in the case of judges) or a national arbitration institution that commands a measure of respectability among all the parties. Even an institution such as the ICC represents only a vague and shadowy presence for most American lawyers, and to those from developing countries the ICC may be perceived as tending to select arbitrators principally with European or North American backgrounds.

69. Currently the Belgian CODE JUDICIAIRE prohibits courts from hearing challenges to awards made in Belgium if neither party is a Belgian national or resident and the parties have explicitly excluded judicial review:

*Les parties peuvent, par une déclaration expresse dans la convention d'arbitrage ou par une convention ultérieure, exclure tout recours en annulation d'une sentence arbitrale lorsqu'aucune d'elles n'est soit une personne physique ayant la nationalité belge ou une résidence en Belgique, soit une personne morale ayant en Belgique son principal établissement ou y ayant une succursale.*

CODE JUDICIAIRE art. 1717(4) (Belg.).

70. N.C.P.C. art. 1492-1505 (Fr.).

71. LOI FÉDÉRALE SUR LE DROIT INTERNATIONAL PRIVÉ/ BUNDESGESETZ ÜBER DAS INTERNATIONALE PRIVATRECHT [LDIP] ch. 12 art. 176-95 (1989) (Switz.). See *generally* P. LALIVE ET AL., LE DROIT DE L'ARBITRAGE INTERNE ET INTERNATIONAL EN SUISSE (1989).

adopted the UNCITRAL Model Arbitration Law<sup>72</sup> such as Canada,<sup>73</sup> Scotland<sup>74</sup> and Hong Kong,<sup>75</sup> all provide a more *laissez-faire* framework for international arbitration.

### B. What Makes Arbitration International?

A different standard for monitoring arbitration of domestic and international transactions requires criteria to distinguish one from the other.<sup>76</sup> Several criteria might be considered, including the nature of the transaction as well as the parties' residences<sup>77</sup> and/or citizenship.<sup>78</sup> The UNCITRAL Model Arbitration Law combines multiple tests, bringing within its scope arbitrations in which (i) parties have places of business in different countries, (ii) the place of contract performance or the place of arbitration is outside the parties' home country, or (iii) the parties opt to treat the proceedings as international.<sup>79</sup>

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72. UNCITRAL MODEL LAW, adopted by the United Nations Commission on International Trade Law, June 21, 1985. *See generally* IGOR I. KAVASS & ARNO LIIVAK, UNCITRAL: MODEL LAW OF INTERNATIONAL COMMERCIAL ARBITRATION: A DOCUMENTARY HISTORY 70 (vol. 2, 1985).

73. The UNCITRAL Model Arbitration Law has been adopted on the federal level as well as by all Provinces. *See generally* Henri Alvarez, *The Role of Arbitration in Canada - New Perspectives*, 21 U.B.C. L. REV. 247 (1987); Henri Alvarez, *Judicial Intervention and Review under the International Commercial Arbitration Act*, in THE UNCITRAL MODEL LAW IN CANADA (R.K. Paterson & B.J. Thompson eds., 1987).

74. *See* Law Reform (Misc. Provision) (Scotland Act), 38 Eliz. 2, c. 40, § 66 (1990) (Eng.) (enacting the UNCITRAL Model Law for international transactions, and also gives parties to a non-international agreement the right to bring their arbitration within the Act). The UNCITRAL Model Law, as adopted in Scotland, is contained in Schedule 7 to the 1990 Act. *See generally* John Murray (Lord Dervaird), *Scotland and the UNCITRAL Model Law*, 6 ARB. INT'L 63 (1990). Article 34(2)(a)(v) of the Scottish version of the Model Law adds "corruption, fraud and bribery" as grounds for vacatur. Law Reform (Misc. Provisions) (Scotland Act), 51 Eliz. 2, Sch. 7, art. 34(2)(a)(v) (1992) (Eng.).

75. Hong Kong adopted almost verbatim the UNCITRAL Model Law in its 1990 Arbitration Ordinance, Hong Kong Laws Chapter 341. *See* Arbitration Ordinance, Hong Kong Laws Ch. 341 Part IIA §§ 34A-34D (1990) (P.R.C.). *See generally* NEIL KAPLAN, JILL SPRUCE & MICHAEL MOSER, HONG KONG AND CHINESE ARBITRATION: CASES AND MATERIALS (1994). Although the People's Republic of China has resumed sovereignty over the former British colony, Hong Kong remains a "Special Administrative Region" with many of its own laws, including a separate arbitration ordinance. *See* BASIC LAW OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA (Apr. 4, 1990) (in effect for a fifty-year transitional period ending June 30, 2047).

76. On characterization in conflict-of-laws, see Bernard Audit, *Qualification et Droit International Privé*, 18 DROITS: REVUE FRANÇAISE DE THEORIE JURIDIQUE 55 (1993).

77. *See, e.g.*, LDIP art. 176, 192 (1989) (Switz.).

78. For example, the United States excludes from the New York Convention contracts arising from relationships entirely between citizens of the United States, unless involving property, performance or enforcement abroad. 9 U.S.C. § 202 (2002).

79. UNCITRAL Model Arbitration Law, § 1(3).

A party-oriented test to define international arbitration, which looks to the residence of the litigants, has been adopted in Belgium<sup>80</sup> and Switzerland.<sup>81</sup> A less mechanical approach, asking whether a transaction implicates international commerce, has been adopted by the French.<sup>82</sup> To the limited extent that the United States recognizes international arbitration's specificity, a hybrid approach is taken.<sup>83</sup>

A residence-based test seems most sensible.<sup>84</sup> The linguistic and procedural differences that justify a *laissez-faire* arbitration regime are more likely to arise when U.S. residents seek to avoid having foreigners haul them into court in Paris, Rio, or Shanghai, rather than when one U.S. citizen sues another in New York over goods and/or services destined for export. A residence-based test would also meet concerns expressed by some nations that a separate legal

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80. See CODE JUDICIAIRE art. 1717 (Belg.) (making nationality as well as residence a criterion for application of the special international regime).

81. See LDIP art. 176 (1989) (Switz.) (applying the statutory provisions on international arbitration to arbitration if at least one of the parties had neither its domicile nor its habitual residence in Switzerland). For discussion of recent Swiss case law on the definition of international arbitration, see Gabrielle Kaufmann, *When is a Swiss Arbitration International?* JUSLETTER, Oct. 7, 2002, available at <http://www.weblaw.ch/jusletter> (last visited Sept. 16, 2003). Professor Kaufmann-Kohler calls into question a decision of the Swiss *Tribunal fédéral* of June 24, 2002, in which the arbitrators had considered the relevant criterion to be the residence of the parties to the arbitration agreement. *Id.* The reviewing court held that what counted was the residence of the parties to the arbitral proceedings, thus ignoring contracting parties which did not participate in the arbitration. *Id.*; see also LDIP art. 192 (1989) (Switz.) (covering the right to opt out of any judicial review of awards if neither party is resident in Switzerland).

82. See N.C.P.C. art. 1492 (Fr.) (referring to disputes that "implicate international commerce"). For a recent case testing this definition in the context of a consumer contract (where a pre-dispute arbitration clause would normally not be valid), see *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. *Id.*

83. The United States excludes contracts between U.S. citizens from the scope of the New York Convention, which covers primarily foreign awards. 9. U.S.C. § 202 (2003). However, an agreement between U.S. citizens will be deemed to fall under the Convention if the parties' relationship "involves property located abroad, envisages performance or enforcement abroad or has some other reasonable relation with one or more foreign states." *Id.*; see *Lander v. MMP Invs.*, 107 F.3d 476, 478-80 (7th Cir. 1997) (in which the Convention was applied between two American companies in connection with their contract to distribute manufacturer's shampoo products in Poland.) Moreover, the United States applies the New York Convention to non-domestic awards rendered in the United States if the award was made within the legal framework of another country (i.e. foreign law) or involving parties domiciled or having their principal place of business outside the United States. *Bergesen v. Joseph Muller Corp.*, 710 F.2d 928, 932 (2d Cir. 1983).

84. As a matter of drafting, corporate entities should probably be considered residents if organized under the law of, or possessing a principal place of business in, the forum country. Thus, for example, a U.S. branch of a foreign corporation would be considered a United States resident, as would an alien individual present in the United States more than 183 days during any calendar year.

framework for international arbitration conflicts with treaty prohibitions on nationality-based discrimination.<sup>85</sup>

#### IV. JUDICIAL SCRUTINY OF AWARDS

##### A. *Statute, Treaty, and Public Policy*

Judicial scrutiny of most awards made in the United States generally follows the lines provided by Chapter 1 of the FAA. By contrast, the New York Convention controls court review of foreign awards, which is to say decisions rendered abroad.<sup>86</sup>

As discussed earlier, things are a bit more complicated for awards made in the United States that have a direct nexus to international commerce. These arbitrations may give rise to an overlap between the judicial control allowed under the FAA for awards rendered in the United States and the New York Convention provisions applicable to awards “not considered as domestic.”<sup>87</sup>

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85. See *Phillip Alexander Securities & Futures Ltd. v. Bamberger*, Court of Appeal, reported in *The Times*, July 22, 1996 (losses in futures trading in an Anglo-German transaction). Sections 85-87 of the 1996 English Arbitration Act (containing a special regime for domestic arbitration prohibiting pre-dispute waiver of appeal on points of English law) never entered into force due to a perceived conflict with TREATY ESTABLISHING THE EUROPEAN COMMUNITY, as amended by the TREATY ON EUROPEAN UNION, which in Article 12 (former Article 6) provides that “any discrimination on the grounds of nationality shall be prohibited.” Concern was expressed that provisions of the British consumer protection law would have protected British but not German customers, and that even a residence based distinction might have constituted disguised nationality-based discrimination. The Secretary of State was given the right to order repeal or amendment of the protective régime (Act § 88) which was exercised in Section 3, Statutory Instrument 3146, providing that the Act would come into force “except sections 85 to 87” (relating to domestic arbitration). The English decision to forego a separate international regime is a bit puzzling, since the British could have dodged the EU bullet with something like the French test for characterizing arbitration, which looks to see whether the arbitration “implicates international commerce.” Belgium, thus far, seems to have gotten away with using nationality as one of the tests for its special regime allowing exclusion of all court review. See CODE JUDICIAIRE art. 1717(4) (Belg.).

86. New York Convention art. I(1). For example, courts in Boston would normally apply the Convention to an award made in Paris, but not to an award rendered in Chicago. See FAA Chapter 2. For Latin American countries, the Panama Convention applies many of the same principles. See FAA Chapter 3. When the requirements for both the Panama and New York Conventions are met, the former applies if a majority of the parties to the arbitration agreement are citizens of states that have ratified or acceded to that Convention. 9 U.S.C. § 305 (2002).

87. New York Convention art. I (3) and 9 U.S.C. § 202, discussed *supra* notes 25-26 and accompanying text. For cases interpreting the reference in Article I to awards “not considered as domestic,” see *Lander Co. v. MMP, Invs.*, 107 F.3d 476, 478-80 (1997) (describing an arbitration between two American companies selling shampoo in Poland), *Bergesen v. Joseph Muller Corp.*, 710 F.2d 928, 931 (2d Cir. 1983) (arbitration between Swiss company and Norwegian ship owner).

While such non-domestic awards are explicitly subject to standards for confirmation enumerated in the New York Convention, nothing is said about any special grounds for their vacatur. This problematic disjunction between grounds to confirm and grounds to vacate<sup>88</sup> is particularly troublesome since in practice awards will be subject to simultaneous motions to vacate (by the loser) and to confirm (by the winner). Consequently, any modification to the FAA might coordinate the vacatur and confirmation principles applied to “non-domestic” awards.<sup>89</sup>

At first blush it may seem puzzling that courts intervene at all in a process designed to be private. Ironically, it is precisely the business managers’ desire to have their disputes settled out of court that leads judges to play a role in international arbitration. When a litigant resists implementation of the bargain to arbitrate, courts must decide whether to defer to the parties’ contract.

Arbitration proceeds in the shadow of government power at several stages. The validity of an arbitration clause may first be questioned in a motion to compel arbitration or to stay judicial proceedings. During the arbitration itself, litigants sometimes request interim measures such as enforcement of subpoenas or pre-award attachment of assets.

Perhaps the most critical point comes in the arbitration endgame, after the arbitrator’s decision, when the loser may resist award recognition. As one form of risk management, judicial review attempts to resolve tensions between the rival goals of award finality (necessary to make arbitration reliable) and procedural fairness (without which aberrant decisions would sap community confidence in the process). Annulment of aberrant awards also has an *in terrorem* effect that helps to reduce problems at earlier stages, since most arbitrators are understandably averse to the public rebuke inherent in having their awards vacated.

If an award is set aside where made, it not only becomes unenforceable at the situs but also may lose its treaty-based validity abroad.<sup>90</sup> Judicial review is vital when the winner seeks to attach the loser’s assets or to block competing lawsuits.<sup>91</sup>

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88. See 9 U.S.C. § 207 (2002). (incorporated by reference into implementation of the Panama Convention). In addition, the FAA extends to three years the time for confirmation of “non-domestic” awards, while confirmation of domestic awards must be made within one year from the date of the award. 9 U.S.C. § 9 (2002).

89. See *id.*

90. It may be that under national law an award is enforceable regardless of the absence of any treaty mandate. See generally *Chromalloy Aeroservices v. Egypt*, 939 F. Supp. 907, 911 (D.D.C. 1996); see also New York Convention art. V(1)(e), discussed in William W. Park, *Duty and Discretion in International Arbitration*, 93 AM. J. INT’L ARB. 805 (1999); Christopher R. Drahozal, *Enforcing Vacated International Arbitration Awards: An Economic Approach*, 11 AM. REV. INT’L ARB. 451 (2000).

91. See generally William W. Park, *Duty and Discretion in International Arbitration*, 93 AM. J. INT’L ARB. 805 (1999).

At all stages of the arbitral process, questions may arise about the “subject matter arbitrability” of cases that affect sensitive public norms and delicate choice-of-law issues.<sup>92</sup> However, a long line of federal court decisions has distinguished domestic and international arbitrability, recognizing a hierarchy of values that make it inappropriate in international arbitration to impose flat prohibitions on arbitration of public law questions such as antitrust and securities regulation.<sup>93</sup> Nevertheless, American courts have indicated that they will refuse to recognize arbitration clauses that operate in tandem with choice-of-law provisions to constitute a “prospective waiver” of otherwise applicable mandatory norms.<sup>94</sup>

The Convention’s practical effectiveness can also depend on the idiosyncrasies of national procedural law. The New York Arbitration Convention requires enforcement of awards “in accordance with the rules of procedure of the territory where the award is relied upon.”<sup>95</sup> Recent Court of Appeals decisions have shown how troublesome national law can be, citing the above-quoted language (“procedure of the territory where the award is relied upon”) as an escape hatch from treaty enforcement obligations. On *forum non conveniens* grounds, one court has refused to confirm an award rendered in Moscow,<sup>96</sup> while another has denied recognition to a London award

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92. Article V(2) of the New York Convention permits courts to refuse award recognition *sua sponte* if they find “the subject matter of the difference is not capable of settlement by arbitration” or “the recognition or enforcement of the award would be contrary to the [recognition forum’s] public policy.”

93. See generally *Mitsubishi Motors Corp.*, 473 U.S. 614, 637-38 (1985) and *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); see also *Sonatrach v. Distrigas Corp.*, 80 B.R. 606, 612 (Bankr. D. Mass. 1987). See generally William W. Park, *Private Adjudicators and the Public Interest: The Expanding Scope of International Arbitration*, 12 BROOKLYN J. INT’L L. 629 (1986); Stephen J. Ware, *Default Rules from Mandatory Rules: Privatization of Law Through Arbitration*, 83 MINN. L. REV. 703 (1999). The decision in *Mitsubishi* presumed that American courts could control aberrant arbitral decisions by taking a second look at awards to insure that public policy concerns were properly addressed. *Mitsubishi*, 473 U.S. at 638. This approach is not without its problems. In an international context, assets outside the United States may be available to enforce awards, obviating any need for the assistance of American courts. Moreover, in arbitrations outside the United States arbitrators will understandably fear that departure from the parties’ choice of law will increase the risk of award vacatur at the situs on the basis of excess of arbitral authority.

94. *Mitsubishi*, 473 U.S. at 637.

95. New York Convention art. III.

96. See *Monégasque de Reassurances SAM v. Nak Naftogaz of Ukraine*, 158 F. Supp. 2d 377, 380 (S.D.N.Y. 2001), *aff’d* 311 F.3d 488 (2002). The award was rendered in connection with a gas pipeline in Ukraine. *Id.* A reinsurance company based in Monaco (subrogated to the rights of a Russian company) sought recognition of an \$88 million award against the defaulting party. *Id.* Complicating factors in the case include the fact that one respondent (Ukraine) was both a sovereign state and a non-signatory to the arbitration agreement. *Id.* While theories exist under which non-signatories of arbitration clauses may be bound (such as agency, alter ego and estoppel), the Second Circuit noted that application of any of these principles would



on the basis that “minimum contacts” with the United States were absent, thus raising U.S. Constitutional notions of “due process” and personal jurisdiction.<sup>97</sup>

The decisions are unsettling to many observers who read the Convention reference to national law as including only minor matters such as filing requirements and fees.<sup>98</sup> Significantly, however, the decisions note an absence of identifiable property within the jurisdiction,<sup>99</sup> thus reducing the effect of the cases to situations in which a winning respondent seeks award recognition in order to preclude competing lawsuits.

## B. *Why, When, and How Courts Review Awards*

### 1. Alternatives

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require extensive discovery of documents outside the United States, and most probably a trial. *Monegasque*, 311 F.3d at 500.

97. See *Glencore Grain Rotterdam BV v. Shivnath Rai Harnarain*, 284 F.3d 1114, 1127 (9th Cir. 2002) (discussing London Rice Brokers’ Ass’n arbitration) (stating that sales in California not sufficient to establish jurisdiction over transaction involving a Dutch grain trader and an Indian rice exporter); see also *CNA Reinsurance Co. v. Trustmark Ins. Co.*, 2001 WL 648948 (N.D. Ill. 2001). The Third and Fourth Circuits reached similar results in cases bearing the same name relating to attempts to enforce the same award, arising out of contracts between a Guernsey metals trader and a Russian mining company. See *Base Metal Trading v. OJSC Novokuznetsky Aluminum Factory*, 283 F.3d 208, 215-16 (4th Cir. 2002); *Base Metal Trading v. OJSC Novokuznetsky Aluminum Factory*, 2002 WL 31002609 (3d Cir. 2002) (finding a lack of the “minimum contacts” with the United States required by due process).

98. To apply an admittedly imperfect analogy, while in the United States local law generally determines grounds for revocation of arbitration clauses, a state may not impose legal obstacles that sabotage the pro-arbitration policy of the Federal Arbitration Act. See *Doctor’s Assocs. v. Casarotto*, 517 U.S. 681, 686 (1996); *Allied-Bruce Terminex v. Dobson*, 513 U.S. 265, 281-82 (1995); *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Securities Industry Ass’n v. Connolly*, 883 F.2d 1114, 1114 (1st Cir. 1989).

99. In *Monégasque de Reassurances*, the district court stated that “it is not clear that Naftogaz has any assets in the United States from which Monde Re could recover.” *Monégasque de Reassurances S.A.M. (Monde Re) v. Nak Naftogaz of Ukraine*, 158 F. Supp. 2d at 386. The Second Circuit stated that “the jurisdiction provided by the [New York] Convention is the only link between the parties and the United States.” 311 F.3d at 499. In *Glencore* the Ninth Circuit stated that “Glencore fails to identify any property owned by Shivnath Rai in the forum against which Glencore could attempt to enforce its award.” *Glencore*, 284 F.3d at 1128. The presence of property would seem relevant in light of the decision in *Shaffer* making a distinction between jurisdiction on the merits of a dispute and jurisdiction to enforce judgment. See *Shaffer v. Heitner*, 433 U.S. 186, 186 n.36 (1977):

Once it has been determined by a court of competent jurisdiction that the defendant is a debtor of the plaintiff, there would seem to be no unfairness in allowing an action to realize on that debt in a State where the defendant has property, whether or not the State would have jurisdiction to determine the existence of the debt as an original matter.

For a subsequent analysis of *Shaffer*, see generally *Burnham v. Superior Court of California*, 495 U.S. 604 (1990), discussing California jurisdiction to serve a New Jersey resident in the context of a divorce petition.

As in any reform, overhaul of arbitration rules and statutes implicates a process of comparing alternatives. Most countries permit judges to vacate decisions of perverse arbitrators who have ignored basic procedural fairness or overreached their authority.<sup>100</sup> Another paradigm also gives a right to appeal an award's substantive legal merits.<sup>101</sup> Some countries allow a choice between these alternatives, with default rules that require litigants either to "opt in"<sup>102</sup> or to "opt out"<sup>103</sup> of appeal on the substantive merits of the case<sup>104</sup> or permit hybrid grounds for vacatur that imply something beyond a simple mistake.<sup>105</sup>

## 2. Situs Review

Public scrutiny of arbitration is inevitable at the time of award recognition. Judges can hardly ignore the basic fairness of an arbitral proceeding when asked to give an award *res judicata* effect by seizing assets or staying a court action. Less evident, in an international context, is why the arbitral situs should necessarily monitor an award prior to an enforcement action. Often an arbitral situs is chosen only for geographical convenience or procedural neutrality,<sup>106</sup> and the dispute involves neither property nor activity at the place of arbitration. In such circumstances, the arbitral situs might dispense with any pre-enforcement review of the arbitrator's decision.

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100. See, e.g., UNCITRAL MODEL LAW art. 34; N.C.P.C. art. 1502 (Fr.); ZPO art. 1059 (F.R.G.); LDIP art. 190 (1989) (Switz.); 9 U.S.C. § 10 (2000). While the Swiss statute does not enumerate bias explicitly, other bases for vacatur (such as lack of due process or violation of public policy) serve to address arbitrator prejudice. In some cases "public policy" is added as a ground for vacatur. See UNCITRAL MODEL LAW, art. 34(2)(b)(ii); N.C.P.C. art. 1502(5) (Fr.); ZPO, art. 1059(2)2.b (F.R.G.); LDIP art. 190(2)(e) (1989) (Switz.). See generally William W. Park, *Why Courts Review Arbitral Awards*, in RECHT DER INTERNATIONALEN WIRTSCHAFT UND STREITERLEDIGUNG IM 21. JAHRHUNDERT: LIBER AMICORUM KARL-HEINZ BÖCKSTIEGEL 595 (R. Briner et al., eds., 2001).

101. See Arbitration Act, 1996, § 69 (Eng.); William W. Park, *The Interaction of Courts and Arbitrators in England*, 1 INT'L ARB. L. REV. 54 (1998), reprinted in 13 INT'L ARB. REP. 21 (June 1998).

102. See discussion of *Harris v. Parker* and related cases, discussed *infra* notes 145 and accompanying text.

103. See Arbitration Act, 1996, § 69 (Eng.) (permitting exclusion of appeal on questions of English law).

104. See discussion of Switzerland's arbitration regime *infra* notes 239-44 and accompanying text.

105. See discussion of vacatur for "manifest disregard of the law" *supra* notes 32-39 and accompanying text. Moreover, Swiss cantonal law has long allowed awards to be set aside for "arbitrariness," defined to include "evident violations of law or equity." See CONCORDAT SUISSE SUR L'ARBITRAGE art. 36(f) (1969) (Switz.).

106. See also W. MICHAEL REISMAN, SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION 113, 116 (1992) (distinguishing between "primary" and "secondary" control). See generally W. LAURENCE CRAIG, ET AL., INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION, 28.03 (3d ed. 2000).

The proper extent of judicial review of awards at the arbitral situs has been the subject of lively debate between those favoring a “delocalized” regime with little or no judicial scrutiny of international arbitration and advocates of a more territorial approach that gives greater leeway to courts to monitor arbitrations conducted within their jurisdiction.<sup>107</sup> Some countries have deliberately reduced the impact of local law on international arbitration.<sup>108</sup>

The trend toward delocalization does not mean that courts at the place of arbitration should never review awards. The prospect of no court scrutiny at the arbitral situs is almost certain to affect adversely the victims of defective arbitrations, the health of international arbitration, and in some cases the interests of the reviewing state itself.<sup>109</sup> After the fact, of course, the winner will reject extensive court intervention, while the loser will see appeal as a less appalling prospect. However, at the time the arbitration clause is signed, before the results of any arbitration are known, the existence of basic procedural safeguards will enhance rather than diminish the arbitral process.

### 3. Efficiency

Although no system of judicial review will be completely foolproof (fools being quite ingenious), common sense suggests that arbitrator misconduct is less likely when questionable behavior is subject to public scrutiny relatively soon after the proceedings.<sup>110</sup> Situs review

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107. See also William W. Park, *Lex Loci Arbitri and International Commercial Arbitration*, 32 INT'L & COMP. L.Q. 21, 22-47 (1983); William W. Park, *Duty and Discretion in International Arbitration*, 93 AM. J. INT'L LAW 805, 808-13 (1999); Jan Paulsson, *Delocalisation of International Commercial Arbitration*, 32 INT'L & COMP. L.Q. 53, 53-61 (1983); cf. Philippe Fouchard, *La Portée internationale de l'annulation de la sentence arbitrale dans son pays d'origine*, 1997 REV. ARB. 329, 351-52 (1997); Francis Mann, *Lex Facit Arbitrum*, in LIBER AMICORUM FOR MARTIN DOMKE 157 (P. Sanders ed., 1967), reprinted in 2 ARB. INT'L 241, 254-61 (1986).

108. Until 1989, for example, arbitrations in Switzerland were subject to the Intercantonal Arbitration Concordat, which in Article 24 directs arbitrators to fill procedural gaps by reference to Swiss federal law. By contrast, analogous provisions of the current Swiss international arbitration law contain no such rule, but permit the parties to agree upon the rules of procedure, either directly or by reference to the rules of an arbitration institution or a national procedural law of their choice.

109. This conclusion assumes an honest judiciary. An absence of situs review might be preferable in parts of the world lacking a tradition of judicial independence, where the business community may prefer to take its chances with potential arbitrator misbehavior as the lesser of two evils. In practice, the risk of corrupt judges is best addressed through the market, by the parties' informed choice of the arbitral situs.

110. For example, the prospect of judicial review is likely to sensitize arbitrators to the potential benefit in allowing testimony from a witness they might otherwise not wish to hear. Whether the expense of procedural fairness is justified will depend on the facts of each case. Every additional witness costs time and money. Equilibrium in judicial review requires constant sensitivity to the competing concerns of winners and losers. For divergent analyses of the effect of procedural safeguards on arbitration, compare generally Eric Posner, *Arbitration and the Harmonization of International Commercial Law*, 39 VA. J. INT'L L. 647 (1999) with Keith N. Hylton, *Agreements to*

usually occurs immediately after the award is rendered, when documents and witnesses are more readily available and recollections have not become stale.

By promoting confidence that arbitration will not be a lottery of erratic results, situs review also furthers respect for awards outside the country in which the arbitration occurs. Without a right to have procedurally unfair awards vacated at the situs, victims of procedural irregularity must prove an award's illegitimate character *de novo* wherever it might be presented for recognition, running from country to country to oppose invalid decisions.<sup>111</sup> For the defendant, this might mean greater difficulty in resisting asset attachment in multiple jurisdictions where property is located. The claimant would face the equally daunting task of showing that the defective award should not bar subsequent arbitral proceedings.<sup>112</sup>

Perhaps the best evidence of business community desire for court scrutiny at the arbitral situs lies in Belgium's failed experiment in mandatory "non-review" of awards.<sup>113</sup> Hoping that a completely *laissez-faire* system would attract arbitration, in 1985 Belgium eliminated all motions to vacate awards in disputes between foreign parties.<sup>114</sup> Contrary to expectations, business managers turned out to be unimpressed by the new system.<sup>115</sup> Consequently, in 1998 the Belgian legislature enacted a new statute that now leaves a safety net of judicial review as the default rule.<sup>116</sup>

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*Waive or to Arbitrate Legal Claims: A Legal Analysis*, 8 SUP. CT. ECON. REV. 209 (2000).

111. This concern lay at the heart of France's international arbitration decree, promulgated after court decisions held that French judges lacked power to vacate awards made in international arbitrations. By allowing award annulment for procedural irregularity, excess of authority and violation of public policy, N.C.P.C. art. 1502 (Fr.) now addresses fears that a complete absence of judicial control might lead foreign courts to hesitate to enforce French awards. Décret No. 81-500, May 12, 1981, 1981 J. OFFICIEL RÉP. FRANÇAISE 1398-1406, in effect reversing *Gen. Nat'l Maritime Transp. Co. v. Société Götaverken Arendal*, Feb. 21, 1980, *Cour d'appel de Paris*, REV. ARB., 1980, 524 and *AKSA v. Norsolor*, Dec. 9, 1980, *Cour d'appel de Paris*, 1981 REV. ARB., 1981, 306; 20 I.L.M. 883.

112. See *Hilmarton v. OTV*, *Cour de cassation*, REV. ARB. June 10, 1997, 376 (an award vacated in Switzerland granted *exequatur* in France). For earlier decisions in the *Hilmarton* matter, see *Cour d'appel de Paris*, REV. ARB. 1993, 300, confirmed by *Cour de cassation*, REV. ARB. 1994, 327 (recognizing the vacated award) and *Cour d'appel de Versailles*, REV. ARB. 1995, 639 (upholding a decision by the *Tribunal de grande instance de Nanterre* recognizing a second award rendered after annulment of the award recognized earlier in France).

113. See discussion *infra* notes 114-15 and accompanying text.

114. See CODE JUDICIAIRE art. 1717(4) (Belg.) (as enacted in 1985, before amendment of May 19, 1998, effective August 17, 1998).

115. See Bernard Hanotiau & Guy Block, *La loi du 19 mai 1998 modifiant la législation belge relative à l'arbitrage*, 16 ASA BULL. 528, 532 (1998).

116. So far there seems to be little reliable indication of how the business community has received this change, particularly in light of arbitration's

#### 4. Vitality of National Substantive Law

In addition to efficiency arguments discussed above, some countries have also adopted merits review of awards to foster the development and stability of the forum's substantive law. By their public nature, court cases often create behavioral rules to guide business conduct outside a particular dispute.<sup>117</sup> Mandatory judicial review of awards on the legal merits of the case thus fertilizes legal development by creating a publicly available "legal capital" of new principles to meet changing commercial circumstances.<sup>118</sup> Concerns about the development of substantive law once led England to restrict waiver of appeal on points of English law in so-called "special category" arbitrations related to insurance, commodity contracts and admiralty questions.<sup>119</sup> While arbitration also creates precedent through reasoned awards published in sanitized form,<sup>120</sup> such *lex mercatoria* is arguably less accessible than a court case given the duty of confidentiality covering much arbitration.<sup>121</sup>

The history of securities arbitration in the United States has illustrated the utility of such review. Following the United States Supreme Court decision to uphold the arbitrability of customer claims

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confidentiality. Article 1717(4) of the Belgian Judicial Code provides that any challenge to awards must be made through an explicit statement.

117. Under the "public law model" of litigation, cases guide future transactions of non-litigants. See Robert G. Bone, *Lon Fuller's Theory of Adjudication and the False Dichotomy Between Dispute Resolution and Public Law Models of Litigation*, 75 B.U. L. REV. 1273, 1293-98 (1995). For discussion of analogous notions in connection to resolution of disputes arising from internet sales, see Michael Schneider & Christopher Kuner, *Dispute Resolution in International Electronic Commerce*, 14 J. INT'L ARB. 5 (Sept. 1997) at <http://www.disputes.net/cyberweek2001/interelecommerce.htm> (last visited Aug. 31, 2003).

118. In the United States, one influential proponent of this perspective argues that the law should discourage settlement as well as arbitration agreements. See Owen Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1085-87 (1984).

119. See Arbitration Act, 1979 § 4(1) (Eng.) (abrogated in 1996) (prohibiting exclusion of appeal on the merits of a case unless either the contract was explicitly subject to a legal system other than English law or the exclusion was concluded after the arbitration began). The drafters of England's 1979 Arbitration Act operated on the assumption that the law of England should have preeminence in the restricted areas, to be maintained by new judgments covering new commercial controversies. "Commodity contract" was defined to include agreements for the sale of goods on English commodity exchanges. Maritime questions were defined as claims falling within the Admiralty jurisdiction of the High Court. See generally William W. Park, *Judicial Supervision of Transnational Commercial Arbitration*, 21 HARV. INT'L L.J. 87, 100 (1980).

120. See generally 1 ICC ARBITRAL AWARDS 1971-85 (Sigvard Jarvin & Yves Derains eds., 1990); 2 ICC ARBITRAL AWARDS 1986-90 (Sigvard Jarvin et al. eds., 1994); 3 ICC ARBITRAL AWARDS 1991-95 (Jean-Jacques Arnaldez et al. eds., 1997).

121. See generally William W. Park, *Control Mechanisms in the Development of a Modern Lex Mercatoria*, in LEX MERCATORIA AND ARBITRATION 143, 165-66 (Thomas Carbonneau ed., 1990) (rev. 1998).

against brokerage houses,<sup>122</sup> there has been a marked decrease in court decisions addressing broker-customer relations, resulting in a freeze of the relevant law.<sup>123</sup>

On balance, merits review would clearly *not* be appropriate for an international arbitration statute, at least not as a default rule. In international arbitration, the parties' interest in procedural neutrality would almost always outweigh any benefits derived from using commercial disputes to develop substantive law.<sup>124</sup> Moreover, the argument for substantive merits review is strongest when the law of the situs governs the relevant contract, which is much less frequent in international rather than domestic contracts.<sup>125</sup>

## V. THE DEVIL IN THE DETAILS: POSSIBLE CONTOURS OF NEW FAA PROVISIONS

### A. *Optimal Judicial Review for International Arbitration*

An optimum legal framework for international arbitration would limit court scrutiny to narrow review standards, regardless of whatever judicially-administered anti-abuse measures might be appropriate for domestic cases. The best default rule for judicial review of international awards gives losers a right to challenge awards only for excess of authority and basic procedural unfairness (bias or denial of an opportunity to present one's case), but not the merits of the case.<sup>126</sup>

If the substance of a dispute could regularly be second-guessed by judges, arbitration would become no more than foreplay to litigation. A century and a half ago, the U.S. Supreme Court refused to allow an award vacatur for mistake of fact or law, noting that to do so "would make an award the commencement, not the end, of

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122. See *Shearson/American Express v. McMahon*, 482 U.S. 220, 222-24 (1987) (fraud claims under Exchange Act § 10b and Rule 10b-5); *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477 (1989) (Securities Act § 12(2) claims).

123. See Alan R. Palmiter, *SECURITIES REGULATION* § 11.2.5, at 366 (2d ed. 2002).

124. The negative effect of the law being developed through awards rather than cases is more worrisome with respect to consumer transactions, where awards traditionally do not state reasons (at least in the United States) and are not published.

125. While the law of the arbitral situs does sometimes govern cross-border contracts, more often the dispute resolution clause represents a compromise, with language clauses such as "Arbitration in Geneva under English law" providing for arbitration in one country under the law of another.

126. As discussed *infra* notes 140-44 and accompanying text, proposal of the "fairness" model for judicial scrutiny of awards as a default rule does not mean that "merits review" should not be added on an optional basis.

litigation.”<sup>127</sup> On occasion this may result in what the Second Circuit once called “looser approximations” of rights than those available in court.<sup>128</sup>

Limited review, however, does not mean no review at all. Few commercial actors would want to buy into a system with no prospect for rectifying gross procedural unfairness. In agreeing to arbitrate, business managers generally assume the risk that arbitrators may “get it wrong” on the substance of the dispute but do not bargain for denial of fundamental due process. When one side regrets its bargain to arbitrate *after* the award is rendered, courts should maintain a relatively hands-off approach that balances the interests of winners and losers.<sup>129</sup> Normally, judicial intervention is justified only to promote the basic integrity of the process and the arbitrators’ respect for the contours of their mission.<sup>130</sup>

A statute for international arbitration should exclude consumer and employment contracts, at least below certain statutorily defined limits.<sup>131</sup> Such a “carve out” would reduce the type of conflict that has

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127. See *Burchell v. Marsh*, 58 U.S. 344, 349 (1855). In *Burchell*, a New York merchant succeeded in ruining the business of an Illinois store owner through oppressive lawsuits, and by having the store owner arrested on charges of dishonesty and perjury. To resolve the differences between them, the parties agreed to arbitration (called “arbitrament” in the agreement) by a three member panel that awarded damages which effectively wiped away the debt of the ill-treated Illinoisan. In reversing a circuit court vacatur of the award, the Supreme Court provided a succinct précis of the proper scope of judicial review in arbitration:

If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact. A contrary course would be a substitution of the judgment of the chancellor [the judiciary] in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation.

*Id.*

128. *Am. Almond Prods. v. Consol. Pecan Sales*, 144 F. 2d 448, 451 (2d. Cir. 1944) (Hand, J.) (confirming an award for breach of contract in the sale of pecans where arbitrators had awarded damages even without evidence on market price).

129. A dissent by Justice Holmes commented that “[t]he most enlightened judicial policy is to let people manage their own business in their own way, unless the ground for interference is very clear.” *Dr. Miles Med. Co. v. John D. Park & Sons*, 220 U.S. 373, 386 (1911).

130. The text of the law, of course, must be read in the context of its application. Even a statute that allows challenge only for defects related to procedural regularity may allow wiggle room for an overzealous judge to examine a dispute’s legal merits under the guise of correcting arbitrator excess of authority. For an English perspective on the relationship between error of law and excess of jurisdiction, see ALFRED T. DENNING, *THE DISCIPLINE OF THE LAW* 74 (1979) (“Whenever a tribunal goes wrong in law it goes outside the jurisdiction conferred on it and its decision is void.”). See also *Pearlman v. Keepers and Governors of Harrow School*, 3 W.L.R. 736, 743 (Eng. C.A. 1978) (“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.”).

131. The statute might also exclude agreements with small businesses. However, as Rudyard Kipling might have written, this question involves other stories for another day. For the time being it might be placed in a box of thoughts labeled “awaiting further light.”

sometimes arisen when international arbitration statutes were not clear about the scope of their coverage.<sup>132</sup>

The UNCITRAL Model Law might serve as a useful starting point for developing grounds for judicial review of awards in an international dispute,<sup>133</sup> subject to several modifications. Suggested language for a new FAA Chapter is set forth in the Appendix, incorporating appropriate portions of the Model Law.

First, vacatur on grounds of “public policy” remains highly problematic, principally because this chameleon-like concept risks misapplication when refracted through parochial cultural lenses.<sup>134</sup> While public policy analysis is unavoidable when judges seize property, such a malleable notion may not be necessary when enforcement is not requested.<sup>135</sup> By contrast, procedural defects such as excess of authority and denial of the right to be heard, being more universal in nature, lend themselves less to disruptive application.<sup>136</sup>

Admittedly, some public policy violations will call for judicial action. If an award rendered in Boston grants damages for the sale of illegal arms to a terrorist organization, a court in Massachusetts

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132. See *Meglio v. Société V2000, Cour de cassation*, 1997 REV. ARB. 537 (note E. Gaillard); 1998 REV. CRIT. DR. INT'L PRIVÉ 87 (note V. Heuzé) (holding that French resident's purchase of limited series Jaguar escaped restrictions on consumer arbitration).

133. Article 34 of the Model Law allows award vacatur for (i) invalidity of the agreement, (ii) lack of proper notice, (iii) excess of arbitral jurisdiction, (iv) irregular composition of the arbitral tribunal, (v) non-arbitrable subject-matter and (vi) conflict with public policy.

134. See, e.g., *Laminoirs-Trefileries-Cableries de Lens, S.A. v. Southwire Co.*, 484 F. Supp. 1063, 1068-69 (N.D. Ga. 1980) (vacating award that applied French interest rate to international contract).

135. If German and Italian companies choose New York to arbitrate a dispute that has no effect in the United States, it might be best to leave to European judges the task of deciding whether the award is compatible with whatever public policy might be represented by usury laws or currency controls.

136. Other than when raised before the arbitral tribunal itself, public policy may be considered by courts not only when asked to vacate, confirm or recognize an award, but also when asked to enforce an agreement to arbitrate. In the last of these contests public policy is usually discussed as “subject matter arbitrability.” For two recent attempts in England to address public policy in the context of international commercial arbitration, see *Westacre Investments v. Jugoimport*, 1999 Q.B. 740 (Eng.), *aff'g* Q.B., December 19, 1997, 3 W.L.R. 770 (Eng.) and *Soleimany v. Soleimany, C.A.*, 3 W.L.R. 811 (1998) (Eng.). See also Homayoon Arfazadeh, *L'ordre public du fond et l'annulation des sentences arbitrales internationales en Suisse*, REV. SUISSE DR. INT. & DR. EUROPÉEN 223 (1995). See generally Audley Sheppard & Nagla Nassar, Co-Rapporteurs, *Final Report on Public Policy as a Bar to Enforcement of International Arbitral Awards*, in INT'L LAW ASS'N, COMMITTEE ON INTERNATIONAL COMMERCIAL ARBITRATION, PROCEEDINGS OF NEW DELHI CONFERENCE (2002), available at <http://www.ila-hq.org/pdf/international%20commercial%20arbitration/international%20commercial%20arbitration%202002.pdf> (last visited Sept. 16, 2003). The report states that award non-recognition may be justified for violation of “international public policy” (emphasis added), which is described in the negative as something other than policy “common to many States” and as “narrower in scope than domestic public policy.” *Id.*



would have a hard time resisting vacatur of the decision.<sup>137</sup> The issue is not so much the existence of a properly-conceived escape hatch but the temptation to invoke the concept abusively on parochial grounds.

One option might be to adopt explicitly the French distinction between public policy applicable to domestic and international cases.<sup>138</sup> The latter concept, referred to as *internationale* public policy, would be constituted not by any supra-national norms, but rather by the policy applied by national courts to cross-border transactions with no direct impact on the forum.

Second, arbitrator bias and corruption should be included explicitly as grounds for annulment. The Model Law contains no reference to annulment for partiality, and thus public policy must be pressed into service to deal with defective awards rendered by biased arbitrators. A direct approach to the problem would be superior. Sensibly, Scotland's adoption of the Model Law contains special provisions in this regard.<sup>139</sup>

Finally, litigants might be given an explicit statutory option to contract into review on the legal and factual merits of the dispute. On exclusion, American courts have traditionally taken the position that parties may not dispense with the minimum standard of review provided by the FAA.<sup>140</sup> However, circuits are divided on whether

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137. Similarly, a U.S. judge might vacate an award implementing religious or racial discrimination even if allowed under the applicable foreign law.

138. See N.C.P.C. art. 1502(5) (Fr.). While both *internationale* and *domestic* public policy are creatures of French courts, the latter addresses policies relevant only in an internal context. The former implicates cross-border rather than purely French interests. Thus an international commercial dispute may be arbitrable even though the principal contract from which it arises violates French domestic public policy. Examples of violations of international public policy include procedural fraud (falsifying documents) and improper extension of time limits for rendering an award. See also BERNARD AUDIT, *DROIT INTERNATIONAL PRIVÉ* § 302 (1991) (suggesting that a better terminology might be "public policy in the sense of private international law" (*ordre public au sens du droit international privé*)). See generally HENRI BATIFFOL & PAUL LAGARDE, *DROIT INTERNATIONAL PRIVÉ* § 363 (8th ed. 1993).

139. See Law Reform (Misc. Provision) (Scotland Act), 1990, c.40, schedule 7, art. 34(2)(a)(v) (Eng.) (allowing vacatur if an award "was procured by fraud, bribery or corruption").

140. See, e.g., *Hoelt v. MVL Group, Inc.*, 343 F.3d 57 (2003) (holding that a federal court is not deprived if the power to review an award for "manifest disregard of law" because the parties have provided that the award "shall not be subject to any type of review or appeal whatsoever"). See also *M & C Corp. v. Erwin Behr GmbH*, 87 F.3d 844, 847 (6th Cir. 1996) (stating that contract terms purporting to waive judicial review "merely reflect a contractual intent that the issues joined and resolved in the arbitration may not be tried *de novo* in any court"). Only one American decision has suggested (in ill-reasoned *dictum*) that there exists a right to discard the minimum grounds for vacatur under the FAA. See *Roadway Package System, Inc. v. Kayser*, 257 F.3d 287, 293 (3d Cir. 2001) (suggesting that parties could "opt out of the FAA's off-the-rack vacatur standards"). Surprisingly, the court cited cases (*Lapine* and its progeny) relating not to exclusion of review, but to expansion of court scrutiny. Courts in France have taken a similar approach. Attempts to waive N.C.P.C. art. 1504 were dismissed in *Diseno v. Société Mendes*, *Cour d'Appel de Paris*, Oct. 24, 1994, 1995 REV. ARB. 263. See generally PHILIPPE FOUCHARD, EMMANUEL GAILLARD & BERTHOLD GOLDMAN, *TRAITÉ DE L'ARBITRAGE COMMERCIAL INTERNATIONAL* § 1597, at 931 nn.142-46 (1996).

parties to an arbitration clause can by contract expand the judicial review function.<sup>141</sup> Some allow expansion,<sup>142</sup> while others hold that the FAA's grounds for court scrutiny constitute a ceiling as well as a floor.<sup>143</sup>

While some commentators fear that to allow expansion of judicial review would change the character of arbitration, creditable arguments exist in favor of freedom of contract on the matter. At least as between sophisticated parties to an international contract, the right to elect merits review would seem almost a corollary of the right to elect courts. The wisdom of providing for judicial review in a given case is a question quite different from whether the right should be available.<sup>144</sup>

Concerning the parties' ability to *lower* the judicial review standards by excluding all court scrutiny at the situs, the right rule is less certain. When all parties are from outside the United States the chances of the award affecting American interests are slim, which would favor allowing litigants the liberty to eliminate the possibility of vacatur where the award is rendered. However, an award's international currency is likely to be enhanced by some minimum review at the situs, which supports an argument for American courts to maintain some power to scrutinize the award for conformity with basic procedural fairness and public policy of an international nature.

From a treaty perspective, divergent standards for international and domestic cases would be entirely consonant with American

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141. See generally Alan Scott Rau, *Arbitrability and Judicial Review: A Brief Rejoinder*, 13 WORLD ARB. & MED. REP. 71 (Mar. 2002); Victoria Holstein, *Co-opting the Judicial Review of Arbitral Awards Through Contract*, 12 WORLD ARB. & MED. REP. 276 (Nov. 2001); Christopher R. Drahozal, *Standards for Judicial Review of Arbitral Awards in the United States: Mandatory Rules or Default Rules?*, 16 INT'L ARB. REP. 27 (Sept. 2001); William H. Knull & Noah D. Rubins, *Betting the Farm on International Arbitration: Is It Time to Offer an Appeal Option?*, 11 AM. REV. INT'L ARB. 531, 545-47 (2000); Andreas Lowenfeld, *Can Arbitration Coexist With Judicial Review?*, 3 ADR CURRENTS 1 (Sept. 1998); Alan Scott Rau, *Contracting Out of the Arbitration Act*, 8 AM. REV. INT'L ARB. 225, 246-56 (1997).

142. See *Harris v. Parker College of Chiropractic*, 286 F.3d 790, 793-94 (5th Cir. 2002); *Syncor Int'l Corp. v. McLeland*, 120 F.3d 262, 262 (4th Cir. 1997); *Gateway Techs. v. MCI Telecomms. Corp.*, 64 F.3d 993, 996-97 (5th Cir. 1995); *New England Utils. v. Hydro-Quebec*, 10 F. Supp. 2d 53, 62-64 (D. Mass. 1998).

143. See *Chicago Typographical Union v. Chicago Sun-Times*, 935 F.2d 1501, 1505 (7th Cir. 1995); *Kyocera Corp. v. Prudential Bache Trade Servs.*, 391 F.3d 987 (9th Cir. 2003), overruling en banc *Lapine Technology Corp. v. Kyocera Corp.*, 130 F.3d 884 (1997); *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925, 932 (10th Cir. 2001).

144. Often the advisability of a merits review clause will be evaluated retroactively, and will depend on whether a party has won or lost the arbitration. One person's delay is another's due process. In *Kyocera v. Prudential-Bache*, the award went up to the Court of Appeals again with regard to substantive questions that included *inter alia* seller's knowledge that a contract term had been incorporated into the final agreement, entitlement to rescission, the effect of insolvency and evidence for lost profits. See *Kyocera*, 299 F.3d 769, 773-76 (9th Cir. 2002).

commitments to trading partners.<sup>145</sup> The New York Arbitration Convention requires recognition of foreign awards on the same footing as domestic ones<sup>146</sup> but always subject to the condition that awards vacated at the arbitral situs lose presumptive validity under the treaty's enforcement scheme.<sup>147</sup> The Convention leaves each country free to establish its own grounds for vacating awards made within its territory.<sup>148</sup> A national arbitration statute may impose

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145. At least one country has enacted legislation providing that an award vacated where rendered may lose its enforceability, even if the vacatur occurs after recognition. See ZPO, § 1061, No. 3 (F.R.G.) (*Wird der Schiedsspruch, nachdem er für vollstreckbar erklärt worden ist, im Ausland aufgehoben, so kann die Aufhebung der Vollstreckbarerklärung beantragt werden.*).

146. New York Convention art. III. In some cases this deference is conditioned on a principle of territorial reciprocity, by which foreign awards are enforced only if rendered in another Convention country. See art. I(3). Thus the winner of an arbitration in Iran (which to date has not adhered to the Convention) could not use the Convention to enforce its award in the United States, which has taken the reciprocity reservation to the Convention's application.

147. Article V(1)(e) of the New York Convention permits recognition and enforcement to be denied to awards set aside in the country where made. The treaty's French text lends itself to a more forceful interpretation, providing that "recognition and enforcement will not be refused unless the award . . . was annulled where rendered" (*"La reconnaissance et l'exécution de la sentence ne seront refusées que si la sentence . . . a été annulée ou suspendue"*). The Chinese, Russian and Spanish versions seem to comport with the permissive English. Thus vacatur at the arbitral situs will not in all cases uproot the defective decision. Some judges have disregarded annulments, relying on the Convention's permissive language (award enforcement "may" be refused) as well as Article VII which in some circumstances permits national law to override more restrictive Convention terms. See *Chromalloy Aeroservices v. Egypt*, 939 F. Supp. 907, 911 (D.D.C. 1996) (enforcing an award vacated in Egypt); *Hilmarton v. OTV, Cour de cassation*, June 10, 1997, 1997 REV. ARB. 376 (award vacated in Switzerland given effect in France). The emerging trend is toward the more sensible practice of granting comity to foreign annulment decisions. See *Baker Marine Ltd. v. Chevron Ltd.*, 191 F.3d 194 (2d Cir. 1999). See generally Richard W. Hulbert, *Further Observations on Chromalloy: A Contract Misconstrued, a Law Misapplied, and an Opportunity Foregone*, 13 ICSID REV. 124, 144 (Spring 1998); Jan Paulsson, *May or Must Under the New York Convention: An Exercise in Syntax and Linguistics*, 14 ARB. INT'L 227, 229 (1998); William W. Park, *Duty and Discretion in International Arbitration*, 93 AM. J. INT'L LAW 805, 811 (1999).

148. For a suggestion that Article V be amended to reduce the effect of the arbitral situs, see Kenneth R. Davis, *Unconventional Wisdom: A New Look at Articles V and VII of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 37 TEXAS INT'L L.J. 43, 86 (2002) (proposing that annulment power be limited to "courts of the country whose law governs the arbitration"). While intriguing and creative, the proposal would likely be a trap for the unwary creating more problems than it would solve. When negotiating a contract, the parties rarely insert a reference to any legal system other than the law intended to govern the merits of the dispute. If there is any assumption about the *lex arbitri* it is that this will be the law of the place of proceedings. For example, if an American company contracted to do construction in China, the agreement might include reference to Chinese law by virtue of the place of performance. However, the parties would normally provide for arbitration in some neutral location such as London in order to reduce the prospect of intervention by courts of one party. To give annulment power to courts of the country of applicable law would exacerbate matters. In this connection, in one case a court in New York stayed an arbitration being conducted in New York until the validity of the agreement to arbitrate was determined by courts in Venezuela, which had been designated as the

judicial review for whatever grounds the legislators consider appropriate or for no grounds at all.<sup>149</sup>

Characterization of a transaction as international or domestic might be made according to two criteria: the nature of the transaction<sup>150</sup> and the parties' residences.<sup>151</sup> For example, arbitration would be international if only one side to the dispute is resident in the United States.<sup>152</sup> An alternative approach would characterize arbitration as international if the underlying controverted transaction implicates cross-border trade, finance, and investment.<sup>153</sup>

The most sensible approach would seem to be one based on residence. The special status of international arbitration justifies itself as a way to promote neutrality in dispute resolution among commercial actors from different countries. Difficult linguistic and procedural issues are more likely to arise when business managers from one nation must sue contracting parties abroad, not when they have litigation with compatriots concerning goods destined for export.

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applicable law. *See Pepsico v. Officina Central de Asesoria*, 945 F. Supp. 69, 71-72 (S.D.N.Y. 1996) *mot. denied*, No. 97-7318 and No. 97-7386 (2d Cir. 1997).

149. By contrast, Article 9 of the European Arbitration Convention (European Convention on International Arbitration, art. 3, 484 U.N.T.S. 349 (1969)), which supplements the New York Convention among residents of member states, allows non-recognition for award annulment only if the annulment was based on standards that track the first four defenses to foreign award enforcement. Accordingly, courts in Germany could refuse comity to a French annulment for violation of "international public policy," not among the approved defenses. From a policy perspective, this approach is problematic in its indiscriminate mixing of both good and bad review standards. Arbitration would be impeded by some grounds for annulments that fall outside Convention-approved standards. For example, a requirement that all arbitrators must sign an award would give dissenters a tool to sabotage proceedings. However, other non-Convention grounds for review (such as monitoring arbitrator bias and error) might further legitimate interests of the parties and the regulating state.

150. N.C.P.C. art. 1492 (Fr.) defines arbitration as international if it "implicates international commerce." *See also* FAA § 202 (excluding from the scope of the New York Convention agreements solely between U.S. citizens *unless* "the relationship involves property located abroad or envisages performance or enforcement abroad." In *Lander v. MMP*, this provision was applied to bring within the Convention an arbitration in New York between two American corporations who had contracted to distribute shampoo products in Poland. *Lander v. MMP*, 107 F.3d 476, 477-78 (7th Cir. 1997).

151. *See, e.g.*, LDIP art. 176, 192 (1989) (Switz.).

152. Corporate residence might be defined by reference to the place of incorporation and/or the principal place of business. FAA § 202 employs such a test, including as a U.S. citizen any corporation which is "incorporated or has its principal place of business in the United States." Criteria for determining whether arbitrations are international are articulated in negative terms, to exclude from the scope of the New York Convention arbitration agreements "entirely between citizens of the United States" unless they relate to property, performance or enforcement abroad, or have some "other reasonable relation" with a foreign country.

153. Section 1(3) of the UNCITRAL Model Law adopts both tests, characterizing arbitration as international if the parties' places of business are in different states, or if the transaction has a connection to a state other than the parties' places of business. In addition, the Model Law allows parties to opt to treat their agreement as international.

## B. Secondary Matters

In addition to a more sensible framework for judicial review of arbitral awards, reform is warranted in several other areas that implicate international transactions: (i) arbitral jurisdiction, (ii) the role of state law, (iii) judicial deference to the parties' choice of arbitral venue, and (iv) election to expand court scrutiny of awards. While of secondary importance compared with mandatory judicial review standards, reform in these areas would significantly improve the climate for international arbitration in the United States.

### 1. Jurisdictional Determinations

Arbitration is a consensual process.<sup>154</sup> Therefore allocating jurisdiction between courts and arbitrators remains a vexing problem with significant implications for arbitral autonomy, efficiency, and access to justice. The arbitral tribunal's competence to determine its own power has been articulated in many countries under the variegated jurisdictional principle referred to as "*compétence-compétence*."<sup>155</sup> The United States lags behind other nations in articulating how far arbitrators may rule on their authority, either as a preliminary matter (subject to subsequent court review) or in a more final and binding way. Confusion has been created by the "arbitrability *dictum*" in *First Options of Chicago v. Kaplan*,<sup>156</sup> suggesting that in some instances courts must defer to arbitrators' decisions on their jurisdiction.

The problems of arbitral jurisdiction have been complicated by questions arising from the so-called "separability" doctrine (by which the validity of an arbitration clause is tested separately from the validity of the main contract)<sup>157</sup> and the presumption in favor of arbitrability which has on occasion resulted in findings of implied

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154. A distinguished First Circuit judge has recently referred to the "abecedarian tenet" that a party cannot be forced to arbitrate if it has agreed to do so. *Intergen N.V. v. Grina*, 344 F.3d 134 (1st Cir. 2003) (Selya, J.). See also Steven Walt, *Decision by Division: The Contractarian Structure of Commercial Arbitration*, 51 RUTGERS L. REV. 369, 370-73 (1999).

155. On the way notions of *compétence-compétence* vary from country to country, see William W. Park, *The Arbitrability Dicta in First Options v. Kaplan*, 12 ARB. INT'L 137, 149-51 (1996); William W. Park, *Determining Arbitral Jurisdiction: Allocation of Tasks Between Courts and Arbitrators*, 8 AM. REV. INT'L ARB. 133, 140 (1997).

156. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995). Also see cases summarized in *PaineWebber, Inc. v. Elahi*, 87 F.3d 589, 596-98 (1st Cir. 1996), describing the split in the circuits on whether time limits in arbitration rules constitute jurisdictional prerequisites to be determined by courts.

157. See *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402-03 (1967). For a recent decision on the costs and benefits of addressing jurisdiction as a preliminary issue (with a separate bifurcated decision on the merits) see *Aoot Kalmneft v. Glencore Int'l AG*, 2001 WL 82510627, July 2001, High Court of Justice (Q.B. 2001), 1 LLOYD'S L. REP. 128 (2002); 2 All E.R. (Comm.) 577, reprinted in 16 INT'L ARB. REP. § A (Aug. 2001).

(rather than actual) consent to the arbitration clause.<sup>158</sup> Since no neutral courts of mandatory international jurisdiction exist to hear disputes if arbitrators misinterpret their powers,<sup>159</sup> jurisdictional problems have a higher profile for cross-border transactions, making it critical for the FAA to provide explicit guidance on separability and *compétence-compétence*.

In the event of ambiguity in the contract, different presumptions would seem to be appropriate depending on whether the case is domestic or international. In a dispute between two residents of the United States, U.S. courts would normally be the default forum expected by the parties. By contrast, in an international transaction where the choice is not between courts in New York or New Jersey, but between ICC arbitration in Paris and courts in either Yemen or Boston, the parties might more logically be presumed to have favored the neutrality-enhancing choice of Paris arbitration.

Three cases, each decided by the U.S. Supreme Court during the past year, might serve as a springboard from which to examine how jurisdictional functions are allocated between courts and arbitrators. In *Howsam v. Dean Witter Reynolds*<sup>160</sup> a broker-customer dispute arose from alleged misrepresentations about the quality of an investment. The 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. *Pacificare Health Systems v. Book*<sup>161</sup> involved a controversy between doctors and managed-health-care organizations. Here the Court essentially allowed the arbitrators themselves to determine whether they could grant treble damages in a RICO claim under an arbitration clause which explicitly denied them the power to award punitive damages.<sup>162</sup>

Finally, a plurality of the Court followed a similar line of reasoning in *Green Tree Financial Corp v. Bazzle*,<sup>163</sup> which involved

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158. See generally *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), (enforcing an arbitration clause against a North Carolina hospital). In *Moses H. Cone*, the Court required interpretation of arbitration clauses “with a healthy regard for the federal policy favoring arbitration.” *Id.* at 24. However, the Court has also stated the presumption in favor of arbitrability should not apply to questions related to the existence of an arbitrator’s jurisdiction. See *First Options*, 514 U.S. at 944-46. For examples of the proper approach to separability, *compétence-compétence* and presumptions, see *Sphere Drake Ins. v. All American Ins.*, 256 F.3d 587, 590 (7th Cir. 2001) (Easterbrook, J.) (noting that “pieces of paper don’t ‘agree’ to do things”), *Sandvik AB v. Advent Int’l Corp.*, 220 F.3d 99, 104 (3d Cir. 2000), and *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1138 (9th Cir. 1991).

159. Cf. *Mercury Constr. Corp.*, 460 U.S. at 17-25.

160. *Howsam*, 537 U.S. 79 (2002).

161. *Pacificare Health Systems, Inc. v. Book*, 123 S. Ct. 1531, *rev’g* *In re Humana Inc., Managed Care Litigation*, 285 F. 3d 971 (11th Cir. 2002).

162. The physicians had filed claims under RICO (Racketeer Influenced and Corrupt Organizations Act), 18 U.S.C. § 1961 *et seq.*

163. *Green Tree Financial Corp v. Bazzle*, 123 S. Ct. 2402 (2003).

an attempt at class action arbitration of disputes arising from consumer loan agreements. Once again, the Supreme Court punted the question to the arbitrator himself.

In *Howsam v. Dean Witter*,<sup>164</sup> the performance of an investment had proved unsatisfactory, causing the customer to bring an NASD arbitration claim against her broker. The brokerage firm filed suit in federal court requesting an injunction, on the ground that the original investment advice was more than six years old and thus ran afoul of the “eligibility rule” which requires any arbitration to be brought within 6 years of the relevant occurrence.<sup>165</sup>

Resolving a split among the circuits over who (judge or arbitrator) decides on “eligibility” requirements,<sup>166</sup> the U.S. Supreme Court held that jurisdiction was for the court. While paying lip service to the principle that judges would normally decide gateway jurisdictional matters unless the parties clearly provided otherwise, the Court engaged in the presumption that the parties intended for arbitrators to determine their own jurisdiction with respect to NASD eligibility requirements. Rightly or wrongly, the Court interpreted the parties’ intent to include a bargain for the presumed expertise of the arbitrators in interpreting the NASD Rules.<sup>167</sup>

While the Court’s line of reasoning is plausible, the presumptions about the parties’ intent may be a bit far fetched. If they agreed that the case is ineligible for arbitration after six (6) years have elapsed, it is questionable whether one can speak of an “arbitrator” at all in the seventh year. Moreover, the decision is disturbing in its failure to distinguish between judicial intervention before and after the arbitration, which leaves the impression that arbitrators decide the jurisdictional question free from any subsequent court scrutiny. One cannot help but wonder whether arbitration is not serving as a rubbish bin for cases that would otherwise clog dockets.

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164. *Howsam*, 537 U.S. 79 (2002). The unanimous decision was written by Justice Breyer, with a concurrence by Justice Thomas who decided 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.

165. While a brokerage firm in the United States would normally want arbitration of the merits of a customer dispute (presuming that arbitrators will be more “reasonable” than juries comprised of individuals sympathetic with the investor), on jurisdictional questions the financial institutions look for decisions by courts rather than arbitrators, on the assumption that arbitrators (who get paid for hearing a case) would be more likely to find jurisdiction. In most cases a finding of ineligibility under the arbitration rules would mean that the claim would also be time barred in court, due to the statute of limitations.

166. See generally William W. Park, *Determining Arbitral Jurisdiction: Allocation of Tasks Between Courts and Arbitrators*, 8 AM. REV. INT’L ARB. 133 (1997); reprinted [2000] ADR LAW J. 19 (Mar. 2000).

167. *Howsam*, 123 S. Ct. at 593. 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.” *Id.*

*Pacificare Health Systems* follows similar lines of reasoning. A group of doctors had filed a nationwide class action against several health maintenance organizations, alleging *inter alia* that the organizations had conspired to refuse proper reimbursement for services provided under the health plans to which the physicians had agreed. The legal basis for the doctors' action included claims under RICO, the Racketeer Influenced and Corrupt Organizations Act, allowing awards of treble damages. Unfortunately, however, the physicians had agreed to resolve disputes through arbitration, and some of the arbitration agreements were explicit in prohibiting arbitrators from awarding punitive damages.

In a relatively brief opinion by Justice Scalia, a unanimous U.S. Supreme Court upheld the health care organizations' right to compel arbitration. The key to the Court's reasoning is its assumption about the ambiguity of the term "punitive damages" and the nature of treble damages in the RICO statute. Since it would be "mere speculation" to presume that arbitrators might deny themselves the power to grant punitive damages, 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>168</sup> This approach invites further questions. Can arbitrators effectively limit vindication of a public right by the way they interpret a contract? If so, where is the role for judicial review to insure that arbitration clauses do not work as a "prospective waiver" of statutory claims?<sup>169</sup> If not, then why let arbitrators address the question? One thing is certain: the case will mean more work for lawyers and scholars.

A similar approach to arbitral jurisdiction was taken in a U.S. Supreme Court decision in *Green Tree Financial Corp v. Bazzle*, concerning loans used to purchase mobile homes and finance residential improvements, with allegations that the lender violated South Carolina's Consumer Protection Code by neglecting to give borrowers notice about the right to name their own lawyers and insurance agents. 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.

Where does all this leave us? The decisions in *Howsam*, *Pacificare* and *Bazzle* are plausible. However, the presumptions about

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168. *Pacificare*, 123 S. Ct. at 1535-36.

169. See *Mitsubishi*, 473 U.S. 6145, 637 n.19 (1985).



the parties' intent may not be self-evident. 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 within the spectrum of matters the parties intended the arbitrator to interpret. Others, however, do not.

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 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.

## 2. The Impact of State Law

The U.S. Supreme Court has not always explained the proper relationship of federal and state arbitration law.<sup>170</sup> Several steps might improve things. First, courts should be directed to look exclusively to federal arbitration law in any transaction involving international commerce. Second, the FAA could provide a statutory definition of the grounds on which an arbitration clause might be found revocable or otherwise invalid.<sup>171</sup> Third, appeal should be allowed when awards arguably falling under the New York Convention have been remanded to state courts.

A bit of background makes things more clear. The FAA is an anomaly. While the Act creates a body of federal law binding on states,<sup>172</sup> its enforcement provisions speak only of federal district courts<sup>173</sup> and create no general basis for federal court jurisdiction.<sup>174</sup>

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170. See generally Alan Scott Rau, *Does State Arbitration Law Matter At All?*, ADR CURRENTS 19 (June 1998).

171. See LOI FÉDÉRALE SUR LE DROIT INTERNATIONAL PRIVÉ [LDIP], discussed *supra* notes 71, 77, 81 and accompanying text.

172. See *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (involving a California franchise act). Some questions may still be reserved for the states. See, e.g., *Muao v. Grosvenor Props.*, 99 Cal. App. 4th 1085, 1092-93 (Cal. Ct. App. 2002) (rejecting application of FAA § 16 providing rules for taking concerning appeals from orders *inter alia* compelling arbitration, refusing to stay litigation and vacating awards).

173. Moreover, FAA enforcement provisions speak of federal district courts. To remedy this problem it has been suggested that 9 U.S.C. § 4 should provide for enforcement of arbitration agreements in "any" court (rather than the current reference to a U.S. district court) and should stipulate that proceedings under the FAA will be deemed to arise under the laws of the United States. See generally Joseph D.

The problem is remedied for international cases through a provision of the FAA that allows removal to federal court of actions relating to arbitrations covered by the New York Convention.<sup>175</sup> Difficulties arise when cases are sent back to state courts. Since remand orders are generally not subject to review, such situations inhibit the creation of a well developed body of federal law on Convention coverage.<sup>176</sup>

More generally, troubles derive from the U.S. Supreme Court's ambivalence toward the role of state arbitration law. In *Volt v. Stanford* the Court held that an arbitration in California could be stayed under provisions of state law,<sup>177</sup> reasoning that by the contractual choice-of-law clause the parties had incorporated California arbitration law into their agreement to arbitrate. However, six years later, the same Court in *Mastrobuono v. Shearson Lehman Hutton*<sup>178</sup> upheld an arbitral award for punitive damages, notwithstanding that the relevant choice-of-law clause called for application of New York law, which prohibits arbitrators from awarding punitive damages.

Squaring these two decisions is not easy.<sup>179</sup> While states cannot make implementation of arbitration agreements more difficult than other contractual commitments,<sup>180</sup> state law generally governs the

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Becker, *Fixing the Federal Arbitration Act by the Millennium*, 8 AM. REV. INT'L ARB. 75 (1997).

174. See *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 26 n.32 (1983). Except in international cases, federal courts do not have jurisdiction to hear a dispute about arbitration unless the dispute raises a question of federal law or implicates the court's diversity jurisdiction over disputes between citizens of different states or between a U.S. citizen and an alien. The FAA itself does not create subject matter jurisdiction. See *PCS 2000 LP v. Romulus Telecomm., Inc.*, 148 F.3d 32, 35-36 (1st Cir. 1998); *Kasap v. Folger Nolan Fleming & Douglas*, 166 F.3d 1243, 1248 (D.C. Cir. 1999). The existence of a federal question has been found in an allegation that the arbitrator "manifestly disregarded" federal securities law. See *Greenberg v. Bear, Stearns & Co.*, 220 F. 3d 22, 25 (2d Cir. 2000). For a recent case on giving broad scope to the concept of actions that "relate to" the New York Convention, see *Beiser v. Weyler*, 284 F.3d 665 (5th Cir. 2002) (discussing an arbitration related to a contract for oil and gas exploration in Hungary).

175. 9 U.S.C. § 205 (2003).

176. See 28 U.S.C. § 1447(d) (2003) (creating an exception only for civil rights cases covered by § 1443). On remand of cases that raise international issues, see generally *Beiser v. Weyler*, 284 F. 3d 665 (5th Cir. 2002), *Severonickel v. Gaston Reymenants*, 115 F.3d 265, 265 (4th Cir. 1997), and *Transit Cas. Co. v. Certain Underwriters at Lloyd's of London*, 119 F.3d 619 (8th Cir. 1997).

177. *Volt v. Stanford*, 489 U.S. 468, 475-76 (1989).

178. *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 58-64 (1995).

179. One way to reconcile the cases is to characterize California policy as less anti-arbitration than that of New York. California only stayed arbitration, while New York prohibited punitive damage claims from being arbitrated.

180. In *Doctor's Associates v. Casarotto*, the Court struck down a Montana "notice requirement" that said arbitration clauses had to be in capital letters on the first page of the contract. See *Doctors Assocs. v. Casarotto*, 517 U.S. 681, 683 (1996). See also *Sec. Indus. Ass'n v. Connolly*, 883 F.2d 1114, 1119-21 (1st Cir. 1989); Allied-

matter of whether and what two contracting parties agreed to arbitrate.<sup>181</sup> The power of states to affect the validity of arbitration clauses derives from FAA Section 2, which provides that an arbitration agreement is valid “save upon such grounds as exist at law or in equity for the revocation of any contract.”<sup>182</sup> While the text itself does not specify whether “at law or in equity” refers to state or federal law, the absence of any federal common law of contracts has generally led courts to look to state law to determine grounds for revocation.<sup>183</sup>

Consequently, state arbitration statutes now come into play when their provisions are perceived to be in harmony with the policies underlying federal law,<sup>184</sup> particularly on ancillary matters such as authority to administer oaths.<sup>185</sup> However, ascertaining the existence of harmony or conflict between federal and state norms is not always an easy task. For example, in the United States, no firm consensus exists on whether the FAA is consistent with state measures that authorize interim relief in arbitration<sup>186</sup> and consolidation of different proceedings that present similar questions of law and fact.<sup>187</sup>

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Bruce Terminex v. Dobson, 513 U.S. 265, 267 (1995); Southland Corp. v. Keating, 465 U.S. 1, 10 (1984).

181. Cook Chocolate Co. v. Salomon, Inc., 684 F. Supp. 1177, 1182 (S.D.N.Y. 1988).

182. 9 U.S.C. § 2 (2003) (noting that the existence of an arbitration agreement is determined by state contract principles).

183. First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995). The Court added a qualification to the effect that “courts should not assume that the parties agreed to arbitrate arbitrability [i.e., jurisdiction] unless there is “clear and unmistakable” evidence that they did so.” *Id.* Some authorities argue that enforcement of *international* arbitration agreements under Article II of the New York Convention is subject to the law agreed upon by the parties (compare provisions under Convention Article V(1)(a) regarding non-recognition of awards), or to an international standard that incorporates only “internationally recognized defenses” to contract enforcement such as duress, fraud and waiver. See Rhône Méditerranée Compagnia Francese di Assicurazioni e Riassicurazioni v. Achille Lauro, 712 F.2d 50, 53 (3d Cir. 1983) (holding arbitration clause valid notwithstanding possible invalidity under Italian law).

184. For example, an arbitrator’s authorization to administer oaths derives from Uniform Arbitration Act § 7.

185. See U.A.A. § 7(a) (2003).

186. Some courts reason that by bargaining for arbitration the parties have implicitly excluded intervention by national courts until an award is rendered, while others view pre-award attachment as a way to maximize the efficiency of the arbitral process consistent with the parties’ presumed intent. See *Cooper v. Ateliers de la Motobecane S.A.*, 57 N.Y.2d 408, 414-16 (1982), where pre-award attachment permitted by state legislation did not withstand a challenge based on inconsistency with the New York Convention. Compare *McCreary Tire & Rubber v. CEAT*, 501 F.2d 1032, 1038 (3d Cir. 1974) (pre-award attachment denied) with *Carolina Power & Light Co. v. Uranex*, 451 F. Supp. 1044, 1053-54 (N.D. Cal. 1977) (pre-award attachment allowed). See generally David E. Wagoner, *Interim Relief in International Arbitration*, 51 DISP. RES. J. 68 (Oct. 1996).

187. While the FAA does not authorize forced consolidation of proceedings, see *United Kingdom v. Boeing*, 998 F.2d 68, 71-73 (2d Cir. 1993) (denying consolidation of two different arbitrations between the British government, on the one hand, and

Federal preemption complicates matters for consumers in particular. The U.S. Supreme Court has struck down on federalism grounds several state initiatives to protect weaker parties against ill-advised agreements to arbitrate.<sup>188</sup> State law would normally govern the formation and scope of an arbitration agreement as it determines the validity of most contracts in the absence of a federal common law.<sup>189</sup> However, the so-called “pro-arbitration” policy of the FAA<sup>190</sup> (better conceived as a pro-contract policy) has been interpreted to preempt states from singling out arbitration clauses for threshold validity limitations more onerous than those imposed on other contracts. Thus, state arbitration statutes fill gaps in federal law only if consistent with the latter’s general purposes.<sup>191</sup>

One potential avenue of escape for states skeptical of arbitration has recently been suggested by the Supreme Court of Montana. In refusing to enforce an arbitration clause against a nonagenarian widow allegedly defrauded by her investment adviser,<sup>192</sup> the court focused on the waiver of rights guaranteed by the Montana Constitution (access to courts and trial by jury) implicit in arbitration. Such waiver was held to have been outside the customer’s “reasonable expectation” and thus invalid against the weaker party in an adhesion contract.<sup>193</sup> Thus, the Montana court struck down the agreement not by singling out arbitration, but by upholding access to

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Boeing and Textron on the other). State law at the arbitral situs has been applied to permit consolidation. *See also* *New England Energy, Inc. v. Keystone Shipping Co.*, 855 F.2d 1, 5 (1st Cir. 1988) (involving a Massachusetts provision permitting courts to order consolidation of related arbitrations).

188. *See* *Doctor’s Assocs. v. Casarotto*, 517 U.S. 681 (1996) (discussed *supra* note 182 and accompanying text); *see also* *Allied Bruce Terminex v. Dobson*, 513 U.S. 265 (1995) (striking down Alabama statute that invalidated pre-dispute arbitration agreements), in which the U.S. Supreme Court held that the FAA applied to the “full limits of Congress’ commerce clause power” and was not limited to transactions “contemplating interstate commerce.” *Id.*

189. *See* *Cook Chocolate Co. v. Salomon, Inc.*, 684 F. Supp. 1177, 1182 (S.D.N.Y. 1988).

190. *See generally* *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

191. The decision to apply the FAA in state courts might well be characterized as good policy but very bad history. While it can certainly be argued that the United States should have a national (rather than simply federal) arbitration law, there is little evidence that Congress so intended in 1925 when passing the FAA. *See* IAN R. MACNEIL, *AMERICAN ARBITRATION LAW* 139-47 (1992) (noting that the transformation of the FAA “occurred with singularly little debate and with virtually no democratic input, not even the elite pressure group politics often passing for democracy these days”); *see also* *Allied-Bruce Terminix v. Dobson*, 513 U.S. 265, 283 (1995) (O’Connor, J., concurring) (accepting that the FAA applied in state courts for reasons of *stare decisis*). Justice O’Connor stated, “I have no doubt that Congress could enact, in the first instance, a federal arbitration statute that displaces most state arbitration law. But I also have no doubt that, in 1925, Congress enacted no such statute.” *Id.*

192. *See* *Kloss v. Edward D. Jones & Co.*, 310 Mont. 123, 135 (2002).

193. *Id.* at 132-33.

constitutional rights generally, under principles of law applicable to all contracts.<sup>194</sup>

One might fear that a pro-arbitration policy will result in overly broad findings of implied consent in consumer cases. Cases taking such an approach would misconstrue the FAA's pro-arbitration policy.<sup>195</sup> At most what can be said is that ambiguous contract language should be presumed to permit arbitration, as was done in *Mastrobuono*,<sup>196</sup> which is quite different from implying an agreement to arbitrate based only on a form which in the fine print recites a duty to arbitrate.<sup>197</sup>

Preemption has been intertwined with questions of party intent in the context of choice-of-law clauses. The question has often been whether contractual selection of state law was intended to encompass arbitration procedures as well as substantive law.<sup>198</sup> Similar questions arise when the contract choice-of-law clauses stipulate the law of a non-U.S. jurisdiction.<sup>199</sup>

### 3. Arbitral Venue

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194. *Id.* at 133-34.

195. The difference between actual and implied consent in the context of arbitration clauses might be illustrated with the example of a bank loan and mortgage. The hopeful home owner will likely have understood and actually agreed to the interest rate and loan term. Less plausible is that the borrower will read, let alone understand, the standard terms in the mortgage. Yet by signing the forms the borrower will be deemed to have impliedly consented to the entirety of the conditions. It is questionable whether consent to arbitrate should be implied when arbitration clauses fall into the latter category.

196. In *Mastrobuono*, the U.S. Supreme Court upheld the arbitrators' right to award punitive damages to a brokerage customer notwithstanding New York substantive law, thus illustrating that the presumption in favor of arbitrability can also work in favor of the consumer. *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 58-61 (1995).

197. Some would go further to argue that renunciation of the right to go to court is too serious a matter to be implied, and that consumer arbitration clauses should be enforced only if the consumer was aware and informed of the choice of forum. Admittedly the law on court selection clauses sometimes runs counter to such consumer protection arguments. In *Carnival Cruise Lines, Inc. v. Shute*, a couple from the State of Washington purchased a cruise ticket to Mexico. *Carnival Cruise Lines*, 499 U.S. 585, 586 (1991). After the unfortunate Mrs. Shute slipped in the ship's galley, the couple filed suit in Washington for injuries and loss of consortium. *Id.* at 588. The boilerplate clauses attached to the ticket provided for litigation in Florida. *Id.* at 587-88. The Court held that a non-negotiated jurisdiction clause could not be refused enforcement solely on the ground that it was not the subject of bargaining. *Id.* at 590-95.

198. For an excellent *tour d'horizon* of the problem, see Note, *An Unnecessary Choice of Law: Volt, Mastrobuono and Federal Arbitration Act Preemption*, 115 HARV. L. REV. 2250 (2002), suggesting that the perceived conflict between *Volt* and *Mastrobuono* can be reconciled by understanding the FAA to preempt state arbitration law only if (i) the parties' agreement is ambiguous and (ii) the state law would defeat FAA policies. *Id.* at 2269.

199. See *New England Utils. v. Hydro-Quebec*, 10 F. Supp. 2d 53, 55, 63-65 (D. Mass. 1998).

In international arbitration, the traditional assumption has been that judges will hold the parties to their agreement on arbitral situs, both as the place for the proceedings and the forum for any annulment action. A recent line of cases, however, has called this principle into question. First, U.S. courts have compelled arbitration outside the contractually-selected venue.<sup>200</sup> Second, courts have suggested that awards may be vacated other than where made,<sup>201</sup> encouraging a race to the courthouse to gain precedence with a “first-filed” motion.<sup>202</sup>

Both lines of cases rest on a decision by the U.S. Supreme Court allowing an award to be set aside at a place other than the arbitral situs. In *Cortez Byrd Chips Inc. v. Bill Harbert Construction Company*<sup>203</sup> the Court held that an award rendered in Alabama could

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200. See *Indian Harbor Ins. Co. v. Global Transport Systems Inc.*, 197 F. Supp. 2d 1, 3 (S.D.N.Y. 2002), justified on the basis of the U.S. Supreme Court decision in *Cortez Byrd Chips, Inc. v. Bill Harbert Const. Co.*, 529 U.S. 203, 203 (2000) (discussed *infra* notes 203-06 and accompanying text). When an insurer brought an action against an insured barge owner, seeking a declaration that it had no obligation to indemnify, the insured filed motion to compel arbitration in San Juan, Puerto Rico. *Id.* at 1. Nevertheless, the court, deemed itself to have discretion to compel arbitration in New York under FAA § 4. *Id.* at 3; see also *Textile Unlimited Inc. v. A.B.M.H. & Co. Inc.*, 240 F. 3d 781, 786 (9th Cir. 2001), permitting an action in California to enjoin arbitration at the contractually-designated situs in Georgia.

201. In *Vulcan Chemical Technologies, Inc. v. Barker*, the Western District Court of Virginia vacated an award made in California and attempted to enjoin confirmation proceedings in California state court. *Vulcan Chemical Technologies, Inc. v. Barker*, 297 F.3d 332, 337-38 (4th Cir. 2002). The Fourth Circuit declared that Virginia court had jurisdiction to hear the action to vacate the California award, although in the instant case the Court of Appeals held that the court in Virginia should have exercised discretion to abstain from exercising jurisdiction in light of the California action under principles announced in *Colorado River Water Conservation Dist. v. U.S.*, 424 U.S. 800 (1976). *Vulcan Chemical*, 297 F.3d at 340; see also *Smart v. Sunshine Potato Flakes*, 2002 WL 31235498 (8th Cir. 2002) (North Dakota confirmation of award made in New Mexico); *Theis Research Inc. v. Brown & Bain*, 240 F.3d 795, 796 (9th Cir. 2001) (directing the California district court to assess the validity of an award made in the District of Columbia in the context of motion to vacate).

202. On the “first to file” rule, see *Orthmann v. Apple River Campground, Inc.*, 765 F.2d 119, 121 (8th Cir. 1985), stating that in cases of concurrent federal jurisdiction, “the first court in which jurisdiction attaches has priority to consider the case.” For international transactions, this and related questions are often addressed under the rubric *lis pendens*, *lis alibi pendens* or *litispentence*. See, e.g., Laurent Lévy & Elliot Geisinger, *Applying the Principle of Litispentence*, [2000] INT’L A.L.R. (Issue 4), at N-28.

203. *Cortez Byrd Chips, Inc. v. Bill Harbert Const. Co.*, 529 U.S. 203, 203 (2000) (Souter, J.) (unanimous). The Contractor moved to confirm an award in Alabama, after the project owner a few days earlier had filed a motion to vacate in Mississippi. Reversing a decision in the Northern District of Alabama upheld by the Eleventh Circuit, the U.S. Supreme Court gave priority to the first filed motion in Mississippi. Ironically, the Supreme Court supported its holding in part by stating that a restrictive reading (limiting vacatur to the award situs) would “preclude any action [in courts of the United States] to confirm, modify or vacate awards rendered in foreign arbitrations not covered by [the New York or Panama Conventions].” *Id.*

be vacated in Mississippi. The FAA venue provisions (making vacatur available “in and for the district wherein the award was made”<sup>204</sup>) were held to be permissive, thus allowing a motion to vacate in any district proper under the general venue statute, including the place of defendant’s residence.<sup>205</sup>

Whatever value such a rule might have in domestic arbitration, it will produce dramatically disagreeable results in an international context. While such a free-for-all might not much matter when competing motions are brought in Alabama and Mississippi, allowing the losing party to seek annulment in its own home court would be extremely disruptive for international arbitration. If a Massachusetts seller and a German buyer agree to arbitrate in London, they expect proceedings in England subject to judicial review by English courts. Had they wanted arbitration and court proceedings in Berlin or Boston they could have bargained for just that.<sup>206</sup> Such cross-border meddling will inevitably invite reactions that jeopardize the stability of cross-border arbitration, one of the great achievements of international business law during the nearly half century since adoption of the New York Convention.

#### 4. Modification of Court Scrutiny

The absence of appeal on the merits of an award can be both an advantage (no judicial second-guessing the parties’ chosen decision-maker) and a drawback (frustrating litigants when the arbitrator gets things wrong, thus reducing arbitration’s attractiveness in the eyes of some business managers). In the United States, a patchwork of uncertain case law governs the parties’ ability to engage in any custom tailoring of their own judicial review standards. Courts have generally interpreted the FAA to deny parties an opportunity to reduce by contract the level of court scrutiny,<sup>207</sup> and attempts to

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204. 9 U.S.C. § 10 (2003). The New York Convention also emphasizes the primacy of the place of arbitration by providing in Article V(1)(e) that Convention states need not recognize an award “set aside or suspended by a competent authority of the country in which . . . that award was made.”

205. Citing 28 U.S.C. § 1391(a)(2), the Court found venue “clearly proper” in Mississippi under the statute providing “among other things, for venue in a diversity action in ‘a judicial district in which a substantial part of the events or omissions giving rise to the claim occurred, or a substantial part of property that is the subject of the action is situated.’” *Cortez*, 529 U.S. at 198.

206. Vacatur of foreign awards would also be contrary to sound prior case law. *See Int’l Standard Electric Corp. v. Bidas Sociedad Anonima Petrolera, Industrial y Commercial*, 745 F. Supp. 172, 178 (S.D.N.Y. 1990) (holding that the FAA did not allow vacatur of a Mexican award notwithstanding that the merits of the dispute were to be decided under New York law). *See also Four Searsons Hotels and Resorts B.V. v. Consorcio Barr, S.A.*, 267 F. Supp. 2d 1335 (S.D. Fla. 2003); *Industrial Risk Insurers v. MAN Guttenhoffnungschutta*, 141 F.3d 1434 (11th Cir. 1998).

207. *See, e.g., Hoeft v. MVL Group Inc.*, 343 F.3d 57 (2003); *M & C Corp. v. Erwin Behr GmbH*, 87 F.3d 844, 847 (6th Cir. 1996); *supra* note 143 and accompanying text.

enlarge the scope of review for error of law and fact have been met with mixed reception.<sup>208</sup>

As to expansion of judicial review, the better approach might be to provide by statute that courts shall respect the litigants' clear agreement for judicial review on legal and factual merits. Otherwise, some parties might shy away from arbitration out of fear that potential arbitrator error presents too great a risk.<sup>209</sup> The default regime would remain one that provides only for review related to procedural fairness.<sup>210</sup>

Concerning the parties' right to lower the standards by excluding all judicial review at the situs, the right rule is less certain. At least when no party to the arbitration is from the United States (thus reducing the chances that U.S. interests will be affected by the dispute), one can see the merit in allowing the parties complete freedom to eliminate court intervention at the arbitral seat. On reflection, however, the wiser path might be to permit courts to provide minimum policing of all arbitration in the United States to ensure basic procedural integrity and compliance with international public policy norms.

### *C. Consumer and Employment Contracts Revisited*

#### 1. The Current Scope of the FAA

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208. See, e.g., *Koycera Corp. v. Prudential Bache Trade Serv.*, 391 F.3d 987 (9th Cir. 2003), *vacating en banc Lapine Technology Corp. v. Kyocera Corp.*, 130 F.3d 884 (1997); *Syncor Int'l Corp. v. McLeland*, 120 F.3d 262, 262 (4th Cir. 1997); *Gateway Techs. v. MCI Telecomms. Corp.*, 64 F.3d 993, 996-97 (5th Cir. 1995); *New England Utils. v. Hydro-Quebec*, 10 F. Supp. 2d 53, 62-64 (D. Mass. 1998); *supra* notes 105, 147 and accompanying text.

209. See, e.g., William H. Knull, II & Noah D. Rubins, *Betting the Farm on International Arbitration: Is It Time to Offer an Appeal Option?*, 11 AM. REV. INT'L ARB. 531, 533 (2000) (stating that possible consumers will choose not to arbitrate because their transactions are too large to bear the risk); Peter B. Rutledge, *On the Importance of Institutions: Review of Arbitral Awards for Legal Errors*, 19 J. INT'L ARB.(2) 81 (2002); Alan Scott Rau, *Contracting Out of the Arbitration Act*, 8 AM. REV. INT'L ARB. 225 (1997). At least one state (New Jersey) has such a regime for its "Alternative Procedure for Dispute Resolution Contract Actions." See N.J. STAT. ANN. §§ 2A:23A-13 (2000) (permitting vacatur because the arbitrator "committed prejudicial error by erroneously applying the law to the issues and facts"); see also Michael Scodro, *Arbitrating Novel Legal Questions: A Recommendation for Reform*, 105 YALE L.J. 1927, 1946 (1996) (practitioners have recommended against bringing novel legal claims before arbitrators).

210. In a sense, expansion of judicial review can be seen as a restriction on arbitral jurisdiction, with the parties giving the arbitrators power only to render only advisory opinions. See generally Alan Scott Rau, "Arbitrability" and *Judicial Review: A Rejoinder*, 1 J. AM. ARB. 159 (2002). Professor Rau uses the multipurpose term "arbitrability" not in reference to topics that may be submitted to arbitration (in the context of sensitive policies related to subjects such as competition and securities law), but rather as a synonym for the contractual contours of the arbitral mission. See *id.*



A separate statute for international business arbitration would be less urgent if American arbitration law contained protective provisions for consumer and employment contracts. Recently, however, the U.S. Supreme Court has expanded rather than reduced the scope of the FAA with respect to such transactions.<sup>211</sup>

Particularly instructive is the decision in *Circuit City v. Adams*,<sup>212</sup> holding that the FAA covers all employment contracts except those related to “transportation workers” (such as seamen and railroad employees) engaged in interstate commerce. Hailed as a victory for arbitration, *Circuit City* may end up doing more harm than good to business arbitration. On remand the Ninth Circuit applied the FAA, but held that the arbitration clause was unenforceable due in part to the fact that it was linked to a limitation on damages.<sup>213</sup> When one legal framework covers all arbitration, such precedents risk being trotted out in international contexts. Regardless of the correct rule for employment contracts, the right to contract for damage caps is clearly desirable in international commerce, where such caps facilitate cross-border transactions by permitting corporations to manage global risks more effectively.

## 2. Making Distinctions

Recognizing that values which commend arbitration in one context make it questionable in another, Congress could enact statutory safeguards to reduce the prospect that arbitration clauses in standard form agreements maneuver ill-informed individuals before biased arbitrators far from home.<sup>214</sup> Arbitration clauses are different from other contracts in that they affect not only substantive rights but also the procedure by which the rights are vindicated. Agreements to waive access to otherwise competent courts are

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211. *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 116-21 (2001) (permitting arbitration of an employment discrimination claim against an electronics retailer that had been originally filed in California state court); *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 82-83, 92 (2000) (allowing arbitration of a claim under the Truth in Lending Act related to sale of a mobile home in Alabama). Although the arbitration clause will bind the employee, it will not normally prevent action by government agencies that are non-parties to the clause. See *E.E.O.C. v. Waffle House, Inc.*, 534 U.S. 279, 296-98 (2002) (holding that E.E.O.C. may obtain victim-specific remedies in court in an enforcement action against a former employer who had agreed to arbitrate discrimination claims).

212. *Circuit City*, 532 U.S. 105 (2001).

213. *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 891-92 (9th Cir. 2002). In addition, the Court found unconscionable the unilateral nature of the clause, which bound only the employee. *Id.* at 892. For another recent case finding an arbitration clause unconscionable, see *Ting v. AT&T*, 182 F. Supp. 2d 902, 927-36 (N.D. Cal. 2002).

214. For articles exploring the role of consent in securities arbitration, see generally Richard Speidel, *Contract Theory and Securities Arbitration, Wither Consent?*, 62 BROOK. L. REV. 1329 (1996), Bruce Selya, *Arbitration Unbound?: The Legacy of McMahon*, 62 BROOK. L. REV. 433 (1996), and Jeffrey Stempel, *Bootstrapping and Slouching Toward Gomorrah: Arbitral Infatuation and the Decline of Consent*, 62 BROOK. L. REV. 1381 (1996).

qualitatively different from contract terms such as price or interest rate.<sup>215</sup> Therefore, criteria for enforcing agreements to arbitrate might reasonably require evidence of actual informed consent, perhaps in the form of an agreement made *after* the dispute arises.<sup>216</sup>

While no reliable studies exist of arbitration's fairness and efficiency, a growing body of anecdotal evidence suggests that certain industry-specific arbitral institutions operate as assembly lines to turn claims into awards, with inadequate notice and little due process. Without endorsing some of the more inflammatory rhetoric of consumer advocates and plaintiffs' lawyers,<sup>217</sup> one can still appreciate how arbitration can become an instrument of injustice when an arbitral institution dominated by a single industry nominates arbitrators whose reappointment (thus compensation) indirectly depends on the satisfaction given to the industry.<sup>218</sup>

Many scholars justify these clauses as ways to promote efficiency and lower the price of goods and services.<sup>219</sup> In some cases this may be correct, as when excessive liability inhibits productive activity.<sup>220</sup>

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215. See Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 335 (1996) (stating that adhesion contracts lack the characteristics traditionally providing the moral justification for enforcing the promises they contain).

216. Other alternatives to promote informed consent (such as a separate document) would likely be less effective, since the dominant party could in effect require signature of the arbitration clause as a pre-condition to the main contract. Some commentators might go even further and argue that as a matter of public policy the right of consumers to seek redress of grievances in court should not be subject to waiver at all. The emotional force of this argument varies according to the arbitration paradigm one has in mind, whether "efficient dispute resolution" or "something companies do to deny customers their day in court."

217. One commentator reportedly went so far as to suggest that "arbitrators are not required to follow the law." See interview with Cliff Palefsky, *reported in Analysis & Perspective*, 70 U.S.L.W. 2755, 2756 (2002). The assertion that arbitrators are allowed to be lawless is at odds with the existence of "manifest disregard of the law" as a standard for judicial review, and inconsistent with the provisions of many arbitration rules. For example, Article 17(3) of the ICC Arbitration rules requires application of law unless the parties have expressly authorized arbitrators to act as *amiables compositeurs*, a shorthand term for decisions based on the arbitrator's sense of fairness, free of legal constraints.

218. If the loser in such a system is a large corporation with access to counsel, an award based on an unjust process would normally result in a motion for vacatur, as well as damage to the reputation of the arbitrator and the supervisory institution. The prospect of such checks and balances seems less likely if the loser is a low-paid employee who finds it difficult to muster resources for a challenge or a publicity campaign.

219. See, e.g., Keith N. Hylton, *Agreements to Waive or to Arbitrate Legal Claims: A Legal Analysis*, 8 SUP. CT. ECON. REV. 209, 223-24 (2000) (explaining that the alternate savings enhances wealth if litigation costs exceed the increased deterrence benefits).

220. The effect of jury verdicts on medical practice constitutes one example of the potentially pernicious effect of undue liability. See, e.g., *Nevada May Limit Jury Awards to Stem Exodus of Doctors*, BOSTON GLOBE, July 29, 2002, A-2, cols. 4-5, reporting on orthopedists who shut down practices because of high insurance premiums, causing closure of the trauma unit at the Nevada University Medical

It is uncertain whether merchants who escape liability in connection with their services and merchandise will pass the savings on to the consumer, rather than put them into management bonuses and shareholder dividends. Other responses to the problem of too much liability might include systematic law reform or judicial acceptance of limitations of liability clauses,<sup>221</sup> rather than schemes to escape the legal system altogether.<sup>222</sup>

The point here is not to argue that pre-dispute arbitration clauses are always unsuited to consumer and employment disputes. This debate is best left to those with greater understanding of economics and or social justice. Rather, my goal is simply to emphasize that without limits on spillover from domestic to international arbitration, the latter may not reach its full potential due to uncertainty about the level of freedom from judicial intervention. A separate statute would help to insulate arbitration from the undue judicial intervention that is inevitable in consumer and employment cases.

### 3. Importing the European Experience

Europeans take for granted that consumer transactions should be subject to a separate legal framework.<sup>223</sup> The European Union has adopted forceful limitations on the validity of consumer arbitration clauses<sup>224</sup> and other “unfair” contract terms.<sup>225</sup>

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Center. Initiatives to cap malpractice awards were spurred by the discontinuance of coverage by a group that had insured most of the state’s physicians. *Id.*

221. On the “economic loss rule” in limitation of liability, see *Eastern River Steamship v. Delaval*, 476 U.S. 858, 868-71 (1986), expressing a need to keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages.

222. Admittedly there is no need for legal decisions to be the preferred form of dispute resolution. Family, school and church controversies, for example, would seem better resolved outside the courts. However, once the controversy implicates either public concerns or property within the jurisdiction of some government, recourse to state courts and legal principles becomes hard to avoid. A telling illustration can be found in the complex criteria for judicial intervention in intra-church property disputes in the United States, which almost from its beginnings as a federal system has aimed to avoid the entanglement of church and state. See, e.g., *Serbian Orthodox Diocese v. Milivojevich*, 426 U.S. 696, 713 (1976) (First Amendment prohibits inquiry into church procedures); *Baker v. Fales*, 16 Mass. 488, 520 (1820) (declining to allow church practices to be set as law).

223. See generally Jean Sternlight, *Is the U.S. Out on a Limb? Comparing the U.S. Approach to Mandatory Consumer and Employment Arbitration to that of the Rest of the World*, 56 U. MIAMI L. REV. 831 (2002). For a thoughtful paper on alternative forms of consumer protection in arbitration, see David Butler, *Consumer Arbitrations: A South African and International Perspective* (presented to the Southern African Association of Arbitrators in Sandton, South Africa, Sept. 15, 2000) (copy on file with author).

224. Council Directive 93/13/EEC (Apr. 5, 1993), 1993 (L 95) 29; see also Council Directive 98/27/EC, 1998 (L 166) 51 (relative to injunctions for the protection of consumers’ interests). Consumer contracts include agreements related to property, services or credit with any natural person acting for purposes outside his trade,

European member states have implemented this Directive in various ways. For example, in England general consumer protection regulations have been expressly made applicable to arbitration agreements.<sup>226</sup> The 1996 Arbitration Act extends the consumer protection scheme to arbitration agreements regardless of whether they cover present or future disputes and regardless of what law is applicable to the arbitration agreement.<sup>227</sup> Moreover, arbitration agreements will be considered unfair (thus presumptively invalid) if they relate to claims below an administratively fixed amount.<sup>228</sup>

Independent of the European Union Directive, many European countries have their own traditions of protecting consumers and less sophisticated parties. France has long made a distinction between the pre-dispute *clause compromissoire* and the post-dispute *compromis*, the former being valid only in contracts between merchants

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business or profession. Like any definition, this one may have unintended effects when a consumer is the party with the economic power and sophistication. If an impecunious carpenter builds a house for a prosperous captain of industry, the latter (entering into an agreement outside the scope of his or her profession) would technically be the protected consumer. Cf. LDIP art. 120 (1989) (Switz.) (governing choice of law) (referring to contracts “for current personal or family consumption” which are “not connected with the [consumer’s] professional or business activity”).

225. Article 6 of Council Directive 93/13/EEC provides that such “unfair” terms “shall not be binding.” 1993 (L 95) 31. Article 3(3) refers to an Annex of unfair terms, which gives examples of unfairness, one of which (in § 1(q)) includes terms that hinder consumers’ rights “to take legal action” or] “to take disputes exclusively to arbitration not covered by legal provisions.” *Id.* The meaning of this curious phraseology is not immediately clear, at least to the author. Most arbitration would seem to be “covered by legal provisions” in the sense of being subject to the relevant national arbitration statute. Several constructions of these words (none entirely satisfactory) could be suggested: (1) arbitration agreements are per se invalid in all consumer transactions; (2) consumer contracts may not contain “equity clauses” which permit arbitrators to decide without reference to a fixed legal system; (3) consumers may not waive appeal on questions of law, presuming such right exists under the relevant legislation.

226. Arbitration Act §§ 89-91 extends application of the Unfair Terms in Consumer Contracts Regulations of 1994, which implement European Council Directive 93/13/EEC. Arbitration Act, 1996, §§ 89-91 (Eng.). These sections cover Scotland, while the rest of the Act applies only in England and Wales. *Id.*

227. These regulations invalidate “unfair” contract terms causing “significant imbalance in the parties’ rights and obligations” to the consumer’s detriment. *See* Consumer Contract Regulations §§ 3, 4. Consumers include individuals acting for purposes outside their business. *Id.* § 2. One schedule to the accompanying Consumer Contract Regulations contains an illustrative list of terms that may be regarded as unfair, and therefore non-binding. These examples of unfairness include terms that require consumers to “take disputes exclusively to arbitration not covered by legal provisions.” Unfair Terms in Consumer Contracts Regulations, 1994, schedule 3, § 1(q) (Eng.).

228. The current floor on presumptive unfair claims is £5000, fixed for England, Wales and Scotland by the Secretary of State, and for Northern Ireland by the Department of Economic Development. Arbitration Act § 91 and Unfair Arbitration Agreements (Specified Amount) Order 1999, 1999 No. 2167, brought into force on January 1, 2000. On consumer arbitration in Britain, see M. J. CHAPMAN, COMMERCIAL & CONSUMER ARBITRATION (1997).

(*commerçants*) or persons contracting with respect to a professional activity.<sup>229</sup> In Germany, both parties must sign consumer arbitration agreements, which must either be contained in a separate document or have notarial certification.<sup>230</sup> Sweden prohibits enforcement of pre-dispute arbitration clauses with respect to goods and services supplied for private use.<sup>231</sup>

American legislation to protect consumers and employees could take the European model as its starting point. A suitable ceiling should be imposed on the legislation's scope, however, carving out from the protective framework any compensation or transactions for goods and services above a fixed sum. There would seem to be little need to protect the CEO of a major corporation seeking to escape arbitration commitments with respect to the purchase of a Rolls Royce or enforcement of a multi-million dollar golden parachute.<sup>232</sup>

#### D. A *Smörgåsbord* Approach

Outside the United States there has been widespread recognition of the need for varying levels of judicial intervention in different types of arbitration. As mentioned earlier, minimal review standards meet the need for a more level playing field in cross-border arbitration. Such a "less-is-more" approach has been adopted in many countries, including Belgium, France and Switzerland, as well as places that have adopted the UNCITRAL Model Arbitration Law such as Hong

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229. See C. CIV. art. 2061 (Fr.) (recently liberalized by Law No. 2001-420 of May 15, 2001, art. 126, J.O., May 16, 2001, at 7776 (Loi sur les nouvelles relations économiques, art. 126), to provide that ". . . a pre-dispute arbitration clause is valid in contracts concluded with respect to professional activity . . . *la clause compromissoire est valable dans les contrats conclus à raison d'une activité professionnelle*"). Pre-dispute clauses are now allowed among members of the so-called liberal professions (such as lawyers, doctors and architects), tradesmen (*artisans*) and farmers (*agriculteurs*), as well as in professional partnerships agreements. See generally Philippe Fouchard, *La Laborieuse réforme de la clause compromissoire par la loi du 15 mai 2001*, 2001 REV. ARB. 397 (2001); C. COM. art. 631 (Fr.) (covering merchants).

230. See ZPO art. 1031(5) (F.R.G.). In Germany, the *Notar* (the *notaire* in France, Switzerland, Belgium and analogous offices in other European countries) is a legal professional, with little resemblance to the notary known in the United States.

231. *Lag om Skiljeförfarande*, 1999, § 6, reprinted in 1999 STOCKHOLM ARBITRATION REPORT 111 (vol. 1, 1999) (covering disputes between businesses and consumers concerning goods and services "principally for private use" (*huvudsakligen enskilt bruk*)).

232. For a recent case in which a discharged company president was found to have waived his right to challenge a AAA award, see *Brook v. Peak International Ltd.* 294 F. 3d 668, 674 (5th Cir. 2002). On arbitration of upper level employees, see Stuart J. Schwab & Randall Thomas, *What Do CEO's Bargain For?: An Empirical Study of Key Legal Components of CEO Contracts* (forthcoming 2003-04), finding that a third of CEO contracts (180 of the 548 surveyed) include arbitration clauses, and expressing doubt that these clauses were the result of coercion by employers. See also Edward Brunet, *Seeking Optimal Dispute Resolution Classes in High Stakes Employment Contracts*, 23 BERKELEY J. EMP. & LAB. L. 107, 110-19 (2002) (exploring dispute resolution clauses with the highly skilled employee).

Kong and Scotland.<sup>233</sup> The aim is to reduce the barriers to cross-border economic cooperation created by fear of foreign fora, which can inhibit productive risk-taking in overseas markets.

In many jurisdictions the type of judicial review will depend principally on the parties' election. England and New Zealand permit litigants to opt into or opt out of appeal on the substantive merits of the case.<sup>234</sup> Switzerland, Belgium, and at least one Canadian province allow (under certain circumstances) exclusion of all judicial review at the arbitral situs.<sup>235</sup>

Two of these regimes merit special attention. French arbitration law has long recognized the distinction between domestic and international arbitration,<sup>236</sup> codified in decrees promulgated more than twenty years ago.<sup>237</sup> Striking a balance between the goals of arbitral autonomy and judicial scrutiny of an arbitration's basic procedural integrity, French arbitration law allows courts to set aside international awards rendered in France only on statutorily-limited grounds which are separate from those applicable in domestic cases.<sup>238</sup>

Switzerland goes further, and offers a choice among three options for international arbitration.<sup>239</sup> As a default rule, the Swiss

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233. See CODE JUDICIAIRE art. 1676-1723 (Belg.) (explaining the arbitration review standards); Arbitration Ordinance, Ch. 341 (Hong Kong).

234. See Arbitration Act, 1996, c.23, § 69 (Eng.) (providing for appeal on questions of English law unless "otherwise agreed" by the parties). The 1996 New Zealand Arbitration Act has a similar aim with a somewhat more complex structure. Section 6 of the Act says that Schedule 2 (containing provisions not applicable to all arbitration) applies to domestic arbitration if there has been no agreement otherwise (i.e., opt out) and to international arbitration only if the parties so agree (i.e., opt in). For example, Clause 5 of Schedule 2 allows appeal on point of law with leave of court. Section 11 of the Act permits enforcement of an arbitration clause against a consumer only if in a separate agreement the consumer certifies that he or she agrees to the arbitration. See generally David A.R. Williams, *The New Zealand Experience with the UNCITRAL Model Law*, 7 LCIA NEWS 4 (August 2002).

235. See LDIP art. 192 (1989) (Switz.); CODE JUDICIAIRE art. 1717(4) (Belg.). Through case law Ontario, Canada, seems to have arrived at somewhat the same result. See generally *Noble China, Inc. v. Lei*, 42 O.R.3d 69 (1998).

236. See generally MATTHIEU DE BOISSESON, *DROIT FRANÇAIS DE L'ARBITRAGE INTERNE ET INTERNATIONAL* (1990); PHILIPPE FOUCHARD, EMMANUEL GAILLARD & BERTHOLD GOLDMAN, *TRAITÉ DE L'ARBITRAGE COMMERCIAL INTERNATIONAL* (1996).

237. See N.C.P.C. art. 1442-1491 (Fr.) (enacted in 1980 for domestic arbitration); N.C.P.C. art. 1492-1507 (Fr.) (enacted in 1981 for international arbitration).

238. Annulment criteria for international awards set forth in Article 1502 permit vacatur if (i) the arbitrator decided without an arbitration agreement, (ii) the arbitral tribunal was irregularly composed, (iii) the arbitral tribunal violated its mission, (iv) due process (literally "the principle of adversarial process") was not respected or (v) award recognition would be contrary to international public policy. N.C.P.C. art. 1502 (Fr.).

239. See LDIP art. 176-195 (1989) (Switz.). See generally P. LALIVE ET AL., *LE DROIT DE L'ARBITRAGE INTERNE ET INTERNATIONAL EN SUISSE* (1989). The scope of the LDIP is defined by a residence-oriented test, which applies the statute to an arbitration if at least one party is foreign, in the sense of being neither domiciled nor habitually

federal statute provides five bases for challenge of awards related to procedural fairness and public policy.<sup>240</sup> Parties may opt for more expansive scrutiny under cantonal standards<sup>241</sup> that include vacatur for “arbitrariness” under the *Intercantonal Arbitration Concordat*.<sup>242</sup> By explicit agreement, review of awards may be excluded entirely<sup>243</sup> if no party is resident in Switzerland.<sup>244</sup>

## VI. FEAR OF REFORM OVERDOSE

### A. A Pandora’s Box of Special Interests

Opponents of arbitration reform in the United States sometimes express fear that Congress will not know where to stop in cleaning up the FAA.<sup>245</sup> The legislative process will open a Pandora’s box of special interest groups wishing to tinker unduly with the enforcement of arbitration agreements. As one colleague remarked, “You don’t want to see how laws or sausages are made.”

In particular, there is concern that an alliance of consumer advocates and the so-called “plaintiff’s bar” (trial lawyers who bring tort actions) will work to reduce the enforceability of pre-dispute arbitration clauses, which have been portrayed as a way to deny fundamental rights and promote damage awards less generous (others would say more reasonable) than those granted by civil juries.<sup>246</sup>

Apprehension of reform is puzzling on several levels. Initially, one might ask why special interests should *not* get involved if change is needed. Why should the law allow a bank to force a single mother from Boston to arbitrate her credit card debt in Alaska under rules

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resident in Switzerland at the moment the arbitration clause is signed. *See* Kolbrunner v. Federici, D.T.F. (October 27, 1995).

240. Grounds for challenge include (i) irregular composition of the arbitral tribunal; (ii) an erroneous jurisdictional decision; (iii) a decision beyond the matters submitted to the arbitrators, or failure to decide a matter within the request for arbitration; (iv) failure to respect the “equality of the parties” or the adversarial process; (v) incompatibility of the award with public policy (*ordre public*). *See generally* Gabrielle Kaufmann-Kohler, *Articles 190 et 191 LDIP: Les Recours Contre les Sentences Arbitrales*, 10 ASA BULL. 64 (1992).

241. At the present, reforms are underway to “federalize” Swiss procedural law in a way that may ultimately reorganize provisions of the Intercantonal Arbitration Concordat to put them on a federal level.

242. “Arbitrariness” is defined to include “evident violations of law or equity.” CONCORDAT INTERCANTONAL SUR L’ARBITRAGE art. 36(f) (Switz.).

243. The statute speaks of a *déclaration expresse / ausdrückliche Erklärung*.

244. LDIP art. 192 (1989) (Switz.) provides, “If neither of the parties has its domicile, its habitual residence or a business establishment in Switzerland, they may by express declaration in the arbitration agreement or in a subsequent written agreement waive all judicial recourse against the arbitral award. . . .”

245. *See generally* Richard E. Speidel, *Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform*, 4 OHIO ST. J. DISP. RESOL. 157 (2002).

246. Tort claims often find their way into arbitration through broad clauses covering “questions related to or arising in connection with” the contract.

giving her little hope of presenting her case? Moreover, during the past three decades the United States has seen several instances of rational arbitration reform that did not occasion catastrophe.<sup>247</sup> If the past is any guide to the future, Congress should be able to replicate the common sense shown in earlier arbitration legislation.<sup>248</sup>

Attacks on abusive employment and consumer arbitration have already begun, both in the form of judicial actions<sup>249</sup> and legislation.<sup>250</sup> In light of these understandable initiatives (some of which actually aim at the right target), the question now may not be whether special interest groups will get involved but whether their influence can be channeled in a way that does not interfere with legitimate international interests.

### *B. Random Change or Reasoned Reform?*

The inevitability of reform makes it all the more vital to consider a separate statute for cross-border arbitration.<sup>251</sup> Problematic forces for change are operating in the backlash against arbitration of consumer, employment, and small business disputes,<sup>252</sup> building on

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247. In 1970, Chapter II of the FAA adopted the New York Convention, and in 1990, Chapter III implemented the Panama (Inter-American) Arbitration Convention. In 1988, Congress eliminated the Act of State doctrine in enforcement of arbitration agreements and awards, clarified the effect of sovereign immunity in international arbitration, and refined the right of interlocutory appeal from arbitration-related court orders. *See* 9 U.S.C. §§ 15-16 (2002) (explaining what an appeal may be taken from). Moreover, in May, 2002, the so-called “Comma Act” made certain technical changes to § 10 of the FAA (providing for award vacatur). *See* Comma Act, Pub. L. No. 107-69, 116 Stat. 1758 (indenting, changing words, and redesignating subsections).

248. The fear that participatory democracy cannot produce a reasonable arbitration statute notwithstanding sensible legislation on prior occasions brings to mind the academic gibe, “You may be right in practice, but can your idea work in theory?”

249. *See, e.g.*, *Kloss v. Jones*, 310 Mont. 123, 146-47 (2002) (refusing to compel arbitration against a financial adviser accused of negligence and breach of fiduciary duty, finding the arbitration clause to be an impermissible attempt to waive access to courts and trial by jury, which were considered basic rights guaranteed by the Montana Constitution. For a survey of critiques against employment arbitration, see Steven Greenhouse, *Case Challenges Employees’ Waiving Right to Sue*, N.Y. TIMES, May 5, 2003, at A21.

250. The American Arbitration Association 1st year compiled a list of more than fifty federal legislative proposals that either limit or expand ADR. *See Report from Washington—ADR Legislation of the 107th Congress*, DISPUTE RESOLUTION TIMES 4 (Oct.-Dec. 2002).

251. The inexorable nature of reform brings to mind the words carved over the door to the house of the eminent Swiss psychiatrist Carl Jung, “*Vocatus atque non vocatus Deus aderit*” (Whether summoned or not, God will be present). The words were also carved on Jung’s tombstone in the Protestant cemetery in Kusnacht, outside of Zürich.

252. In addition to initiatives for consumer and employment contracts, changes related to shipping arbitration are also under consideration. The Committee on Maritime Arbitration of the Maritime Law Association has drafted amendments that



legitimate concerns addressed several years ago by the American Arbitration Association.<sup>253</sup>

Legislative initiatives include the Predatory Lending Consumer Protection Act, which would prohibit mandatory arbitration clauses in certain mortgages,<sup>254</sup> and the Motor Vehicle Franchise Contract Act, which makes pre-dispute arbitration clauses unenforceable in automobile franchises.<sup>255</sup> Amendments to the FAA have been proposed which make employment arbitration agreements unenforceable unless concluded *after* the dispute arises.<sup>256</sup> At the state level, anti-arbitration measures have been tailored to pass muster on federalism concerns,<sup>257</sup> including a series of statutes

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would cover only maritime arbitration. These proposals would permit consolidation of separate proceedings, 9 U.S.C. § 4(b), appointment of a second arbitrator by the claimant if the respondent fails to appoint its arbitrator promptly, subpoenas and court assistance to preserve testimony, and arbitrator modification of awards for clerical errors. 9 U.S.C. §§ 4(b)-(c), 7(b)-(c), 11(d) (West 2003).

253. See American Arbitration Association, *Consumer Due Process Protocol* (May 1998) (implementing special measures related to matters such as consumer access to information, convenient location, moderate cost and speed).

254. S. 2438, 107th Cong. (2002) (introduced by Senator Paul Sarbanes, Chair of the Senate Banking Committee). The bill would apply to any mortgage with an APR that exceeds by six per cent (for first mortgages) or eight per cent (for second mortgages) the rate for U.S. Treasury securities. *Id.*

255. Motor Vehicle Franchise Contract Act, § 11028, Pub. L. No. 107-273, 116 Stat. 1758 (enacted as 15 U.S.C. § 1226), which became law in November 2002. The statute is sometimes known as the Bono Bill in recognition of its original sponsor the late Sonny Bono. The statute provides that “arbitration may be used to settle such controversy [arising out of a motor vehicle franchise contract] only if after such controversy arises all parties to such controversy consent in writing to use arbitration to settle such controversy.” An earlier version of this law, introduced by Senators Grassley and Feingold, would have added a Section 17 at the end of Chapter 1 of the FAA. S. 1020, 106th Cong. § 2 (1999). The fact that the provision was kept out of the FAA itself has provided some comfort to forces skeptical of reform. For a description of the legislative process from the perspective of the National Automobile Dealers Association, see Harry Stoffer, *A Lesson in Sausage Making: Or How NADA Got Congress to Ban Mandatory Binding Arbitration*, 77 AUTOMOTIVE NEWS (No. 6022), Jan. 27, 2003.

256. S. 2435, 107th Cong. § 3 (2002) (introduced by Senators Kennedy and Feingold). This would effectively overrule the U.S. Supreme Court decision in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001) (discussed *supra* notes 211-13 and accompanying text).

257. The Revised Uniform Arbitration Act (RUAA), however, seems to be relatively free from the anti-arbitration backlash, leaving the issue of unconscionable arbitration clauses to general state contract law. See Uniform Arbitration Act § 12 (amended 2000), 7 U.L.A. 1 (Supp. 2002); Stephen L. Hayford & Alan R. Palmiter, *Arbitration Federalism: A State Role in Commercial Arbitration*, 54 FLA. L. REV. 175, 226 (2002); Timothy J. Heinsz, *The Revised Uniform Arbitration Act: Modernizing, Revising, and Clarifying Arbitration Law*, 7 J. DISP. RESOL. 1, 15 (2001) (stating that the doctrine requires enforceability of arbitration agreements under state law determined by the same standards applied to other contracts); Richard E. Speidel, *ICANN Domain Name Dispute Resolution, The Revised Uniform Arbitration Act, and the Limitations of Modern Arbitration Law*, 6 J. SMALL & EMERGING BUS. L. 167, 179 (2002); Thomas J. Stipanowich, *Arbitration: Future Lies Down a Number of Divergent Paths*, 6 J. DISP. RESOL. 16, 16-20 (2000); Stephen J. Ware, “Opt-In” for Judicial Review of Errors of Law Under the Revised Uniform Arbitration Act, 8 AM. REV. INT’L ARB. 263, 263 (1999); see also ABA Section of Litigation, Arbitration—Fixing What’s

enacted in California.<sup>258</sup>

Consumer advocacy groups have recently questioned arbitration in a report published by Ralph Nader's "Public Citizen," arguing that arbitration inhibits individuals from vindicating rights in consumer and employment cases.<sup>259</sup> The study calls into question (as unsubstantiated) the claim that arbitration is more economical than court litigation.<sup>260</sup> Fees to arbitrators and supervisory organizations add to the parties' expenses.<sup>261</sup> And no evidence has been mustered that expenses related to witnesses, attorneys, and discovery are lower in arbitration than in litigation.<sup>262</sup>

The American Bar Association has also expressed reservations about arbitration.<sup>263</sup> Although allowing retainer agreements to require arbitration of fee disputes and malpractice claims, the ABA guidelines require that the client be apprised of arbitration's "advantages and disadvantages," a requirement that will no doubt add some fun to the negotiation of these agreements.<sup>264</sup>

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Broke After 70 Years under the Uniform Arbitration Act (ABA Annual Meeting, Washington D.C., 1997).

258. During 2002, the California legislature passed several measures that regulated arbitration, effective the first of January 2003. See CAL. CIV. PROC. CODE §§ 1281.92, 1281.96 (West 2003) (requiring disclosure of information by arbitrators and publication of certain information by any "private arbitration company" that administers consumer arbitration); see also *id.* at § 1284.3 (prohibiting in consumer arbitration the assessment of fees and costs against the non-prevailing party). Ethics standards, adopted in 2002 by the California Judicial Council, reportedly led the American Arbitration Association to end its system for arbitrator membership in the Association, from fear that AAA membership might be considered evidence of arbitrator bias. California Assembly Bill 3029 (passed by the Assembly on August 30, 2002 and vetoed by Governor Gray Davis on September 30, 2002).

259. See Public Citizen, *Arbitration Q & A*, available at <http://www.citizen.org/congress/civjus/arbitration/articles.cfm?ID:7490> (last visited Sept. 15, 2003) (explaining why the group opposes arbitration).

260. See PUBLIC CITIZEN CONGRESS WATCH, *THE COSTS OF ARBITRATION* (Jackson Williams ed., 2002). For comment on the report, see Thomas J. Stipanowich, *Publisher's View on "The Costs of Arbitration,"* 20 CPR ALTERNATIVES 103 (May 2002).

261. On a societal level, of course, the cost of paying judges would have to be factored into any comparison of courts and arbitration.

262. See also *Mandatory Arbitration Not For All Employers; Cost, Fairness Still Subject of Debate*, 70 U.S.L.W. (BNA) No. 46, at 2755 (2002) (June 2002) (offering general discussion of recent criticisms of consumer arbitration).

263. See ABA Comm. on Ethics and Prof'l Responsibility, Formal Op. 02-425 (Feb. 20, 2002).

264. *Id.* (concerning attorneys' arbitration agreements with clients, which may not include limitations of liability). The Opinion is based *inter alia* on MODEL RULES OF PROF'L CONDUCT, Rules 1.4, 1.5 (2003) (duty to explain to client risks of alternative courses of action and requirements of fee agreements); see also MODEL RULES FOR CLIENT PROTECTION: MODEL RULES FOR FEE ARBITRATION R. 1(c) (2002), which style their effect as "voluntary for clients and mandatory for lawyers if commenced by a client"; California State Bar Standing Comm. on Prof'l Responsibility and Conduct, Formal Op. No. 1989-116, 1989 WL 253264, \*5-6; D.C. Options No. 211 and 218; cf. *Henry v. Gonzales*, 18 S.W.3d 684, 692-94 (Ct. App. Tex. 2000) (Hardberger, J., dissenting) (upholding an arbitration clause in a retainer agreement). See generally

## VII. INVESTOR-HOST STATE ARBITRATIONS

### A. *Blurred Lines: The NAFTA Experience*

To safeguard assets abroad, the United States has traditionally encouraged resolution of expropriation claims through arbitration, which was presumed to be a fairer and more efficient mechanism to determine compensation than either host state courts or gunboat diplomacy.<sup>265</sup> Recently, however, classic preferences have been blurred as have distinctions between host and investor nations and between public and private dispute resolution. Many of the litigators who focus on private-to-private disputes are now involved in both “mixed” arbitration (governments and private investors) and public disputes entirely between governments.<sup>266</sup> In large measure, the transformation results from NAFTA’s investment protection scheme which has made the United States and Canada respondents in actions brought by investors from other NAFTA countries.<sup>267</sup> Consequently, North American perceptions of international arbitration have changed vividly with the press now carrying accusations that arbitration involves “secret tribunals” that ignore public interest and constitute an “attack on American values.”<sup>268</sup>

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Steven Quiring, *Attorney-Client Arbitration: A Search for Appropriate Guidelines for Pre-Dispute Agreements*, 80 TEX. L. REV. 1213, 1213 (2002); Alan Scott Rau, *Resolving Disputes Over Attorneys’ Fees: The Role of ADR*, 46 S.M.U. L. REV. 2005 (1993).

265. See generally Guillermo Aguilar Alvarez & William W. Park, *The New Face of NAFTA Arbitration*, 28 YALE INT’L L.J. 365 (2003). See also William W. Park, *Arbitration and the FISC: NAFTA’s “Tax Veto”*, 2 CHI. J. INT’L L. 231, 236 (2001). Arbitration might be conducted pursuant to a private concession, perhaps using institutional rules such as those of the ICC, or a non-supervised procedure under the UNCITRAL Rules. In the alternative, treaty-based arbitration might go forward under the auspices of the World Bank’s ICSID regime or one of the many bilateral investment treaties.

266. For example, in a recent boundary dispute before the ICJ, a British commercial firm (Freshfields) represented claimant, a Canadian commercial arbitrator (Yves Fortier) served as *ad hoc* judge and the co-author of a commercial arbitration treatise (Michael Reisman) acted as expert. See ICJ: Case Concerning Maritime Delimitation and Territorial Questions Between Qatar and Bahrain, 40 I.L.M. 847, 847-52, 859, 896-97 (March 16, 2001) (giving Bahrain sovereignty over certain islands in the “Trucial States” placed under British protection in the early 19th century to safeguard trading routes with India from plunder by local tribes). See generally Malcolm Evans, *Decisions of International Tribunals: The International Court of Justice*, 51 INT’L & COMP. L. Q. 709, 709-18 (2002).

267. See Chapter 11, North American Free Trade Agreement, December 17, 1992, Can.-Mex.-U.S., 32 I.L.M. 289, 642-46 [hereinafter NAFTA]. Lines have also been blurred between public and private arbitration, once considered distinct subjects. At a recent symposium of the London Court of International Arbitration, the Deputy Secretary General of the Permanent Court of Arbitration emphasized that institution’s willingness to administer arbitration between private parties as well as between sovereign states. Bette Shifman, Remarks at London Court of International Arbitration Symposium, Tylney Hall, Rotherwick, England (May 11, 2002).

268. An advertisement in the *Washington Post* attacked investment arbitration as a “Fast Track Attack on America’s Values” with “Secret Courts for Corporations.” WASHINGTON POST, Dec. 5, 2001, at A-5 (advertisement placed by the Global Trade

Claims filed *against* the United States made arbitration look less appealing.<sup>269</sup> Perceived threats to legislative prerogatives led to suggested deviations from traditional arbitration practices such as confidentiality.

The flap over NAFTA adds new dimensions to the cost-benefit analysis of how much discretion should be given to arbitrators conducting proceedings and judges reviewing awards. More than most commercial arbitration, NAFTA disputes have considerable third party effects. Intense review of NAFTA awards violates the member countries' commitment to leave resolution of investment disputes to arbitrators.<sup>270</sup> The risk of political interference in the NAFTA arbitral process is one more reason that international arbitration should be subject to a more *laissez-faire* arbitration scheme, which would limit the opportunity for judicial interference. At the same time, adoption of specific procedural protocols to be applied by arbitrators would likely encourage public respect for the arbitral process and thereby reduce the prospect of a backlash that would curtail the fair resolution of investment disputes.<sup>271</sup>

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Watch division of Ralph Nader's Public Citizen advocacy group). A *New York Times* article accused investment arbitration of leading to "national laws being revoked, justice systems questioned and environmental regulations challenged." Anthony De Palma, *NAFTA's Powerful Little Secret*, N.Y. TIMES, March 11, 2001, Section 3, at 1. Bill Moyers hosted a television special in which NAFTA was called a "sophisticated extortion racket" in which "secret NAFTA tribunals can force taxpayers to pay billions of dollars in lawsuits." *Now With Bill Moyers: Trading Democracy* (PBS television broadcast, Feb. 1, 2002), available at [http://www.pbs.org/now/transcript\\_tdfull.html](http://www.pbs.org/now/transcript_tdfull.html). For a different approach to the interaction of international trade and governmental regulatory structures, see Ronald A. Cass & John Haring, *Domestic Regulation and International Trade: Where's the Race? Lessons from Telecommunications and Export Controls*, in THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW: ESSAYS IN HONOR OF ROBERT E. HUDEC 111, 111-54 (Daniel L.M. Kennedy & James D. Southwick eds., 2002), also published in 11 JOURNAL DES ÉCONOMISTES ET DES ÉTUDES HUMAINES 531, 531-74 (2001).

269. To some observers the U.S. attitude toward investment arbitration suggests a double standard (arbitration for U.S. citizens abroad but not when foreigners invest here), reminiscent of a character in a Jules Romains novel who liked honesty "only in others." A foreign emissary who helped himself to a share of the bribes his government paid French newspapers was shocked that intermediaries had skimmed from these payments. See JULES ROMAINE, 2 LES HOMMES DE BONNE VOLONTE, Pt. 9 (*Montée des Périls*), Sec. XXX (*Réponse de Marc Strigelius*), 335 (Robert Laffont ed., 1988) ("*M. Coubersky, lequel se charge de prélever sur ces millions une gorgée abondante, semble trouver mauvais que les intermédiaires aient une soif parente de la sienne. C'est un homme qui aime l'honnêteté d'autrui.*").

270. For recent reiterations of this theme, see Charles H. Brower, *Beware of the Jabberwock: A Reply to Mr. Thomas*, 40 COLUM. J. TRANSNAT'L L. 465, 479 (2002); Charles N. Brower & Lee A. Steven, *Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11*, 2 CHI. J. INT'L. L. 193, 196-202 (2001).

271. In addition to classic investment arbitration, the emerging arbitral resolution of international transfer pricing disputes raises similar sovereignty-related questions. Although framed as arbitration between two countries, the taxpayer will

Essentially, NAFTA Chapter 11 gives business managers from a member country the right to arbitrate investment grievances regardless of whether an agreement to arbitrate actually exists in a negotiated investment concession, thus eliminating foreign investor recourse to home country intervention against the host state. The initial part of Chapter 11 imposes substantive norms for cross-border investment (forbidding discrimination and requiring “fair and equitable” treatment as well as compensation for nationalized property,)<sup>272</sup> while the second portion provides arbitration as a remedy for a host state’s breach of its duties.<sup>273</sup>

### B. *Judicial Review and Investment Arbitration*

An aggrieved investor may choose either arbitration supervised by the World Bank’s International Centre for the Settlement of Investment Disputes (ICSID) or a proceeding conducted under the UNCITRAL arbitration rules.<sup>274</sup> Should the investor want ICSID arbitration, however, there is a slight limitation. Neither Mexico nor Canada is yet a party to the Washington Convention establishing ICSID,<sup>275</sup> and thus arbitration must proceed under the so-called “Additional Facility” designed to give World Bank supervision outside the Convention framework.<sup>276</sup>

Consequently, in any available arbitration forum, NAFTA Chapter 11 awards will be subject to judicial review at the place where rendered.<sup>277</sup> Unlike “pure” ICSID arbitration (where the Washington Convention forecloses vacatur motions in national courts

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usually be the real party in interest. The evolution of fiscal arbitration will require collaboration between tax and arbitration to create new frameworks for both the conduct of the arbitration and judicial review of awards. *See generally* Brower & Steven, *supra* note 270, at 195-97.

272. NAFTA Chapter 11 echoes the compensation criteria traditionally advocated by the United States. While the terms “prompt, adequate and effective” compensation (which originated in a 1938 communication to Mexico from US Secretary of State Cordell Hull) do not appear in the text of Chapter 11, the combination of compensation factors listed in NAFTA Article 1110 (“paid without delay,” “fair market value” and “fully realizable”) amount to the same result. *See* Restatement (Third) Foreign Relations Law of the U.S. § 712, cmts. c, d, and Reporter’s n.2 (1987). NAFTA Article 1110(1) adopts a four-part structure, requiring that the expropriation (1) have a public purpose, (2) be applied on a non-discriminatory basis, (3) “in accordance with due process of law and Article 1105(1)” [“fair and equitable treatment”] and (4) result in “payment of compensation in accordance with paragraphs 2 through 6 [of Article 1110],” which adopt the fair market value standard.

273. *See* NAFTA, *supra* note 267, at 639-42.

274. *Id.* at 643.

275. *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, Mar. 18, 1965 (entered into force Oct. 14, 1966), in ICSID BASIC DOCUMENTS 25 (1985).

276. ICSID ADDITIONAL FACILITY RULES 5 (2003).

277. NAFTA, *supra* note 267, at 643.

in favor of a special system of internal quality control,)<sup>278</sup> both UNCITRAL and Additional Facility awards may be challenged in national courts.<sup>279</sup>

The significance of judicial review of NAFTA awards was illustrated in *Metalclad*,<sup>280</sup> in which the Supreme Court of British Columbia was required to decide whether a NAFTA award fell under its International Commercial Arbitration Act which provides a narrower scope of review than the otherwise applicable Provincial statute.<sup>281</sup> An arbitral tribunal had ordered Mexico to pay compensation for acts of the municipality of Guadalcazar that prevented operation of a hazardous waste facility owned by U.S. citizens. Although hearings were held in Washington D.C. for the sake of convenience, the arbitration's official situs was Vancouver. Mexico then petitioned to have a NAFTA award set aside by the British Columbia Supreme Court.<sup>282</sup>

Surprisingly, the choice of applicable statute turned on the meaning of "commercial" rather than "international." Mexico argued against application of the International Act (which requires that arbitration be commercial as well as international) on the ground that the proceedings related to a regulatory rather than a commercial relationship.<sup>283</sup> The court disagreed, finding that the case was commercial in the sense that it "arose out of a relationship of investing."<sup>284</sup> Characterizing the arbitration by reference to the underlying transaction (a cross-border investment) placed the dispute within the terms of the International Act. Thus court scrutiny focused

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278. See *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, in ICSID CONVENTION, REGULATIONS AND RULES art. 52 (2003).

279. Park, *supra* note 265, at 234-35.

280. See *Metalclad v. United Mexican States* (Case No. ARB(AF)/97/1), 5 ICSID 209, 210-12 (ICSID Aug. 2000) (finding expropriation without adequate compensation where a U.S.-owned company was prevented by Mexican municipality from operating a hazardous waste facility in Mexico). For the British Columbia Supreme Court decision vacating and remanding the award in part, see *United Mexican States v. Metalclad*, 5 ICSID 236, 236-38 (Judicial Review, Supreme Ct. of British Columbia (May, 2001), deleting certain paragraphs of the prior decision and adjourning the proceedings to give the arbitral tribunal an opportunity to resume the arbitration for purposes of determining certain issues related to a Mexican ecology decree. NAFTA Chapter 11 proceedings are not the only investment arbitrations subject to judicial review. See, e.g., *Czech Republic v. CME Czech Republic B.V.* (Svea Court of Appeals, Sweden, May 15, 2003), with introductory note by Thomas Wälde, 42 I.L.M. 915 (2003).

281. The British Columbia Commercial Arbitration Act catches arbitration excluded from the International Act (which was based on the UNCITRAL Model Law). The domestic statute allows a more generous role for court intervention, including appeal on points of law. *Metalclad*, 5 ICSID 236, 246-48 (2001).

282. *Id.* at 239.

283. *Id.* at 247.

284. *Id.*

on whether the award exceeded the arbitrators' powers, rather than on whether the arbitrators made a substantive mistake.<sup>285</sup>

Should a court in the United States face a similar scenario, it would be unfortunate if the temptation existed to examine the substantive merits of a case under the "manifest disregard of the law" standard. Arbitration has been selected as the optimum way to resolve cross-border investment disputes precisely because the parties prefer an adjudicator less political than national courts. The FAA's current universality presents an invitation for mischief.

### C. Political Reaction and Notes of Interpretation

For the United States, NAFTA began to create problems when Canadian investors brought claims for failure to grant "fair and equitable treatment" and *de facto* expropriation without compensation.<sup>286</sup> The better known cases included complaints about a California ban on gasoline additives,<sup>287</sup> a Mississippi jury award against a Manitoba funeral director,<sup>288</sup> and a Massachusetts court decision upholding Boston's refusal to execute a land sale with a Montreal developer.<sup>289</sup>

Political reaction to such NAFTA cases has been intense.<sup>290</sup> The

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285. In the end, the court refused to set aside the award in its entirety, deciding that not all of the arbitrators' findings exceeded their authority. *Id.* at 267.

286. See generally *Methanex Corp. v. USA*, Amended Claim filed Feb. 12, 2001, available at <http://www.naftaclaims.com>; *Loewen Group v. United States*, Final Award, June 26, 2003, 42 I.L.M. 811 (2003); Jonathon Harr, *The Burial*, THE NEW YORKER, Nov. 1, 1999, at 70.

287. *Methanex*, *supra* note 286.

288. *Loewen Group, Inc. v. U.S.A.*, ICSID Case No. ARB (AF)/98/3, Interim Award on Jurisdiction, Jan. 5, 2001, Final Award, June 26, 2003 (denying liability) (Anthony Mason, Abner J. Mikva & Michael Mustill arbs.), 42 I.L.M. 811 (2003), at [www.naftaclaims.com](http://www.naftaclaims.com). The \$500 million verdict included \$400 million in punitive damages. Appeal required a bond of 125% (\$625 million) as security. The rich tapestry of this dispute is set forth in Harr, *supra* note 286, at 70.

289. *Mondev International Ltd. v. USA*, 42 I.L.M. 85, 86, Award, Oct. 2002 (denying liability) (Ninjan Stephens, James Crawford & Stephen Schwebel arbs.). See generally Jack Coe, *Denial of Justice and NAFTA Chapter 11—The Mondev Award*, 3(1) INT'L ARB. NEWS 2 (Winter 2002/2003). See also Rudolph Kass, *How Sharp are the Tiger's Teeth*, 47 BOSTON BAR ASS'N JOURNAL 10 (Sept/Oct. 2003). On the underlying claim, see the opinion written by Justice Charles Fried (as he then was) in *Lafayette Place Assocs. v. Boston Redevelopment Auth.*, 694 N.E.2d 820, 835-37 (Mass. 1998), holding that the developer was precluded from suing Boston and the Boston Redevelopment Authority.

290. Current U.S. concerns echo the rhetoric of 19th-century Argentine economist Carlos Calvo, who attempted to protect the economic sovereignty of Latin America through the "Calvo Doctrine" (first announced in 1868 in LE DROIT INTERNATIONAL THÉORIQUE ET PRATIQUE), which required investor submission to local courts, effectively eliminating arbitration. See generally, K. Lipstein, *The Place of the Calvo Clause in International Law*, 1945 BRIT. Y.B. OF INT'L L. 130, 137-45 (1945). In 1974, the Calvo doctrine was pushed further in the so-called "New International Economic Order" adopted by the United Nations General Assembly in an attempt (unsuccessful as history has shown) to give host state courts an exclusive right to determine the measure of compensation for expropriated property. See Charter of

Chairman of the Senate Finance Committee endorsed establishment of an appellate review of NAFTA awards<sup>291</sup> as well as government screening of arbitration to avoid having “frivolous or inappropriate claims” considered by arbitrators.<sup>292</sup> The current version of the 2002 Trade Act includes an appellate body to correct “manifestly erroneous interpretations of law” and a mandate of “transparency” by making arbitration proceedings public and allowing *amicus curiae* submissions from both business and labor organizations.<sup>293</sup>

Bowing to what some observers believe to be public pressure in the United States, the NAFTA Free Trade Commission in 2001 issued *Notes of Interpretation*, effectively interpreting (or restating, depending on perspective) NAFTA requirements so as to limit the liability of host countries in connection with several matters currently *sub judice*.<sup>294</sup> Responding to the criticism of the confidentiality of NAFTA arbitration (referred to by critics as “lack of transparency”), the *Notes of Interpretation* provide that nothing in NAFTA imposes “a general duty of confidentiality” on the parties to a Chapter 11 arbitration.<sup>295</sup>

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Rights and Duties of States art. 2(2)(c), *reprinted in* CHARTER OF ECONOMIC RIGHTS AND DUTIES OF STATES: ANTECEDENTS AND TEXT 35, *discussed in* William W. Park, *Legal Issues in the Third World's Economic Development*, 61 B.U. L. REV. 1321, 1327 (1981).

291. See Rossella Brevetti, *Baucus Welcomes Options Administration Is Considering on Investor-State Disputes*, BNA INT'L TRADE, Mar. 28, 2002, at 529 (discussing Letter of Mar. 26, 2002 from Max Baucus to Trade Representative Robert Zoellick). In reaction, on Mar. 28, 2002, the Senate Finance Committee's ranking Republican Charles Grassley urged Trade Representative Zoellick to reject such screening. See Rosella Brevetti, *Grassley Urges Zoellick to Reject Government Screening for Investor Suits*, REG. LAW & ECONOMICS, Apr. 1, 2002, at A-6. Industry groups, including the National Association of Manufacturers, have also expressed concern for the preservation of investor protections for U.S.-owned businesses abroad.

292. A similar screening mechanism already exists with respect to expropriation claims that implicate tax measures. See NAFTA, *supra* note 267, art. 2103(6).

293. See Trade Act of 2002, Pub. L. No. 107-210 § 2102(b)(3), 116 Stat. 994 (2002), which includes the Bipartisan Trade Promotion Authority Act of 2001 (H.R. 3005) and the Andean Trade Preference Act (H.R. 3009), accompanying House of Representatives Report 107-518, June 19, 2002.

294. A breach of another NAFTA provision or a separate international agreement will not in itself establish that “fair and equitable treatment” has been denied under Article 1105. The meaning of international law has been limited to “customary” minimum standards, thus preventing recourse to other sources of international law that might either impose or relax restrictions on host State treatment of foreign investors. See Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L L. 365, 397-98 (2003).

295. NAFTA, *Notes of Interpretation of Certain Chapter 11 Provisions*, July 31, 2001, Part A, *reprinted in* 13 WORLD TRADE & ARBITRATION MATERIALS, No. 6, 139, 139 (2002). In this context, it is worth noting that for decades before NAFTA, expropriation claims against developing countries had been arbitrated in confidential proceedings under ICSID, UNCITRAL and ICC Rules without complaint from the industrialized investor nations.



Confidentiality is nothing special for NAFTA arbitration but represents the long-established practice for most international arbitration. Moreover, the jury system in the United States has given Americans long experience with secret deliberations and an absence of reasoned decision making.

To some observers, the *Notes of Interpretation* constitute *de facto* modification of NAFTA that departs from the member countries' original meaning and thus requires approval in accordance with "applicable legal procedures of each Party."<sup>296</sup> To date, no satisfactory way has been found to resolve the potential conflict between the requirements for amendment under NAFTA and the provisions of Chapter 11 that permit Free Trade Commission interpretations.

For investment arbitration to fulfill its promise, some mechanism must be found to promote greater arbitral sensitivity to vital host state interest.<sup>297</sup> The ebb and flow of arbitration's wisdom may have to accommodate political reality. While the *Notes of Interpretation* may be helpful to guide arbitrators toward sensitivity to the public interest, the task is best accomplished without the intervention of national courts.

Expropriation cases by their nature engender political fervor, which is why NAFTA charges international arbitrators rather than national judges with deciding investment disputes. Clearer FAA provisions for international arbitration, limiting the grounds for judicial review, would be a step in resisting the risk of political interference. An occasional "wrong" arbitral award is a small price to pay for the net aggregate gain to prosperity through enhanced cross-border investment.

## VIII. CONCLUSION

Arbitration by its nature is polycentric: one might more accurately speak of arbitrations in the plural. A wide variety of disputes are included into one category, implicating differences related to the sophistication of the parties, the character of the disputes, and the public interests at stake. The current legal framework for arbitration conducted in the United States attempts to

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296. See NAFTA, *supra* note 267, art. 2202. One award has suggested that *Notes of Interpretation* which fail to respect the text of NAFTA would not be binding on arbitrators deciding Chapter 11 disputes. See *In re Pope & Talbot*, 41 I.L.M. 1347, 1362-65 (2002) (ordering Canada to pay \$461,556 plus interest in damages). At footnote 37 (paragraph 47) the Award states, "[w]ere the Tribunal required to make a determination whether the [NAFTA Free Trade] Commission's action is an interpretation or an amendment, it would choose the latter."

297. For a caution about backlash toward investor-government arbitration, see Michael Goldhaber, *Czech Mate*, AMERICAN LAWYER, Mar. 2002, at 87 (describing how a U.S. investor used arbitration to vindicate expropriation claims against the Czech Republic), which quotes a noted international arbitration lawyer warning how a Canadian win in a high profile NAFTA case (*Loewen*) could cause a hostile reaction toward NAFTA.

squeeze all types of arbitration into the Procrustean bed of a single set of standards for judicial review.

The United States should seriously consider eliminating judicial discretion to review the substantive merits of awards in international cases. The domestically nourished doctrine of “manifest disregard of the law” risks misapplication in cross-border contests. The FAA should be cantonized into separate regimes for domestic and international arbitration, thus permitting the latter to evolve independent of whatever protective legislative and judicial initiatives might be appropriate to address concerns developed in a domestic context.

Bifurcated statutes in France and Switzerland, along with the type of consumer protection regimes that have been implemented through the European Union, could serve as models for the United States. Options for different levels of judicial scrutiny of awards should be available.

No system is likely to find the perfect balance between flexibility and certainty. Legislators and courts will be called to a process of regular fine-tuning that aims at a reasonable counterpoise between competing objectives, giving business managers the appropriate climate in which to consummate cross-border transactions.

This paper makes no suggestion of radical reform.<sup>298</sup> “Go slow” seems the best approach. However, for cross-border arbitration to reach its full potential, distinctions should be made in judicial review of domestic and international awards.

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298. Some great Frenchman (both Talleyrand and Valéry have been given credit) rightly remarked, “*Tout ce qui est excessif est insignifiant*” (Anything excessive becomes insignificant).

## Appendix: Review of International Awards Made in the United States

### 1. Scope

(a) Except as provided in subsection 1(b), this chapter shall apply to any arbitration with its seat in the United States, in which at least one party is resident or incorporated outside of the United States at the time the agreement to arbitrate was concluded.

(b) Unless the agreement to arbitrate was entered into after the dispute arose, this Chapter shall not apply to (i) an employment contract in which the yearly remuneration of the employee is less than [\$ XYZ] or (ii) an agreement concluded with respect to a consumer transaction.

(c) A consumer transaction includes any agreement related to property, services or credit with any individual for purposes outside his trade, business or profession if the amount in dispute is less than [\$ ABC].

### 2. Award Vacatur

In any of the following cases the United States court in the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration:

(i) a party to the arbitration agreement was under some incapacity, or the said agreement is not valid under the applicable law; or

(ii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

(iii) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties; or

(iv) the award was procured by fraud, bias or corruption;

(v) the award is in conflict with international public policy or the subject matter of the dispute is not capable of being submitted to arbitration.

### 3. Time Limit for Vacatur

An application for setting aside an award covered by this Chapter must be brought no later than three (3) months from the date on which the party making that application has received the award.

### 4. Jurisdiction for Vacatur

An action to vacate an award covered by this Chapter may be brought only in the district wherein the award was made. In no event may a federal court vacate an award made outside the United States.

### 5. Exclusion of Other Grounds for Vacatur

Unless the parties have explicitly provided for judicial review under Chapter 1 of this title, no award covered by this Chapter may be vacated on any grounds other than as provided above.

## **Notes**

### 1. *Separate FAA Chapter or Tinkering with Existing Provisions?*

The proposal set forth above is intended as a stand-alone set of rules to cover vacatur of awards in international proceedings conducted within the United States. An alternative approach would be simply to tinker with the language of Chapters 2 and 3 that implement the New York and Panama Convention schemes for recognition of foreign and “non-domestic” awards.

Admittedly, such a wide net may complicate the prospects for adoption of the statute. The more obvious the change, the more likely that there will be opposition. From a political perspective, less is often more.

Two concerns tip the scales in favor of separate provisions. First, judicial interpretation of the existing FAA Chapters has often been problematic. One may wish to reduce the prospect of ill-advised judicial creativity by establishing a framework which, to the extent possible, will operate independently of prior case law. Second, a fresh start would permit an approach more user-friendly to foreigners, particularly if the text of the legislation picks up some of the language and format used by the Model Law.

## 2. *Fraud, Bias and Corruption*

The proposed statutory language goes beyond the text of the Model Law by suggesting inclusion of “fraud, bias or corruption” as an explicit ground for vacatur. Some might argue that this is unnecessary. Admittedly, those defects are subsumed under “violation of public policy” and “inability to present one’s case,” defenses to award enforcement that may be pressed into service against bias and corruption under the New York Convention<sup>299</sup> as well as national arbitration statutes in countries influenced by the UNCITRAL Model Law.<sup>300</sup>

No good reason argues for leaving these matters to judicial interpretation. An explicit prohibition on fraud and corruption, added for the avoidance of doubt, is unlikely to be seen to imply that fraud and corruption are acceptable in awards subject to the New York Convention. Moreover, inclusion of fraud, bias and corruption as grounds for vacatur could be expected to make the legislation more politically palatable. Otherwise, one can easily imagine complaints that the legislative proposal lacked the most basic protections. Explicit statutory language seems far more likely to convince Congress of the proposal’s fairness than reference to learned foreign treatises that link bias and fraud to public policy violations.

## 3. *Definition of International Arbitration*

The scope of the proposed legislation is narrower than that of both FAA Chapter 2 and the UNCITRAL Model Law. The former includes even disputes between U.S. citizens as long as they implicate property or contract performance abroad. The Model Law combines multiple tests, bringing within its scope arbitrations in which (i) parties have places of business in different countries, (ii) the place of contract performance or the place of arbitration is outside the parties’ home country, or (iii) the parties opt to treat the proceedings as international.

A residence-based test seems more sensible.<sup>301</sup> The linguistic and procedural differences that justify a *laissez-faire* arbitration regime are likely to arise when U.S. residents seek to avoid courts in

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299. See, e.g., ALBERT JAN VAN DEN BERG, THE NEW YORK CONVENTION OF 1958 302, 306, 331, 377-82 (1981) (addressing the scope of Articles V(1)(b) (inability to present his case) and Article V(2)(b) (violation of public policy)).

300. With respect to public policy under the Swiss LDIP, see generally P. LALIVE, J.F. POUDRET, & C. REYMOND, LE DROIT DE L’ARBITRAGE INTERNE ET INTERNATIONAL EN SUISSE 430 (1989), insisting that *ordre public* has a procedural (as well as substantive) aspect capable of rectifying abusive arbitrator behavior.

301. Corporate entities should probably be considered residents if organized under the law of, or possessing a principal place of business in, the forum country. Thus, for example, a U.S. branch of a foreign corporation would be considered a U.S. resident, as would an alien individual present in the United States more than 183 days during any calendar year.

Paris, Rio or Shanghai, rather than when one U.S. citizen sues another in New York over goods and/or services destined for export.

#### 4. *Opt-out Provisions*

Some litigants may want the greater protection afforded by whatever paternalistic intervention might be afforded under FAA Chapter 1. Some commentators fear that expansion of judicial review would change the character of arbitration. However, freedom of contract would likely have beneficial effects on balance, reducing the apprehension of “wild card” awards in high stakes cases affecting the proverbial family jewels of a litigant. At least as between sophisticated parties to an international contract, the right to elect merits review would appear to be almost a corollary of the right to elect courts. By contrast, good arguments exist for denying the right to exclude all court scrutiny, given that an award takes on a presumptive validity throughout the world under the New York Convention. In other words, the statutory framework for judicial review of international arbitration in the United States would constitute a floor but not a ceiling.

#### 5. *Public Policy*

In the hope of reducing an overly parochial use of public policy, the statutory proposal adopts the French distinction between public policy applicable to domestic cases and public policy applicable to international cases. The latter concept, referred to as *ordre public international*, derives from the policy national courts consider relevant to cross-border transactions with no direct impact on the forum. Thus, for example, an interest rate that would violate public policy in a purely domestic transaction might be acceptable in a cross-border context.

#### 6. *Consumers and Employees*

The type of *laissez-faire* judicial review scheme proposed for international contracts between sophisticated parties is not appropriate for consumer transactions and employment contracts, where heightened court scrutiny provides a healthy measure of paternalistic protection for the weaker party. One might argue that such restrictions also belong in other parts of the FAA and perhaps also in the New York Convention itself. Indeed that would seem eminently sensible, and might well be on the agenda of those seeking to improve other parts of arbitration’s legal framework.

#### 7. *Jurisdiction for Award Vacatur*

By limiting vacatur to the place where the award is made, the proposed legislation makes clear that U.S. courts should not be in the business of setting aside decisions in foreign arbitrations. Contrary to the implication in *Cortez Byrd*,<sup>302</sup> defects in awards rendered abroad can best be addressed if and when they are presented for recognition and/or enforcement in the United States.

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302. See, e.g., *Cortez Byrd Chips, Inc. v. Bill Harbert Const. Co.*, 529 U.S. 203, 203 (2000) (justifying adoption of expansive venue requirements as a way to permit an “action under the FAA in courts of the United States to . . . vacate awards rendered in foreign arbitrations not covered by either convention”).