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ARBITRATION IN BANKING AND FINANCE

WILLIAM W. PARK*

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"The human species, according to the best theory I can form of it, is composed of two distinct races: the men who borrow and the men who lend."¹

INTRODUCTION

The world's bifurcation into debtors and creditors has created yet another class of people: those involved in resolving disputes between lenders and borrowers. To promote reliability in financial dispute resolution, credit agreements have generally provided that potential controversies will be submitted either to courts in the bank's home jurisdiction,² or to courts of a major money center such as London or New York.³

In the alternative, parties to a financial transaction might agree to resolve disputes between them by arbitration, thus conferring adjudicatory competence on private rather than public decision-makers. Arbitration has long been common in settling commercial⁴ and insurance⁵ disputes, where its use tends to reduce litigation costs. In an international context, arbitration serves to level the playing field where there exists a particularly acute fear of the other side's "hometown justice."

In contrast to the commercial and insurance communities, bankers have traditionally preferred judges over arbitrators. This should not be surprising. A

¹ Charles Lamb, *Two Races of Men*, in *ESSAYS OF ELIA* (1823).

² In addition, banks sometimes reserve the right to pursue the borrower before other competent courts, such as those at the borrower's domicile. See discussion of unilateral clauses, *infra* at notes 147-61 and accompanying text.

³ See generally LEE C. BUCHHEIT, *HOW TO NEGOTIATE EUROCURRENCY LOAN AGREEMENTS* (1995), at 126-31.

⁴ See generally cases discussed in THOMAS CARBONNEAU, *CASES & MATERIALS ON COMMERCIAL ARBITRATION* (1997); W. MICHAEL REISMAN, W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, *INTERNATIONAL COMMERCIAL ARBITRATION* (1997); WILLIAM W. PARK, *INTERNATIONAL FORUM SELECTION* (1995); IAN MACNEIL, RICHARD SPEIDEL & THOMAS STIPANOWICH, *FEDERAL ARBITRATION LAW* (1994); W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION* (2d ed. 1990).

⁵ See, e.g., *Quackenbush v. Allstate Ins. Co.*, 116 S. Ct. 1712 (1996) (declaring that in a motion to compel arbitration in federal court, abstention in favor of state court not appropriate); *U.S. Fire Ins. Co. v. National Gypsum*, 101 F.3d 813 (2d Cir. 1996) (holding that in an arbitration of insurance coverage of bodily injury claims against asbestos producers, preclusive effect of court decision must be arbitrated).

debtor's default usually results from simple inability or unwillingness to pay, rather than any honest divergence in the interpretation of complex or ambiguous contract terms. Arbitration therefore may appear as an unnecessary invitation to a "split the difference" award, reminiscent of King Solomon's famous threat to cut the baby in two.⁶ Moreover, financial institutions with a security interest over a debtor's assets will usually find it easiest to bring a court action where the pledged property is located. Finally, going to court may also give the lender the benefit of summary procedures for the enforcement of promissory notes and other commercial paper obligations.⁷

Herd mentality and respect for custom provide other clues to the banker's hesitation to embrace private adjudication. Not without good reason, the financial sector has tended to be conservative, wary of rapid change.⁸ If suing borrowers in court rather than before arbitrators has worked well enough in the past, few bankers will buck the trend.

Increasingly, however, the financial community is finding benefits to arbitration, particularly in connection with securities transactions, guarantees, documentary credits, consumer loans, and public sector lending. This Article will examine how arbitration has developed in each of these selected areas. In addition, it will analyze the major elements in the efficiency calculus of financial arbitration: (i) the multilateral treaty network for the enforcement of arbitral awards; (ii) the arbitrator's ability to ignore "Act of State" defenses arising from foreign exchange controls; and (iii) the risk of excessive American jury awards with respect to both punitive damages and "lender liability" claims.

No dispute resolution clause will satisfy every segment of the financial services industry. Rather, the interaction of all elements of a given financial transaction will determine when and how arbitration may (or may not) be appropriate to the resolution of banking and securities controversies. This Article suggests, however, that arbitration merits special consideration when the borrower's assets are found in jurisdictions lacking judgment treaties with the probable litigation forum, when loans are subject to exchange controls, and when debtors might file punitive damage or "lender liability" actions. Arbitra-

⁶ Of course, when Solomon called for a sword to divide the infant, he was rendering only an interim award, designed to discover the real mother. See I Kings 3:24-25.

⁷ See, e.g., CODE DE COMMERCE [C.COM.], art. 641 (Fr.) (providing the *Tribunal de commerce* with power to order an *injonction de payer* with respect to promissory notes).

⁸ For an analysis of factors that explain deference to the past even when it may be inefficient, see Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641 (1996).

tion may also be appropriate when there exists a need for special expertise, such as in the settlement of documentary credit disputes subject to the *Uniform Customs and Practices* of the International Chamber of Commerce.

To the extent that arbitration promotes respect for bargains between creditor and debtor, it commends itself not only to the bankers' self-interest, but also as a matter of sound international economic policy. The greater the risk in loan recovery, the higher the interest rate. Because loans are loans, not gifts, untrustworthy enforcement mechanisms will tend to chill cross-border economic cooperation to the detriment of those countries that depend most on foreign capital for development.

I. ENFORCING LOAN AGREEMENTS

At the outset, arbitration should be distinguished from other non-judicial forms of alternative dispute resolution currently in vogue. Arbitration implies not only the consent of the parties to settle their dispute out of court, but also bindingness of result. On the strength of an arbitral award, assets can be attached and competing litigation precluded.⁹ By contrast, neither mediation nor conciliation is legally binding; both may end up being little more than foreplay to litigation.¹⁰

A. Treaties

Bankers sometimes must enforce court judgments in their favor against assets located outside the country where the judgment was rendered. For example, an American bank that obtained a judgment in New York against a

⁹ Samuel Johnson commented on the salutary effects of looming catastrophe: "[d]epend upon it, Sir, when a man knows he is to be hanged in a fortnight, it concentrates his mind wonderfully." JAMES BOSWELL, 2 LIFE OF JOHNSON 110 (Mowbray Morris ed., Thomas Y. Crowell & Co. 1890).

¹⁰ Dispute resolution possessing a moral force only will be more effective in a closely knit, ethnically homogeneous community with repeat dealings among community members, rather than among culturally diverse and mutually suspicious (or even hostile) commercial actors. See generally JEROLD AUERBACH, JUSTICE WITHOUT LAW (1983); Lisa S. Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

foreign borrower might have to seek its enforcement against property in Europe, Asia or Latin America.

Unfortunately, not all banks will benefit from an adequate treaty network for the recognition of foreign judgments. Although the Bruxelles¹¹ and Lugano¹² Conventions bless Western Europe with a sound mechanism to enforce each others' court judgments, these treaties will be of no avail in recovering loans against assets in non-treaty countries. Moreover, no treaties at all exist for the enforcement of American judgments abroad.¹³ While some countries might as a matter of "comity" enforce a foreign judgment,¹⁴ not all legal systems will be so generous.¹⁵

¹¹ See Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, arts. 13-17, Sept. 27, 1968, *as amended*, 1990 O.J. (C 189) 2.

¹² See Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters, arts. 13-17, Sept. 16, 1988, 1988 O.J. (L 319) 9.

¹³ The United States' failure to conclude any judgments treaty derives in part from our trading partners' apprehension over punitive damages, civil juries, contingency fees and other quaint aspects of the American judicial system. See generally WILLIAM W. PARK, INTERNATIONAL FORUM SELECTION 46-49 (1995).

¹⁴ See, e.g., RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 98 (1988); RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES, § 481 (1987); UNIF. FOREIGN MONEY JUDGMENTS ACT § 3, 13 U.L.A. 261 (1962); A.V. DICEY & J.H.C. MORRIS, THE CONFLICT OF LAWS 418-508, Rules 35-53 (Lawrence Collins ed., 11th ed. 1987);

¹⁵ See, e.g., WETBOEK VAN BURGERLIJKE RECHTSVORDERING [CODE CIV. PROC.], art. 431(1)(Neth.) ("Except for provisions of Articles 985-94 [concerning treaties] decisions rendered by foreign judges or public deeds executed outside the Netherlands cannot be enforced in the Netherlands.") (Translation by Albert Jan van den Berg). See also Danish Code of Civil Procedure § 223-a. Chinese procedure apparently conditions judgment enforcement on an explicit "judicial entrustment" of the judgment by a foreign court to a People's Republic of China tribunal. See Zhonghua Renmin Gongheguo Guowuyuan Gongbao [Foreign Economic Contract Law] Article 204, published in 6 PEOPLE'S REPUBLIC OF STATE COUNCIL GAZETTE 207 (1982) (discussed in Andrew Kui-Nung Cheng, *Enforcement of Foreign Arbitral Awards in the People's Republic of China*, 34 AM. J. COMP. L. 295, 317 (1986)).

In contrast, a worldwide network of bilateral¹⁶ and multilateral¹⁷ treaties provides for the enforcement of arbitral awards. The most important of these treaties is the New York Arbitration Convention,¹⁸ which requires courts of over one hundred contracting states to enforce written arbitration agreements¹⁹ and the resulting awards,²⁰ subject only to a limited litany of defenses related to procedural matters such as the validity of the arbitration agreement, the opportunity to be heard, and the limits of the arbitral jurisdiction.²¹

Many Latin American countries have adopted the Inter-American Arbitration Convention (often referred to as the Panama Convention),²² sometimes in addition to the New York Convention. The Inter-American Convention mirrors much of the New York Arbitration Convention, albeit with a more limited enforcement scheme.²³

In addition, the Washington Convention has established an arbitration procedure under the auspices of the World Bank's International Centre for the Settlement of Investment Disputes ("ICSID"),²⁴ covering disputes arising out of

¹⁶ See RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* (1995).

¹⁷ See *infra* notes 18-25 for discussion of the New York, Panama and Washington Conventions.

¹⁸ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2518, 330 U.N.T.S. 3 [hereinafter New York Convention]. The operation of the New York Convention is supplemented by the European Convention of 1961, but only as between residents of European Convention countries. European Convention on International Commercial Arbitration, Feb. 9, 1968, 484 U.N.T.S. 349 (Geneva).

¹⁹ New York Convention, *supra* note 18, art. II(1), 330 U.N.T.S. at 38.

²⁰ *Id.*, art. III, 330 U.N.T.S. at 40 (requiring that a foreign award be enforced as would be a domestic award).

²¹ *Id.*, art. V, 330 U.N.T.S. at 40, 42.

²² Inter America Convention on International Commercial Arbitration, Panama, 1975, 14 I.L.M. 336 [hereinafter Panama Convention].

²³ The Panama Convention is silent on orders to compel arbitration, stating only that an agreement to arbitrate is "valid." See *id.* Moreover, the Panama Convention provides that execution and recognition of an award "may" be ordered, as contrasted with the New York Convention's mandatory "shall." Finally, the Panama Convention's enforcement obligation applies only to awards that are "not appealable;" no similar limitation is found in the New York Convention.

²⁴ Convention on the Settlement of Disputes Between States and Nationals of Other States, Mar. 18, 1965, 575 U.N.T.S. 159 [hereinafter Washington Convention]. See

investment contracts between a host state and a foreign national.²⁵ Investment treaties frequently contain consent to ICSID jurisdiction, and many define investment to include "all categories of assets," including claims to money.²⁶

B. Lender Liability²⁷

1. Claims by Debtors

A chameleon-like catch-word with several meanings, "lender liability" has been pressed into service by non-performing debtors in the United States seeking damages for a bank's alleged failure to act in "good faith,"²⁸ whether

generally MOSHE HIRSCH, *THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTER FOR THE SETTLEMENT OF INVESTMENT DISPUTES* (1993); W. MICHAEL REISMAN, *SYSTEMS OF CONTROL IN INTERNATIONAL ARBITRATION* 46-106 (1992); Georges R. Delaume, *ICSID Arbitration and the Courts*, 77 AM. J. INT'L L. 784 (1983).

²⁵ Washington Convention, *supra* note 24, art. 25.

²⁶ See RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 25-31, 130-46 (1995). See also Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REVIEW 232 (1995). Consent to ICSID jurisdiction may be given in an individual investment agreement, host state legislation or treaty obligations, but may not be withdrawn unilaterally. The North American Free Trade Agreement (NAFTA) gives investors a right to bring claims for expropriation under the arbitration rules of ICSID, the ICSID "Additional Facility" or UNCITRAL. See NAFTA, art. 1120, ch. 11, § B (1992).

²⁷ See generally HELEN DAVIS CHAITMAN, *THE LAW OF LENDER LIABILITY* (1990); GERALD L. BLANCHARD, *LENDER LIABILITY LAW PRACTICE & PREVENTION* (1989); A. Brooke Oveby, *Bondage, Domination and the Art of the Deal: An Assessment of Judicial Strategies in Lender Liability Good Faith Litigation*, 61 FORDHAM L. REV. 963 (1993); Werner Ebke & James Griffin, *Good Faith and Fair Dealing in Commercial Lending Transactions: From Covenant to Duty and Beyond*, 49 OHIO ST. L. J. 1237 (1989); Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L. J. 131 (1989); Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein and the Uniform Commercial Code*, 68 TEX. L. REV. 169 (1989).

²⁸ On good faith in contract performance, see generally STEVEN J. BURTON & ERIC G. ANDERSEN, *CONTRACTUAL GOOD FAITH* (1995); STEVEN J. BURTON, *JUDGING IN GOOD FAITH* (1992); E. ALLEN FARNSWORTH, *CONTRACTS*, 550-59 (2d ed. 1990); Christina L. Kunz, *Frontispiece on Good Faith: A Functional Approach within the U.C.C.*, 16

under common law²⁹ or statute.³⁰ Analogous regimes have been imposed in some Continental legal systems.³¹

The "lender liability" label has been affixed to duties owed by a creditor to a debtor under theories of breach of contract, fraud and bad-faith in pre-contractual negotiation. Such claims typically arise at termination of a line of credit, acceleration of payment under a note or foreclosure on collateral.³²

WM. MITCHELL L. REV. 1105 (1990); Clayton P. Gillette, *Limitations on the Obligation of Good Faith*, 1981 DUKE L. J. 619 (1981); Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980); E. Allan Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. CHI. L. REV. 666 (1963).

²⁹ In the United States, the duty of "good faith" usually arises under state rather than federal law. See RESTATEMENT (SECOND) OF CONTRACTS, § 205 (1979) (providing that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.").

³⁰ See generally U.C.C. § 1-203 (1995) (providing that "[e]very contract or duty within this Act imposes an obligation of good faith in its performance and its enforcement."); U.C.C. § 1-201(19) (1995) (defining "good faith" generally as "honesty in fact"). Certain portions of the Code extend the "good faith" definition to include the "observance of reasonable commercial standards of fair dealing." See U.C.C. §§ 2-103(1)(b), 2A-103(3), 3-103(a)(4), 4-104(c), 4A-105(a)(6) (1995). Although the Code governs security agreements under its Article 9 (Secured Transactions), it is uncertain whether the Code also covers other aspects of secured loans themselves.

³¹ Article 60 of France's Loi No. 84-46, Jan. 27, 1984, provides "Tout concours à durée indéterminée, autre qu'occasionnel, qu'un établissement de crédit consent à une entreprise, ne peut être réduit ou interrompu que sur notification écrite et à l'expiration d'un délai de préavis fixé lors de l'octroi du concours." ("Any assistance with an indeterminate limit, other than occasional, that a credit institution grants to an enterprise cannot be reduced or interrupted except with written notice, effective at the end of a period fixed at the time the credit was granted.") The Cour de cassation has held that renewal of a fixed-term loan may create an indeterminate credit. See Cour de cassation, Dec. 3, 1991, *Revue Banque* at 842 (1992) (commentary by Rives Lange). If a loan does not contain a specific term, then the courts may deem a "reasonable" term to be implied, which might extend the time required to find substitute financing. See, e.g., decision of Cour d'Appel d'Agen, D. 87, Jur. at 59 (note by Derrida). See generally Stéphane Astruc, *La Responsabilité Bancaire dans l'Octroi du Crédit aux Entreprises* (1994) (unpublished thesis, Univ. of Paris) (on file with author).

³² See, e.g., *Duffield v. First Interstate Bank of Denver*, 13 F.3d 1403 (10th Cir. 1993); *Bank One Texas v. Taylor*, 970 F.2d 16 (5th Cir. 1992); *Reid v. Key Bank*, 821 F.2d 9 (1st Cir. 1987); *KMC Co. v. Irving Trust*, 757 F.2d 752 (6th Cir. 1985); *Martin*

Sometimes claims are made even when a bank exercises explicit powers under a credit agreement.³³ While bankers are most often criticized for being too closefisted,³⁴ some financial institutions have also been faulted for being overly generous with credit.³⁵

To avoid what they consider to be excessive and unpredictable awards by juries in such litigation, several American financial institutions now provide for arbitration in credit agreements.³⁶ These institutions presume that an arbitrator

Specialty Vehicles v. Bank of Boston, 87 B.R. 752 (Bankr. D. Mass. 1988), *rev'd on other grounds*, 97 B.R. 721 (D. Mass. 1989); *Fleet Bank of Maine v. Druce*, 791 F. Supp. 14 (Me. 1992) (letter of credit held a "contract" subject to good faith requirement of U.C.C. § 1-203). Compare cases finding borrower's claim of bad faith not proven, including *Quality Automotive v. Signet Bank Maryland*, 983 F.2d 1057 (4th Cir. 1993); *Roberts v. Wells Fargo AG Credit Corp.*, 990 F.2d 1169 (10th Cir. 1993) (duty of good faith imposed by Oklahoma's "acceleration at will" statute did not cover refusal to renew line of credit); *Glenfed Financial Corp. v. Penick Corp.*, 647 A.2d 852 (App. Div. N.J. 1994); *Diversified Foods v. First National Bank of Boston*, 605 A.2d 609 (Me. 1992); *Baker v. Carroll County Bank & Trust*, 90 Md. App. 761 (Md. Ct. Spec. App. 1992).

³³ Many states have now added credit agreements to statutes of frauds in order to preclude lender liability claims based on alleged oral contract terms. See Todd C. Pearson, Note, *Limiting Lender Liability: The Trend Toward Written Credit Agreement Statutes*, 76 MINN. L. REV. 295 (1991).

³⁴ See cases cited *supra* note 32.

³⁵ Several American banks have recently come under attack for aggressive marketing, allegedly making excessive loans on overpriced houses to low-income borrowers, thereby bringing on foreclosure and bankruptcy. See, e.g., *Lessons in Home Financing*, BOSTON GLOBE, Nov. 6, 1997, at A30; *Bad Credit in Dorchester*, BOSTON GLOBE, Oct. 28, 1996, at A14. Banks in the United States have also been subject to allegations of insufficient lending in poorer communities, leading to remedial legislation in the form of the Community Reinvestment Act, 12 U.S.C. § 2901 (1996). The complexity of mortgage lending to less affluent borrowers is explored in HILLEL LEVINE & LAWRENCE HARMON, *THE DEATH OF AN AMERICAN JEWISH COMMUNITY* (1992).

³⁶ See the model clauses adopted by Bank of California and Bank of America, *reprinted in* JAMES R. BUTLER, *ARBITRATION IN BANKING* (R.M.A. 1988). See generally MICHAEL L. WEISSMAN, *LENDER LIABILITY: HOW TO PROTECT YOURSELF AGAINST UNWARRANTED SUITS* (1988). In June 1992, the Bank of America announced that it would require all deposit and bankcard agreements to be submitted to binding arbitration under the rules of the American Arbitration Association. See statement of Winslow Christien (Senior V.P. and Director of Litigation), *reported in* World Arb. & Mediation Rep. (BNA) 135 (July 1992).

will be less swayed by solicitude for the borrower than will members of a civil jury, whose own credit problems may cause them to empathize with the debtor.

2. Claims by Third Parties

Another incarnation of lender liability relates to a banker's duty toward the borrower's other creditors. Bankers have sometimes been asked to pay their debtors' bills, under the theory that the lenders were *de facto* partners in the borrowers' ventures.³⁷ The plausibility of such claims usually turns on the amount of control exercised by the financier over the management of the borrower's business.

Lenders will not always be able to impose arbitration of such third party claims, simply because a borrower's other creditors will not necessarily have agreed to arbitration. Nevertheless, arbitrators sometimes do hear third party claims, and their commercial sophistication has often led to reasonable solutions.³⁸

³⁷ See, e.g., *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990) (security interest and role in borrower's management created liability for hazardous waste clean-up costs). For French analogues, see Article 180 of Loi 85-98, permitting a court to impose liability on a "dirigeant de fait" of a bankrupt company. See *Law Relating to Judicial Rehabilitation and Judicial Liquidation (Loi relative au redressement et à la liquidation judiciaires des entreprises)*, No. 85-98, Jan. 25, 1985, *Journal Officiel de la République Française* (J.O.), Jan. 26, 1985 (discussing "redressement judiciaire"). Third party lender liability may also be based on general tort responsibility under Articles 1382 and 1383 of the French Code Civil, requiring payment of damages for any harm caused to another by intentional fault or negligence. See CODE CIVIL [C.CIV], arts. 1382-83 (Fr.).

³⁸ See arbitration award in *Schlumberger v. Duferco*, I.C.C. Case 8465, reported in 11 (No. 3) MEALEY'S INT'L ARB. REP. C-1 (1997). The case arose as follows: in connection with an oil drilling contract in Iran, Company #1 owed Company #2 for services performed. Company #2 attempted to recover this amount from Company #3 (the "deep pocket") which, through a separate contract, had helped finance the project. The arbitrators rejected the claim against Company #3 in an award confirmed by the United States District Court for the Southern District of Texas on Mar. 8, 1996, Civil Action H-94-2409.

C. Exchange Controls

When a country freezes or restricts payment of foreign currency obligations,³⁹ borrowers sometimes invoke these exchange controls as defenses to loan recovery,⁴⁰ on the theory that such controls constitute a foreign "Act of State" to which courts must defer. Although principally an American obsession, the Act of State doctrine exercises an influence well beyond common law countries, given the large number of cross-border financial transactions routinely subjected to the law of New York or to the jurisdiction of New York courts.

The Act of State doctrine generally prohibits courts from questioning a foreign government's behavior concerning assets within its territory.⁴¹ Sometimes explained as a limit on judicial interference with the conduct of foreign affairs,⁴² the doctrine might best be understood as a conflict-of-laws rule that imposes foreign law even if such law is contrary to the public policy of the forum.⁴³

Creditors sometimes avoid application of the Act of State doctrine by virtue of judicial manipulation of the situs of the debt in question. Courts may deem the debt to be located outside the territory of the country imposing the

³⁹ On exchange controls, see generally Article VIII(2), International Monetary Fund Articles of Agreement; Dr. Klaus Peter Berger, *Acts of State and Arbitration: Exchange Control Regulations*, in *ACTS OF STATE AND ARBITRATION* 99 (Karl-Heinz Böckstiegel, ed. 1997); Ross Cranston, *The Freezing and Expropriation of Bank Deposits*, in *LEGAL ISSUES OF CROSS-BORDER BANKING* 93-107 (Ross Cranston ed., 1989).

⁴⁰ See, e.g., *Wells Fargo Asia Ltd. v. Citibank*, 852 F.2d 657 (2d Cir. 1988), *vacated and remanded*, 495 U.S. 660 (1990), *aff'd* 936 F.2d 723 (2d Cir. 1991); *Garcia v. Chase Manhattan*, 735 F.2d 645 (2d Cir. 1984); *Allied Bank v. Banco Credito Agricola*, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd* 733 F.2d 23 (2d Cir. 1984), *rev'd on reh'g*, 757 F.2d 516 (2d Cir. 1985); *Perez v. Chase Manhattan* 61 N.Y.2d 460 (N.Y. 1984).

⁴¹ See *RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES*, § 443 (1987).

⁴² See generally *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964).

⁴³ An alternative rationale sees the Act of State doctrine as promoting security of transactions, an explanation that works best when tangibles are concerned. For example, without the Act of State doctrine, one who buys wood or sugar from a revolutionary government might later be subject to a claim brought by the original owner seeking to recover the goods.

exchange controls.⁴⁴ Favorable characterization of the debt situs, however, may come only after years of costly litigation.⁴⁵

The United States has eliminated the Act of State defense in actions to enforce arbitration agreements and awards. The Federal Arbitration Act provides:

The enforcement of arbitral agreements, and the confirmation of arbitral awards, shall not be refused on the basis of the act of state doctrine.⁴⁶

The scope of this remarkably succinct bit of legislation, however, has not been extended to court litigation. Thus, an arbitration clause in a cross-border loan agreement may enhance considerably a creditor's prospect of loan recovery.

D. Sovereign Immunity

To avoid repayment of loan obligations, government debtors often invoke principles of "sovereign immunity," which operate to prevent one country from

⁴⁴ See *Allied Bank v. Banco Credito Agricola*, 566 F. Supp. 1440 (S.D.N.Y. 1983), *aff'd* 733 F.2d 23 (2d Cir. 1984), *rev'd on reh'g*, 757 F.2d 516 (2d Cir. 1985). Such situs manipulation works best when the place of payment and/or applicable law are other than the country of the debtor's residence. For alternative ways to analyze the legitimate extent of exchange controls, see P.S. Smedresman & Andreas Lowenfeld, *Eurodollars, Multinational Banks, and National Laws*, 64 N.Y.U. L. REV. 733 (1989).

⁴⁵ For example, the saga of Wells Fargo's deposit at Citibank's Manila branch involved a half dozen separate federal court decisions concerning whether Wells Fargo could look to Citibank's New York assets for recovery of a deposit that had been blocked under Philippine law. See *Wells Fargo v. Citibank*, 660 F. Supp. 946 (S.D.N.Y. 1987) (recovery allowed), *remanded for clarification*, 847 F.2d 837 (2d Cir. 1988), *recovery ordered again*, 695 F. Supp. 1450 (S.D.N.Y. 1988), *aff'd*, 852 F.2d 657 (2d Cir. 1988), *vacated & remanded* 495 U.S. 660 (1990), *reaffirmed on remand*, 936 F.2d 723 (2d Cir. 1991). Subsequent legislation provides that banks which are members of the Federal Reserve are not required to repay foreign branch deposits blocked by foreign government action, absent an express agreement to the contrary. See Federal Reserve Act § 25C, 12 U.S.C. § 633 (1994).

⁴⁶ 9 U.S.C. § 15 (1994), enacted following a frustrating attempt to enforce an arbitration award against Libya in American courts. See *Libyan American Oil Co. (LIAMCO) v. Libya*, 482 F. Supp. 1175 (D.D.C. 1980), *vacated as moot*, 684 F.2d 1032 (1981).

hauling another country into its courts. The modern rationale for sovereign immunity mirrors the justification sometimes given for the Act of State doctrine: judges should not interfere with the executive branch of government in its conduct of foreign relations.

Although most nations grant immunity to foreign governments and their agencies, immunity is subject to several exceptions. As a general rule, immunity covers "public" rather than "commercial" acts,⁴⁷ with the character of an act determined by its nature rather than its purpose.⁴⁸

Immunity from suit will be further restricted by an arbitration clause. Many national legal systems deny sovereign immunity in an action to enforce an arbitration agreement or to confirm an arbitral award.⁴⁹

Arbitration can be of special benefit to a lender when an award must be enforced against a sovereign debtor's assets in the United States. Normally, a functional connection is required between the property to be attached and the activity that gave rise to the claim. A judgment against a foreign state can be executed only against property used in the same commercial activity upon

⁴⁷ See, e.g., U.S. Foreign Sovereign Immunities Act of 1976, 28 U.S.C. §§ 1602-1611 (1994); State Immunity Act, 1978, ch. 33 (Eng.). A Swiss wrinkle to sovereign immunity requires a link ("internal connection"—*Binnenbeziehung*) between the sovereign act and Switzerland before Swiss courts will accept jurisdiction over the sovereign or its assets. See *Circulaire du Department federal de justice et police*, Nov. 26, 1979, reprinted in [1980] JURISPRUDENCE DES AUTORITES ADMINISTRATIVES DE LA CONFEDERATION 224.

⁴⁸ For the United States, see 28 U.S.C. § 1603(d) (1994). Legislative history indicates that "both a foreign government sale of bonds and a loan from a commercial bank to a foreign government are to be considered activities of a commercial nature." See H.R. REP. NO. 1487, 94th Cong., 2d Sess., at 10 (1976). The British statute defines a commercial transaction to include "any loan or other transaction for the provision of finance and any guarantee or indemnity in respect of any such transaction or of any other financial obligation." See State Immunity Act, 1978, ch. 33, § 3(3)(b) (Eng.).

⁴⁹ In the United States, see 28 U.S.C. § 1605(a) (1994). Compare Great Britain's State Immunity Act, 1978, ch. 33 § 9 (Eng.). The limit on jurisdictional immunity in the United States has both a territorial and a treaty link. An arbitration agreement or award will be enforceable notwithstanding a claim for sovereign immunity if (i) the arbitration takes place in the United States, or (ii) the agreement or award is or may be governed by a treaty calling for the recognition and enforcement of arbitral awards. See 28 U.S.C. § 1605(a)(6) (1994). The latter would include the 1958 New York Convention, *supra* note 18.

which the claim is based.⁵⁰ In the case of a loan, this "same activity" requirement can limit attachment of assets to funds earmarked for debt reimbursement, which may be scarce when the debtor defaults.

The Foreign Sovereign Immunities Act,⁵¹ however, removes this requirement of a functional nexus with respect to arbitral awards. The statute provides that property of a foreign state used for a commercial activity in the United States shall not be immune from attachment in aid of execution if judgment is based on an order confirming an arbitral award.⁵²

An arbitration clause in a loan agreement can also be helpful when the borrower is an international organization. In Britain, a dispute between the International Tin Council (I.T.C.) and its creditors ended up before the House of Lords, which interpreted the I.T.C. Headquarters Agreement with the United Kingdom as granting the I.T.C. sovereign immunity.⁵³ The same Headquarters Agreement, however, had also provided that the I.T.C. would *not* benefit from immunity in the enforcement of arbitration awards. The metal exchanges among I.T.C.'s creditors were thereby protected, since their trading contracts contained arbitration clauses. Banks were in a different situation, however, since few lenders had the foresight to incorporate arbitration clauses in their loan agreements.

E. Interbank Disputes

1. Court Selection Clauses

Not all jurisdictions are user-friendly in matters of court selection. If two banks wish an unbiased judge in a neutral third country to resolve a controversy between them, the contractually-selected neutral court may not always have enough links to the parties or the controverted event to justify hearing the case.

While some countries require their judges to hear cases pursuant to court selection clauses,⁵⁴ others do not. In particular, no American jurisdiction except

⁵⁰ Some property, such as central bank funds (absent an explicit waiver of immunity), is always immune, unless perhaps the central bank functions as a commercial bank in a particular transaction. See 28 U.S.C. §§ 1609-10 (1994).

⁵¹ 28 U.S.C. §§ 1330, 1602-11 (1994).

⁵² 28 U.S.C. § 1610(a)(6) (1994).

⁵³ *J.H. Rayner Ltd. v. Dep't of Trade*, 3 All E.R. 523 (H.L. 1989) (Eng.).

⁵⁴ See, e.g., Article 5 of the Swiss *Loi fédérale sur le droit international privé [LDIP] du 18 décembre 1987*, which mandates respect for court-selection clauses as long as

New York mandates recognition of court selection clauses;⁵⁵ neither federal statute nor treaty enforces choice-of-court clauses in the way that the Federal Arbitration Act and the New York Arbitration Convention enforce arbitration agreements.⁵⁶

Several United States Supreme Court decisions are often cited for the proposition that court selection clauses will be recognized.⁵⁷ Yet these cases actually say only that jurisdiction agreements will be respected if "reasonable" by reference to a multiplicity of factors (place of contract execution, place of performance, location of witnesses and documents, remedies available in the alternate forum, and public policy), all of which vary from case to case.⁵⁸ Moreover, unless a controversy implicates a question of federal law, one foreigner normally may not sue another in federal court, regardless of how eager the litigants are to thrust jurisdiction on the designated tribunal.⁵⁹

Swiss law applies to the dispute.

⁵⁵ See N.Y. GEN. OBLIG. LAW § 5-1402 (McKinney 1989) and N.Y. C.P.L.R. § 327 (McKinney 1989). For a New York choice of forum to be dispositive, the transaction must cover no less than \$1 million, and the parties must have elected application of New York law. Without this statute, two foreign banks might have considerable difficulty getting a New York court to hear their case. See N.Y. BANKING LAW § 200-b (McKinney 1990) and N.Y. BUS. CORP. LAW § 1314(b)(1)-(5) (McKinney 1987).

⁵⁶ For a recent U.S. federal case citing absence of a court selection statute as a factor justifying refusal to enforce a jurisdiction clause, see *Richards v. Lloyd's of London*, 107 F.3d 1422, 1427 (9th Cir. 1997) ("[The Court in *Scherk*] chose to apply the Arbitration Act. It did not weigh reasonableness or pit amorphous policy against an act of Congress.").

⁵⁷ See, e.g., *Carnival Cruise Lines v. Shute*, 499 U.S. 585 (1991); *Stewart Organization Inc. v. Ricoh Corp.*, 487 U.S. 22 (1988); *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

⁵⁸ One decision set forth nine factors relevant to the reasonableness of a jurisdiction clause, emphasizing "the totality of the circumstances measured in the interests of justice." *D'Antuono v. CCH Computax Sys.*, 570 F. Supp. 708 (D.R.I. 1983). See, e.g., *Stewart Organization, Inc. v. Ricoh Corp.*, 487 U.S. 22, 28-32 (1988) (listing factors).

⁵⁹ Federal court power is limited to cases arising on the basis of a federal question or diversity of citizenship. The latter requires litigation between citizens of different states or between a U.S. citizen and a foreigner. For a recent case discussing the complexity of "diversity jurisdiction," see *Dresser Industries v. Underwriters at Lloyd's of London*, 106 F.3d 494 (3d Cir. 1997).

The situation is even more complex for state law,⁶⁰ which allows courts to refuse to enforce court selection clauses either in general⁶¹ or with respect to particular types of contracts.⁶² Even when acknowledging the validity of court selection clauses in theory, state courts may in practice give such clauses a restrictive reading that vitiates their effect.

Some court decisions have construed court selection agreements narrowly, as excluding actions based on extra-contractual wrongs such as deceit and unfair business practices.⁶³ Courts may also restrict the scope of a choice-of-court clause by construing it as a nonexclusive consent to jurisdiction, therefore allowing actions in competing fora.⁶⁴ Whether a clause is exclusive (mandatory)

⁶⁰ State law may apply not only in state courts, but also in federal courts where jurisdiction is based on diversity of citizenship between the parties. Some federal courts see enforcement of a jurisdiction clause as a matter of substantive law, requiring application of state norms in diversity cases under the principle of *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938). Other courts have assumed (often with little discussion) that the matter is procedural and that federal law applies.

⁶¹ As of this writing, at least five states (Idaho, Iowa, Maine, Montana, and Texas) continue to restrict enforceability of court selection clauses. Some Georgia cases have endorsed court selection clauses (*see, e.g.,* *Harry S. Peterson v. National Union Fire Ins.*, 209 Ga. App. 585 (Ga. Ct. App. 1993)), although the Georgia Supreme Court has not overruled its decision disapproving such clauses in *Cartridge Rental Network v. Video Entertainment*, 132 Ga. App. 748 (1974). *See generally* WILLIAM W. PARK, *INTERNATIONAL FORUM SELECTION* 35-36 (1995).

⁶² For a recent illustration of restrictive state law, *see* *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618 (N.J. 1996), arising under the New Jersey Franchise Practices Act (codified at N.J. STAT. ANN. § 56:10-1 (West 1997)). The ill-fated jurisdiction clause would have sent parties to Santa Clara, California.

⁶³ In one case, the trial judge was instructed by the state supreme court to determine whether the "principal focus" of plaintiff's claims was for breach of contract or for extra-contractual wrongs, with the result that to the date of this writing the case has not been sent to the contractually selected forum. *See* *Jacobson v. Mailboxes Etc.*, 646 N.E.2d 741 (D. Mass. 1995).

⁶⁴ *See, e.g.,* *Blanco v. Banco Industrial de Venezuela*, 997 F.2d 974 (2d Cir. 1993) (forum provision held to be non-exclusive due to use of permissive language); *Brooke Group v. JCH Syndicate*, 663 N.E.2d 635 (N.Y. 1996) (jurisdiction clause permissive rather than mandatory, therefore allowing dismissal on *forum non conveniens* grounds of action by American insured against foreign underwriter). *See also* *Medoil Corp. v. Citicorp*, 729 F. Supp. 1456 (S.D.N.Y. 1990) (customer could sue Citibank only at location of branch managing account, while bank could bring action also at customer's residence).

or nonexclusive (permissive) will depend on the intent of the parties as determined by the contract language and context of the agreement.⁶⁵ The exclusivity of a forum selection clause may be either bilateral or unilateral. A bilateral clause imposes a single court on both sides of the transaction, while a unilateral clause limits only one party's jurisdictional choice. Banks have often required borrowers to bring litigation at the bank's domicile, while preserving the right to pursue debtors and their assets wherever they may be found.⁶⁶

The need for predictability in international business argues for the presumptive exclusivity of a court selection clause,⁶⁷ although not all courts follow this commonsense approach. Some decisions have stated that forum selection clauses will be enforced as exclusive only if containing specific language to that effect,⁶⁸ while others have taken the opposite view.⁶⁹ Wisdom, therefore, calls for parties seeking exclusivity to provide that "all disputes shall be decided exclusively by" or "any claim shall be subject to the exclusive jurisdiction of" courts at the desired location.

⁶⁵ Compare *Central Coal Co. v. Phibro Energy, Inc.*, 685 F. Supp. 595 (W.D. Va. 1988) (holding the relevant forum selection clauses to be exclusive), and *Furry v. First Nat'l Monetary Corp.*, 602 F. Supp. 6 (W.D. Okla. 1984), with *Heyco v. Hayman*, 636 F. Supp. 1545 (S.D.N.Y. 1986), *Leasing Service Corp. v. Patterson Enters. Ltd.*, 633 F. Supp. 282 (S.D.N.Y. 1986), and *First Nat'l City Bank v. Nanz*, 437 F. Supp. 184 (S.D.N.Y. 1975) (holding the relevant clauses to be mere nonexclusive consents to jurisdiction).

⁶⁶ See discussion of unilateral arbitration clauses *infra* in Section IV. C.

⁶⁷ See, e.g., *Loi fédérale sur le droit international privé*, art. 5 (Dec. 18, 1987) (Switz.) (providing that "[u]nless stipulated otherwise, the court agreed upon shall have exclusive jurisdiction." ("Sauf stipulation contraire, l'élection de forum est exclusive./Geht aus der Vereinbarung nichts anderes hervor, so ist das vereinbarte Gericht ausschliesslich zuständig.")).

⁶⁸ Compare *John Boutari & Sons v. Attiki Importers*, 22 F.3d 51, 52 (2d Cir. 1994) (quoting *Docksider Ltd. v. Sea Technology*, 875 F.2d 762 (9th Cir. 1989)), and *Utah Pizza Service v. Heigel*, 784 F. Supp. 835 (D. Utah 1992), with *Central Coal Co. v. Phibro Energy, Inc.*, 685 F. Supp. 595, 598 (W.D. Va. 1988) (finding a clause mandatory and stating that "[i]f the parties wished [the clause] to be permissive, they should have drafted it so that that interpretation would be clearly evident.").

⁶⁹ See, e.g., *Central Coal Co. v. Phibro Energy Inc.*, 685 F. Supp. 595, 598 (W.D. Va. 1988) (finding the clause exclusive, the court said "[i]f the parties wished [the clause] to be permissive, they should have drafted it so that that interpretation would be clearly evident.").

A court may also decline to hear a case on grounds of “inconvenient forum” (*forum non conveniens*),⁷⁰ due to the location of witnesses and documents, or the drain on public resources. While one overworked judge might enforce a jurisdiction clause to clear a crowded docket, an equally overworked judge in the contractually-selected jurisdiction may decline to hear the dispute on the basis that a more convenient forum may be found elsewhere.⁷¹ This risk is particularly significant in a transaction between two foreign entities, when the controversy lacks sufficient connection with the state.⁷²

2. Arbitration Clauses

Unlike judges, arbitrators rarely (if ever) refuse to hear a dispute because of *forum non conveniens* or the parties’ lack of diversity of citizenship. If the parties can provide an adequate deposit to cover costs, professors around the world can usually be found eager to supplement meager academic stipends by serving as arbitrators.

Arbitration, of course, suffers from its own forms of uncertainty. Particularly when consolidation of related claims becomes desirable, there will be many disputes better litigated before courts than arbitrators. These drawbacks of arbitration are discussed more fully below in Section V.

⁷⁰ See generally GARY BORN, INTERNATIONAL CIVIL LITIGATION IN UNITED STATES COURTS 289-369 (3d ed. 1996) (cited cases).

⁷¹ At least one circuit court, however, has held that signature of a valid court selection clause constitutes a “waiver of the right to move for a change of venue on the ground of inconvenience to the moving party.” *Northwestern Nat’l Ins. Co. v. Donovan*, 916 F.2d 372, 378 (7th Cir. 1990).

⁷² See *Universal Adjustment Corp. v. Midland Bank, Ltd. (Eng.)*, 184 N.E. 152 (Mass. 1933).

II. SECURITIES⁷³

A. Broker Misbehavior

Securities-related disputes involving broker-dealers now provide one of the most frequent occasions for arbitration in the financial services industry.⁷⁴ The explosion of securities arbitration in the United States dates from 1989, when the United States Supreme Court finally permitted arbitration of securities disputes in domestic transactions.⁷⁵ In Britain, by contrast, courts never displayed the same hostility toward arbitration of securities claims,⁷⁶ probably because awards in domestic cases could traditionally be challenged on their legal merits.⁷⁷

⁷³ See generally Symposium, SECURITIES ARBITRATION: A DECADE AFTER MCMAHON, 62 BROOK. L. REV. 1329 *et seq.* (Winter 1996), with contributions by Norman S. Poser (at 1329), Richard E. Speidel (at 1335), G. Richard Shell (at 1365), Jeffrey W. Stempel (at 1381), Bruce M. Selya (at 1433), Edward Brunet (at 1459), Stephen J. Friedman (at 1495), Marc I. Steinberg (at 1503) and Therese Maynard (at 1533). See also DAVID E. ROBBINS, SECURITIES ARBITRATION PROCEDURE MANUAL (2d ed. 1990); Shelly James, *Arbitration in the Securities Field: Does the Present System of Arbitration Between Small Investors and Brokerage Firms Really Protect Anyone?*, 21 J. CORP. L. 363 (1996); David E. Robbins, *Seven Deadly Sins that Lead to Arbitration Disaster*, in SECURITIES ARBITRATION 489, 489-96 (photo. reprint 1993).

⁷⁴ For 1994, the NASD reported 5,570 new arbitration claims filed under its Code of Arbitration Procedure, up from 318 in 1980. See Deborah Masucci, *Securities Arbitration: A Success Story: What Does the Future Hold?*, 31 WAKE FOREST L. REV. 183 (1996).

⁷⁵ See *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989) (Securities Act of 1933); and *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220 (1987) (Securities Exchange Act of 1934). Earlier Court decisions permitted arbitration of securities disputes in international transactions. See *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974).

⁷⁶ See generally John J. Kerr, Jr., *Arbitrability of Securities Law Claims in Common Law Countries*, 12 ARB. INT'L 171 (1996). For a recent case involving securities arbitration in the United Kingdom, see *Philip Alexander Securities v. Bamberger*, [1977] I.L.Pr. 73 (Queen's Bench Div.) (July 12, 1996) (distinctions in service of injunctions based on nationality inconsistent with non-discrimination principles of European Union) reported in *Exclusion Contrary to EC Law*, TIMES, July 22, 1996, at 42 (Law).

⁷⁷ Before 1979 the "case stated" procedure permitted *de facto* challenge for error of law. The 1979 Arbitration Act replaced the "case stated" procedure with a more limited right

Claims against brokerage firms usually relate to misbehavior such as "churning" (needless buying and selling to generate commissions), unauthorized or unsuitable trading, and misrepresentations. Occasionally brokers are accused of outright theft, euphemistically referred to as misappropriation.

In the United States, arbitration reduces the cost and delay in dealing with such disputes, and reduces the prospect of punitive damages awarded by pro-customer juries. American brokerage firms' customer account agreements usually provide that any disputes will be settled by arbitration. The customer often has the right to elect among several sets of rules, including those of the American Arbitration Association (AAA), the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD).⁷⁸

Not all quarters have been happy with binding dispute resolution under the securities industry's various arbitration rules. In particular, the fairness of arbitration against brokerage houses has been questioned in connection with employment-related claims as well as customer complaints.⁷⁹ These critiques,

of appeal, which was not waivable in domestic cases until after the dispute had arisen. *See* Arbitration Act, 1979, § 3 (Eng.). The 1996 Arbitration Act provides for appeal on points of law, but allows waiver of this act. *See* Arbitration Act, 1996, § 69 (Eng.). Although the 1996 Act prohibited pre-dispute exclusion of such appeal in domestic cases, this provision never entered into force, due to a perceived conflict with the non-discrimination regime of the European Union.

⁷⁸ Under some rules, arbitrators are classified as either "public" (*i.e.*, customer) or "industry" arbitrators, with the latter category including broker-dealers and their employees, as well as attorneys, accountants and other professionals with close ties to the securities industry. *See* NASD CODE OF ARBITRATION PROCEDURE § 19 (1995) (excluding from the public arbitrator category professionals who have worked twenty percent or more for the securities industry during the previous two years). A study completed by the U.S. General Accounting Office ("GAO") has found no evidence of pro-industry bias in such arbitration. *See* U.S. GENERAL ACCOUNTING OFFICE, SECURITIES ARBITRATION: HOW INVESTORS FARE (1992).

⁷⁹ In at least one case the judge ordered discovery into the adequacy of the New York Stock Exchange arbitration rules to resolve claimant's discrimination claims. *See* *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 965 F. Supp. 190 (D. Mass. 1997) (claimant alleging sexual harassment and discrimination), *discussed in* Margaret A. Jacobs, *Brokerage Arbitration System in Spotlight*, WALL ST. J., Oct. 17, 1997, at B2. Ultimately the court denied the motion to compel arbitration, finding that Congress intended to preclude pre-dispute arbitration agreements of discrimination claims brought under Title VII of the Civil Rights Act and that employer's dominance of the NYSE arbitration system made it inappropriate for vindication of civil rights claims. *See*

which often raise questions about the voluntariness of the consent to arbitration, are discussed in Section V(B) below.

B. Punitive Damages

When a wrong is aggravated by defendant's malice, fraud or wanton conduct, civil juries in the United States often award punitive damages for amounts over and above the plaintiff's actual loss.⁸⁰ Arbitration provides one way to reduce the risk of such damages.⁸¹

The securities industry has generally presumed that arbitrators will be more reasonable (*i.e.*, less generous) than juries in granting punitive damages. In addition, the law of some states, including New York, prohibits arbitrators from giving a claimant anything more than compensation for actual loss.

The United States Supreme Court, however, recently upheld an award for \$400,000 to punish broker misbehavior (in addition to \$159,000 in actual loss) notwithstanding that the agreement was governed by New York law, which forbids punitive damages in arbitration.⁸² In *Mastrobuono v. Shearson Lehman Hutton*⁸³ the Supreme Court read the relevant New York choice-of-law clause to refer only to substantive contract law, to the exclusion of state arbitration principles.

Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc., No. 96-12267-NG, 1998 U.S. Dist. LEXIS 877 (D. Mass. Jan. 26, 1998).

⁸⁰ On the Biblical origins of punitive damages, see Exodus 22:1 (requiring multiple payments for theft).

⁸¹ In January 1997, the NASD Board of Governors approved a cap that will limit punitive damages to the lesser of \$750,000 or twice compensatory damages. See REPORT OF THE ARBITRATION POLICY TASK FORCE TO THE BOARD OF GOVERNORS NATIONAL ASSOCIATION OF SECURITIES DEALERS, Fed. Sec. L. Rep. (CCH) ¶ 85,735, § V(B) [hereinafter Ruder Report, so named for Task Force Chairman David Ruder].

⁸² See *Garrity v. Lyle Stuart, Inc.*, 353 N.E.2d 793 (N.Y. 1976) (forbidding punitive damages). Recently, however, at least one New York decision *has* allowed arbitrators to award punitive damages unless the parties have unequivocally agreed otherwise. See *Mulder v. Donaldson, Lufkin & Jenrette*, 224 A.D.2d 125 (N.Y. App. Div. 1996) (reconsidering *Garrity* in light of the *Mastrobuono* decision).

⁸³ 115 S. Ct. 1212 (1995). For a pre-*Mastrobuono* survey of the subject, see E. Allen Farnsworth, *Punitive Damages in Arbitration*, 7 ARB. INT'L 3 (1991).

The decision in *Mastrobuono* is hard to square with previous Supreme Court pronouncements on choice of law in arbitration. A few years earlier, the Court had upheld a stay of arbitration on the basis of a choice-of-law clause deemed to incorporate California state law into the agreement to arbitrate.⁸⁴ Court decisions since *Mastrobuono* have sometimes distinguished the case on the basis of forum public policy or the drafting of the choice-of-law clause, so as to reject the arbitrators' power to grant punitive damages.⁸⁵

Following *Mastrobuono*, the path of prudence for financial institutions wishing to avoid punitive damages lies in explicit exclusionary language in the relevant contract. Reliance on choice of law clauses alone will be unpredictable at best.

C. Time Bars

Certain securities arbitration rules require disputes to be brought within a fixed term after the controverted events.⁸⁶ At present, courts are divided on whether judges or arbitrators should determine the application of time limits.⁸⁷

⁸⁴ See *Volt v. Stanford*, 489 U.S. 468 (1989). In *Volt*, the U.S. Supreme Court relied on a decision of the California state Court of Appeals, which interpreted the choice-of-law clause in issue to cover California arbitration rules. See *id.* at 470. In contrast, the U.S. Supreme Court in *Mastrobuono* interpreted the choice-of-law clause *de novo*. See *Mastrobuono*, 115 S. Ct. at 1215.

⁸⁵ Compare *Dean Witter Reynolds v. Trimble*, 631 N.Y.S.2d 215 (N.Y. App. Div. 1995), with *Merrill Lynch v. Levine*, N.Y. L.J., July 5, 1995, at 26 (N.Y. Sup. Ct.).

⁸⁶ See NAT'L ASS'N OF SEC. DEALERS CODE OF ARB. PROC., Rule 10304 (formerly § 15) (providing that "no dispute, claim or controversy shall be eligible for submission to arbitration under this Code where six years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy."). See generally Sean Costello, *Time Limits Under Rule 10304 of the NASD Code of Arbitration Procedure: Making Arbitrators More Like Judges or Judges More Like Arbitrators*, 52 BUS. LAW. 283 (1996); Lawrence W. Newman & Charles M. Davidson, *Arbitrability of Timeliness Defenses: Who Decides?*, J. INT'L ARB., June 1997, at 137; David Rivkin, *Courts Differ on Arbitrability of Time Limitations*, ADR CURRENTS, Autumn 1996, at 21. Under recently proposed changes to the NASD rules, the six year eligibility rule would be suspended for a three year period. See Ruder Report, *supra* note 81.

⁸⁷ The Third, Sixth, Seventh, Tenth and Eleventh Circuits have considered time limits contained in arbitration rules to constitute a jurisdictional prerequisite to arbitration, to be determined by courts. The First, Second, Fifth, Eighth and Ninth Circuits have held

To justify their decisions, courts have relied on (and sometimes misapplied) the United States Supreme Court's *dicta* on the arbitrators' jurisdiction to determine arbitrability.⁸⁸

As a matter of policy, it is hard to see why or how anyone can have the final say on the fulfillment of a condition that must occur prior to his or her own appointment as a decision-maker.⁸⁹ Determining whether an individual is truly an arbitrator, or only a shameless volunteer expressing a gratuitous opinion, would normally be a function for the courts.

Courts have also struggled with analogous issues related to statutes of limitations. Some decisions have held that statute-of-limitations questions are for judges in the context of a motion to compel arbitration,⁹⁰ but for arbitrators hearing the underlying claim.⁹¹ This approach assumes two separate time limits: one applicable to the principal agreement (to buy, sell, license, lease or lend) and one applicable to the agreement to arbitrate the dispute. Since the arbitrators' job is to apply the relevant substantive law to decide whether there should be recovery, the arbitral tribunal may be called to determine whether such recovery is permitted or barred under the statute of limitations contained

the matter to be for the arbitrator. *See PaineWebber v. Elahi*, 87 F.3d 589, 601 (1st Cir. 1996) (summarizing cases, and holding that time bars applied to arbitrators, citing language in NASD CODE OF ARBITRATION PROCEDURE § 35 which permitted arbitrators to "interpret and determine the applicability of all provisions under this Code."). *But see Merrill Lynch v. Cohen*, 62 F.2d 381 (11th Cir. 1995) (holding time bars to be a matter for courts to decide).

⁸⁸ See discussion of *compétence-compétence* and *First Options v. Kaplan*, 514 U.S. 938 (1995), *infra* notes 207-222 and accompanying text.

⁸⁹ One situation in which an arbitrator may render a binding decision on arbitral jurisdiction occurs when the parties – *subsequent* to the arbitration clause at issue – enter into an agreement submitting the jurisdictional dispute to arbitration. However, alleged "arbitrability agreements" contained in the arbitration clause itself must be approached with great caution. See discussion *infra* at Section V. E., "Arbitral Jurisdiction."

⁹⁰ See *National Iranian Oil v. Mapco*, 983 F.2d 485 (3d Cir. 1992) (looking to the Federal Arbitration Act). Since the FAA does not specify a statute of limitations, the court reasoned that it must borrow the most closely analogous one from state law under the conflict of laws principles of the state in which the court sits. See *id.* at 492.

⁹¹ See *id.* at 491. See also *Avant Petroleum v. Pecten Arabian Ltd.*, 696 F. Supp. 42 (S.D.N.Y. 1988).

in the applicable substantive law. In some cases, of course, the applicable law itself might reserve to courts the matter of timeliness.⁹²

The parties' intent remains the pole star for analysis of who determines whether preconditions to arbitration have been satisfied. To enforce the contract as drafted, judges must examine whether a time bar was explicitly or implicitly incorporated into the arbitration clause as a restraint on the arbitrator's power. If so, only courts should have the last word on the matter.

III. SELECTED FINANCIAL TRANSACTIONS

A. Guarantees

Issuers of guarantees⁹³ often find themselves bound by the dispute resolution clause in the principal contract.⁹⁴ For example, a guarantee in favor of Company Y might incorporate by reference the arbitration clause in the contract between Company Y and Company Z.⁹⁵

General principles of contract interpretation (developed principally in the areas of reinsurance, charter parties and construction) subject a guarantee to the forum selection mechanism in the primary obligation. Whether the guarantor

⁹² Compare *Smith Barney v. Luckie*, 85 N.Y.2d 193 (N.Y. 1995) (holding that N.Y. C.P.L.R. §§ 7502(b) and 7503(a) require courts to decide statute-of-limitations questions), with *PaineWebber v. Bybyk*, 81 F.3d 1193, 1200 (2d Cir. 1996) (holding that the *Mastrobuono* reasoning requires the choice of New York law to be interpreted to refer to New York substantive law only, so as to exclude the New York procedural law that sends statute-of-limitations questions to courts).

⁹³ In particular, arbitration often arises when banks outside the United States issue "first demand guarantees" (*garanties à première demande*), which are payable on the first demand of the beneficiary, without any condition (such as proof of the principal debtor's default) other than the request for payment. On first demand guarantees, see generally, ROELAND BERTRAMS, *BANK GUARANTEES IN INTERNATIONAL TRADE* 36-39 (1990); Bertrand Chambreuil, *Arbitrage international et garanties bancaires*, 1991 REVUE DE L'ARBITRAGE 33.

⁹⁴ See generally Bernard Hanotiau, *La Pratique de l'arbitrage international en matière bancaire*, in *LES MODES NONJUDICIAIRES DE RÈGLEMENT DES CONFLITS* 67 (Bruxelles ed., 1995); Bertrand Chambreuil, *Arbitrage international et garanties bancaires*, 1991 REVUE DE L'ARBITRAGE 33.

⁹⁵ See *Compania Espanol de Petroleos v. Nereus Shipping*, 527 F.2d 966, 969-73 (2d Cir. 1975).

will be bound by the arbitration clause in the principal agreement depends on the parties' intent, which will normally be determined by reference to factors such as the language of the guarantee, the relationship between the guarantor and the principal obligor, and the reasonableness of characterizing several documents as a single transaction.⁹⁶ In order to promote uniformity of contract interpretation, conflict-of-laws doctrine in some countries favors submission of suretyships (whereby one person agrees to answer for the debts of another) and other "accessory" agreements to the same law governing the principal obligation.⁹⁷

⁹⁶ See, e.g., *United States Fidelity v. West Point Construction*, 837 F.2d 1507 (11th Cir. 1988) (performance bond incorporated subcontract terms by reference); *Ameritrust v. Chanslor*, 803 F. Supp. 893 (S.D.N.Y. 1992) (creditors of partnership can compel arbitration by guarantor of partner's obligations); *Hoffman v. Fidelity and Deposit Company*, 734 F. Supp. 192 (D.N.J. 1990) (arbitration provision in construction contract incorporated into performance bond); *O & Y Landmark Associates v. Nordheimer*, 725 F. Supp. 578 (D.D.C. 1989) (individuals who guaranteed obligations of one partnership bound to join arbitration with second partnership); *Lemme v. Wine of Japan Import*, 631 F. Supp. 456 (E.D.N.Y. 1986) (New York distributor sued New York importer and Japanese alcohol producer that guaranteed obligations of importer; Japanese producer deemed to have consented to New York jurisdiction by virtue of consent-to-jurisdiction clause in contract between importer and distributor). But see, *Grundstad v. Ritt*, 106 F.3d 201 (7th Cir. 1997) (reversing summary judgment compelling Norwegian guarantor to arbitrate dispute arising from guarantee of non-competition and payment obligation relative to cruise ship gambling concession; court distinguished cases where separate document contained the guarantee from case in which the guarantee was included beneath signature line of principle agreement); *Progressive Casualty Ins. v. C.A. Reaseguradora Nacional de Venezuela*, 802 F. Supp. 1069 (S.D.N.Y. 1992); *General Electric v. Touns*, 644 F. Supp. 11 (S.D.N.Y. 1985) (guarantors held not to have consented to jurisdiction of courts selected in loan agreement).

⁹⁷ See generally *RESTATEMENT (SECOND) CONFLICT OF LAWS*, § 194 (1988); *EUGENE SCOLES & PETER HAY, CONFLICT OF LAWS*, § 18.27 (2d ed. 1992) (cited cases); *Bernard Audit, DROIT INTERNATIONAL PRIVÉ*, § 797, at 633 (1991). Audit notes, however, that this general rule presumes no contrary agreement by the parties.

B. Documentary Credits

1. The Context: Trade Finance and Performance Guarantees

International business transactions rely increasingly on a payment mechanism known as the documentary credit (or letter of credit) by which banks promise to pay money upon presentation of documents. The "commercial" letter of credit insures a buyer's settlement of the purchase price. A "standby" letter of credit guarantees the ability of one party to a transaction to perform a more general obligation. In a commercial letter of credit the beneficiary presents invoices, proof of insurance, inspection certificates and bills of lading. In a standby letter of credit the beneficiary presents a document certifying that the relevant obligation (for example, loan repayment) has not been performed.⁹⁸

The advantage of a documentary credit lies in its independence from the underlying business relationship. A seller can get paid even if the buyer has complaints about the quality of the merchandise, provided the documents presented to the bank comply with the terms of the credit. To maximize confidence in the credit, the promise of the bank issuing the credit is often ratified by another financial institution (the "confirming bank") in which the beneficiary of the credit may have greater confidence.

Bankers and borrowers being what they are, it is not surprising that documentary credit transactions often give rise to disputes, not only between banks and their customers, but also between issuing and confirming banks. Controversies often result from differing interpretation of the letter of credit terms, sometimes aggravated by allegations of fraud or bad faith. For example, a buyer's bank in Paris might issue a letter of credit in favor of a seller in Boston, confirmed by the seller's bank in Massachusetts. Later the issuing bank might refuse payment, claiming that the requirements of the credit were not met because the bill of lading lacked the mention "Clean on Board." The confirming bank might respond that no such requirement exists under the Uniform Customs and Practices for Documentary Credits ("UCP").⁹⁹ This disagreement on how

⁹⁸ See generally BROOKE WUNNICKE, DIANE WUNNICKE & PAUL TURNER, *STANDBY AND COMMERCIAL LETTERS OF CREDIT* (1996); JOHN DOLAN, *THE LAW OF LETTERS OF CREDIT* (1986); Michael K. Madden & Carole E. Klinger, *Letters of Credit: When Can Payment Be Prevented Or Enjoined?*, *LETTER OF CREDIT UPDATE*, July 1997, at 44.

⁹⁹ See *Uniform Customs and Practices for Documentary Credits*, ICC Pub. No. 500 (1993) [hereinafter UCP]. Cases in which the arbitrator is called to decide only on the basis of the UCP provide an interesting example of application of what has come to be

to interpret the UCP might be surrounded by allegations that the seller never actually shipped the goods, or that the issuing bank used funds that should have gone to pay the credit in order to offset the borrower's unrelated indebtedness to the bank. The following section examines a real life instance of how complex letter of credit disputes can be.

2. A Cautionary Tale About Courts and Credits

If scholars tried to construct an illustration of the hazards of going to court to settle a documentary credit dispute, it would be hard to beat *Clarendon v. State Bank of Saurashtra*.¹⁰⁰ In *Clarendon*, a Swiss beneficiary of a letter of credit, issued by a state bank in India, had to pursue almost four years of judicial proceedings, with three different court decisions, merely to obtain an appellate order remanding the case to a lower court for disposition on the merits of the claim.

The defendant raised legal questions related to alleged procedural defects under the Federal Rules of Civil Procedure: the court's "subject matter jurisdiction," the Foreign Sovereign Immunities Act, and the applicant's arguable status as an indispensable party to the litigation. To the beneficiary, these quibbles must have seemed arcane at best, and totally irrelevant to interpretation of the letter of credit itself. The merits of the case hinged on whether the Uniform Customs and Practices for Documentary Credits requires (as it does) that an issuing bank give prompt notice of refusal to honor a credit by reason of discrepant documents, in this case a bill of lading dated a day earlier than called for in the credit.¹⁰¹ Yet all that the appellate judge decided

called "international law merchant," or *lex mercatoria*. On *lex mercatoria*, see generally essays contributed to *LEX MERCATORIA AND ARBITRATION* (Thomas E. Carbonneau, ed., 1990); see also *UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS* (International Institute for the Unification of Private Law, 1994); FILIP DE LY, *INTERNATIONAL BUSINESS LAW AND LEX MERCATORIA* (1992); W. LAURENCE CRAIG, WILLIAM W. PARK AND JAN PAULSSON, *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION*, ch. 35 (2d ed. 1990); FELOC DASSER, *INTERNATIONAL SCHIEDSGERICHTHE UND LEX MERCATORIA: RECHTSVERGLEICHENDER BEITRAG ZÜR DISKUSSION ÜBER EIN NICHTSTAATLICHES HANDELSRECHT* (Schultess Polygraphischer Verlag Zürich ed., 1989).

¹⁰⁰ 77 F.3d 631 (2d Cir. 1996).

¹⁰¹ Under the UCP the issuing bank must either hold the documents at the disposition of the presenter or return them. See UCP, art. 14, *supra* note 99.

was that the court below should not have dismissed the case on the basis of the alleged procedural defects.

3. Contemplating Alternatives to Court Proceedings

a. Arbitration

To reduce the cost and delay of such documentary credit litigation, parties to letters of credit sometimes agree to submit their controversy to arbitration under the rules of an institution that has developed experience in documentary credit disputes.¹⁰² Special care must be taken in drafting an arbitration clause for a letter of credit, since the dispute may implicate more than two parties. For example, if a controversy involves an applicant or beneficiary as well as the issuing and confirming banks, the arbitration clause should provide for consolidation of all claims before a single arbitral tribunal. Otherwise, a bank may be caught in the middle between inconsistent results of multiple arbitral and/or court decisions.

b. Expertise

Another response to potential documentary credit disputes would be resolution by "experts" convened under the auspices of the International Chamber of Commerce ("ICC"). Developed through almost two years of intensive deliberation by a working party convened by the Banking Commission, the "Rules for Documentary Credit Dispute Resolution Expertise" ("DOCDEX") took effect in October 1997.¹⁰³ The dispute resolution process will be administered by the ICC Centre for Expertise in conjunction with the ICC Banking Commission.

Under the DOCDEX rules, a request for dispute resolution may be filed unilaterally by an aggrieved party, or jointly by all parties to the dispute. From a list maintained by its Banking Commission, the ICC will appoint three

¹⁰² Such institutions include the International Chamber of Commerce, the London Court of International Arbitration, the American Arbitration Association, and the recently created Institute of International Banking Law and Practice.

¹⁰³ ICC Publication No. 577.

independent individuals who will render a decision on the basis of documents alone.¹⁰⁴

Parties to a dispute submitted for DOCDEX resolution may consider the decision to have moral force only. Absent a contrary choice, the decision will be considered non-binding.¹⁰⁵ Consequently, courts are unlikely to apply arbitration statutes or treaties to the DOCDEX process.

4. Distinguishing Experts from Arbitrators¹⁰⁶

The DOCDEX insistence that its decisions are not intended as arbitration awards raises the question of how exactly they *should* be characterized. Notwithstanding Shakespeare's suggestion that what we call something does not matter,¹⁰⁷ it does make a significant difference whether a contractually designated decision-maker is characterized as an "arbitrator" rather than an "expert."¹⁰⁸

An arbitrator's award generally will benefit from the network of enforcement provisions created by multinational treaties and national arbitration statutes. On the other hand, an expert's opinion can be enforced abroad only in a new action under the relevant foreign law, subject to whatever contract

¹⁰⁴ The Rules cover only issues arising under the Uniform Customs and Practices for Documentary Credits or the Uniform Rules for Bank-to-Bank Reimbursement under Documentary Credits ("URR"). Thus an allegation of fraud would fall outside the scope of the expert's mission. See ICC Publication No. 577.

¹⁰⁵ The Rules state that the experts' decision "is not intended to conform with any legal requirements of an arbitration award" (Article 1.3) and that "unless otherwise agreed a DOCDEX decision shall not be binding upon the parties" (Article 1.4). See ICC Publication No. 577.

¹⁰⁶ See generally JOHN KENDALL, *EXPERT DETERMINATION* (2d ed. 1996), at 195-217; MICHAEL MUSTILL & STEWART BOYD, *COMMERCIAL ARBITRATION* 38-50 (2d ed. 1989); CHARLES JARROSSON, *LA NOTION D'ARBITRAGE*, §§ 202-97, at 112-57 (1987); Doug S. Jones, *Is Expert Determination a "Final and Binding" Alternative?*, 63 *ARBITRATION* 213 (1997); Paul Michard, *Introduction, Martindale Hubbell International Arbitration and Dispute Resolution Directory* (1996), at xiii-xiv (discussing the expert determination process).

¹⁰⁷ "What's in a name? That which we call a rose by any other name would smell as sweet." WILLIAM SHAKESPEARE, *ROMEO AND JULIET*, act 2, sc. 1, line 85.

¹⁰⁸ Analogous decision-makers are also known as "adjudicators," "evaluators," or "appraisers."

defenses may exist.¹⁰⁹ Arbitrators will generally benefit from immunity from suit for errors or omissions, while experts will not.¹¹⁰ Under some legal systems an arbitral award might be subject to appeal under statutory provisions for judicial review on the merits of an award,¹¹¹ while decisions of experts would fall outside the scope of such appellate schemes.¹¹²

It is easier to describe the consequences of characterizing a decision-maker as an arbitrator than to describe how the characterization should be made. The existence of a dispute and the adversarial nature of the proceedings are often cited as indicating the exercise of arbitral rather than expert functions.¹¹³ Even if a dispute has arisen, however, a decision-maker may be characterized as an expert rather than an arbitrator.

Criteria relevant to the characterization process will vary from country to country. In general, however, courts usually seek analogies between arbitration and judicial proceedings, on the assumption that arbitrators are substitutes for judges. With respect to the substance of the dispute, experts tend to deal with narrow questions of fact (such as post-closing purchase price adjustments or consideration to be paid for a privately held investment), while more complex legal questions would be given to arbitrators. In matters of procedure, arbitrators are more likely than experts to adopt a decision-making mechanism with the

¹⁰⁹ See generally Jean-François Bourque, *L'Expérience du Centre International d'Expertise de la CCI et le Développement de l'Expertise Internationale*, 1995 REVUE DE L'ARBITRAGE 231.

¹¹⁰ See Arbitration Act, 1996, § 29 (Eng.). See generally Julian D.M. Lew, *Immunity of Arbitrators Under English Law*, in THE IMMUNITY OF ARBITRATORS 21 (Julian D.M. Lew ed., 1990).

¹¹¹ See, e.g., Arbitration Act, 1996, § 69 (Eng.).

¹¹² See, e.g., *Jones v. Sherwood Computer Services*, [1992] 1 W.L.R. 277 (Eng.) (review of expert's decision only for fraud or failure to perform correct function). Cf. *Mercury Communications v. General Telecommunications*, [1996] 1 W.L.R. 48 (Eng.) (House of Lords accepted review of expert's error).

¹¹³ It is sometimes said that the role of experts is to avoid disputes, while the function of arbitrators and judges is to decide them. See *Sport Maska, Inc. v. Zittner*, [1988] 1 S.C.R. 564, 588 (Can.) (finding that evaluators of inventory of bankrupt company cannot benefit from immunity as arbitrators). See also Yves Derains, et al., *Cour Internationale D'Arbitrage de la Chambre de Commerce Internationale*, 120 JOURNAL DU DROIT INTERNATIONAL (J.D.I.) 1001, 1024 (1993) (comment by Dominique Hascher discussing the award rendered in ICC Case No. 6535, involving a construction contract).

basic attributes of a judicial proceeding. In the United States,¹¹⁴ Britain,¹¹⁵ and on the Continent,¹¹⁶ these procedural identification tags include hearings, the application of law, an ultimate determination of legal liability and evidentiary submissions from the parties.

Although the parties' label on their dispute resolution process may create a presumptive characterization, it will not be conclusive. For example, courts have denied New York Arbitration Convention coverage to the determination of the price of shares at the break-up of a joint venture, even though the process was labeled arbitration.¹¹⁷

Perhaps the best approach to distinguishing between an arbitrator and an expert would be to focus on the substance of the claims rather than the nature of the dispute resolution process. Reasoning teleologically, one might ask whether the goals of an arbitration statute or treaty will be served by treating a decision-maker as an arbitrator. Generally, arbitration law comes into play when parties to a controverted event have agreed (or allegedly agreed) to abandon recourse to courts in favor of private dispute resolution. In such event, arbitration law aims to promote finality on the merits while safeguarding minimum standards of procedural fairness. Therefore, arbitration would be the proper characterization of a decision-making process when the questions posed to the decision-maker approximate a request for judicial relief. For example, a building contractor and his customer, fighting over the non-payment of a bill, might ask the decision-maker: "Was the roof completed?" Or they might ask:

¹¹⁴ See, e.g., *Omaha v. Omaha Water Co.*, 218 U.S. 180 (1910); *Sanitary Farm Dairies v. Gammel*, 195 F.2d 106 (8th Cir. 1952); *Shepard & Morse Lumber v. Collins*, 256 P.2d 500 (Or. 1953). See generally SAMUEL WILLISTON, 16A TREATISE ON THE LAW OF CONTRACTS § 1919 (Walter H. Jaeger ed., 3d ed. 1976) (discussing commercial arbitration agreements).

¹¹⁵ See generally JOHN KENDALL, EXPERT DETERMINATION 198-99 (2d ed. 1996) (cited references).

¹¹⁶ See CHARLES JARROSSON, LA NOTION D'ARBITRAGE, §§ 202-97, at 112-57 (1987). See also decision of the Swiss *Tribunal fédéral* in *X et Y contre Z*, Nov. 26, 1991, ATF 117 Ia 365. See discussion in PAOLO MICHELE PATOCCHI & ELLIOTT GEISINGER, CODE DE DROIT INTERNATIONAL PRIVÉ SUISSE ANNOTÉ 433 (1995) (concerning the *Loi fédérale sur le droit international privé*, art. 176 (Switz.)).

¹¹⁷ See, e.g., *Frydman v. Cosmair*, 1995 WL 404841 (S.D.N.Y. July 6, 1995). The decision was rendered under Article 1592 of the French *Code civil* (*arbitrage d'un tiers*). As a consequence, the enforcement of the decision could not be removed to federal court under 9 U.S.C. §§ 203, 205 (1970).

"Does Customer owe \$10,000 to Contractor?" An expert would be more likely to answer the first question, while the second would normally be for an arbitrator.

C. Debt Rescheduling and Public Sector Lending

A British economist reportedly remarked, "If you owe a man £100, you have a problem. If you owe him £1 million, he has a problem." Restructuring a country's external debt often involves amounts so sizeable that the bank, not the borrower, has a problem. Debtor nations may have enough economic muscle to reject jurisdiction clauses designating the lender country's own courts. For example, Brazil's rescheduling agreements accepted New York governing law, but provided arbitration as a dispute resolution mechanism.¹¹⁸

Multilateral and bilateral public sector lending, both to states and state enterprises, also have relied on arbitration clauses in loan and guarantee documentation.¹¹⁹ The *Standard Terms and Conditions of the European Bank for Reconstruction and Development* adopt the UNCITRAL Arbitration Rules, and designate the International Court of Justice as the appointing authority.¹²⁰ The World Bank's *General Conditions Applicable to Loan and Guarantee Agreements* provide for arbitration under an *ad hoc* procedure.¹²¹ And Franco-Iranian loans related to nuclear energy cooperation included arbitration clauses

¹¹⁸ See Deposit Facility Agreement between Banco Central do Brasil and Republica Federativa do Brasil (as guarantor) and Citibank, N.A. (as agent), Sept. 22, 1988, § 12.08(a)-(b).

¹¹⁹ In contrast, private sector lending by the European Bank for Reconstruction and Development retains the option to elect, at the time of a dispute, either to arbitrate or to sue the borrower in its country of residence. If elected by the Bank, arbitration will proceed according to the UNCITRAL Arbitration Rules, with a situs in London and the London Court of International Arbitration as the appointing authority. See generally John W. Head, *Evolution of the Governing Law for Loan Agreements of the World Bank and Other Multilateral Development Banks*, 90 AM. J. INT'L L. 214 (1996).

¹²⁰ See EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT, STANDARD TERMS AND CONDITIONS § 8.04 (Sept. 1994). Other elements of the arbitral procedure provided in the *Standard Terms* include a three member arbitral tribunal, the Hague as the seat of arbitration, and proceedings in English.

¹²¹ See INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, GENERAL CONDITIONS APPLICABLE TO LOAN AND GUARANTEE AGREEMENTS § 10.04 (Jan. 1, 1985).

that were tested when the cooperation went sour after the Iranian revolution, resulting in arbitration and ancillary litigation in both Geneva and Paris.¹²²

IV. DRAFTING THE ARBITRATION CLAUSE¹²³

A. General Principles

The cardinal rule of drafting an international arbitration agreement is to avoid ambiguity and equivocation. Uncertainty about whether, where and how the parties wished to arbitrate will delight only the party wishing to drag its feet, and will often render the clause unenforceable.¹²⁴ Misguided lawyers invite unnecessary litigation by providing that some disputes arising out of the contract will be settled by arbitration, while others are for courts or experts.¹²⁵ In some cases defective clauses can be repaired by courts presuming the parties' intent

¹²² The French Atomic Energy Commission agreed to provide Iran with services, expertise and access to uranium, in return for Iranian loans that totaled \$1 billion. The loan agreement signed by Iran was governed by Iranian law, but provided that any disputes arising in connection with the agreement would be settled in Geneva under the Arbitration Rules of the International Chamber of Commerce. See I.C.C. Arbitration No. 3683 and 5124; Swiss *Tribunal fédéral*, C.E.A. v. République Islamique d'Iran, ATF 116 II (May 17, 1990), reported in *Semaine Judiciaire*, No. 26, at 566 (1990); Cass. le civ. (Fre.) (Judgment of March 20, 1989), 1989 REV. ARB. 653-67 (comment P. Fouchard); Cass. le civ. (Fre.) (Judgment of June 28, 1989), 1989 REV. ARB. 653-57 (comment P. Fouchard). A separate French franc loan was made to a related entity called Eurodif, with an award rendered on Dec. 20, 1990. See *Eurodif est condamné à payer 940 millions de francs à l'Iran*, LE MONDE, Jan. 1, 1991, at 16.

¹²³ For implementation of these principles see Commercial Loan Model Arbitration Clause, Appendix I(1), and for arbitration clauses used by international financial institutions, see Appendix I(2)-(4).

¹²⁴ See *Bauhinia Corp. v. China Nat'l Mach. & Equip. Import & Export*, 819 F.2d 247 (9th Cir. 1987). See also *National Iranian Oil Co. v. Ashland Oil*, 817 F.2d 326 (5th Cir. 1987) (the court deemed itself without power to enforce an arbitration clause providing for arbitration in Iran).

¹²⁵ One sometimes sees, for example, provision for post-closing price adjustments to be decided by experts, while the contract's general dispute resolution clause calls for arbitration. Problems can arise when both experts and arbitrators hear allegations about failure on the warranties.

as to elements that are missing¹²⁶ or self-contradictory.¹²⁷ The indeterminacy of the dispute resolution mechanisms, however, adds an unpleasant layer of contention to business relationships.¹²⁸

Some lawyers advocate pre-arbitration negotiation and mediation.¹²⁹ However, benefits sometimes attending such stipulations will often be outweighed by added expense and delay when a recalcitrant party resists arbitration or challenges an award by arguing that the terms of the negotiation or mediation provisions were not met. For example, a defendant may allege that the claimant did not negotiate in good faith, or that the request for arbitration was filed too long after negotiation or mediation failed.¹³⁰

¹²⁶ See *Jain v. de Méré*, 51 F.3d 686 (7th Cir. 1995) (holding that a court could compel arbitration notwithstanding the fact that a contract failed to specify either location of arbitration or method for appointing arbitrators).

¹²⁷ See *Paul Smith Ltd. v. H & S Int'l Holding Inc.*, [1991] 2 Lloyd's Rep. 127 (1991) (Eng.) (contract provided for both arbitration and submission to the exclusive jurisdiction of the courts of England; reference to English courts was interpreted as a specification of the curial law governing the arbitration, covering matters such as interim measures of protection, vacancies in the arbitral tribunal and the removal of arbitrators for misconduct).

¹²⁸ Compare *Mediterranean Enterprises, Inc. v. Ssangyong Corp.*, 708 F.2d 1458 (9th Cir. 1983) (language calling for arbitration of "any disputes arising hereunder" in a joint venture agreement held not to cover claim of inducing breach of contract under related agency contract), with *J.J. Ryan & Sons, Inc. v. Rhone Poulenc Textile S.A.*, 863 F.2d 315 (4th Cir. 1988) (standard I.C.C. clause providing for arbitration of "all disputes arising in connection with" a distribution agreement held to cover controversies related to ancillary agreements between the parties, as well as claims related to defendant's interference with contracts between plaintiff and its customers), and *S.A. Mineracao da Trindade-Samitri v. Utah Int'l, Inc.*, 745 F.2d 190 (2d Cir. 1984) (clause providing for arbitration "whenever any question or dispute shall arise or occur under" the agreement held broad enough to include claims of fraudulent inducement to contract).

¹²⁹ See, e.g., MODEL MEDIATION AND ARBITRATION CLAUSE FOR COMMERCIAL FINANCIAL SERVICES DISPUTE RESOLUTION, reprinted in Donald Rome, *A New Approach to ADR for the Financial Services Industry*, ADR CURRENTS, Spring 1997, at 14-16 (report developed by a joint committee composed of the ADR Committee of the American College of Commercial Finance Lawyers and the American Arbitration Association).

¹³⁰ See, e.g., Swiss *Tribunal fédéral* decision in *Vekoma v. Maran Coal Company*, Aug. 17, 1995, reprinted in 14 (No. 4) ASA BULLETIN 673 (1996) (Swiss Arb. Ass'n) (commentary by Philippe Schweizer). The contract to ship coal in this case provided for any dispute to be resolved by ICC arbitration in Geneva, subject to the condition that

In addition to an unambiguous submission to arbitration of *all* disputes connected with the contract, other aspects of an arbitration clause include: (i) a workable mechanism for appointing arbitrators; (ii) designation of the place of arbitration; (iii) the standard for fixing the arbitrators' fees; (iv) the language of the arbitration; and (v) the number of arbitrators. Additional items that are usually helpful include a choice-of-law clause (both substantive and procedural¹³¹), provisions for pre-award attachment and interim judicial injunctive relief, and automatic consolidation of related arbitral proceedings. Finally, it is occasionally useful to provide qualifications for arbitrators, clarification of the arbitrator's power to grant punitive damages and to allocate attorney's fees, a "last best offer" procedure (so-called baseball arbitration) and a requirement of reasoned awards.

Many of these items will be covered by reference to the procedural rules of an arbitral institution.¹³² Among the more widely known institutional rules are those of the American Arbitration Association ("AAA"), The International

the claim be filed "within thirty days after it was agreed that the difference or dispute cannot be resolved by negotiation." An arbitration claim filed in May 1992 resulted in an award for the claimant, which defendant succeeded in having annulled on the basis that the claim was not brought within the contractually required thirty days from the breakdown of negotiations. The defendant argued that the trigger event (failure of negotiations) had occurred in January, when a letter from the claimant was met with silence.

¹³¹ Issues related to the arbitration and the arbitration agreement should be decided under the law of the arbitral situs. When the law selected to interpret the principal contract is applied to the arbitration clause as well, a court asked to recognize an arbitration clause in one jurisdiction (*e.g.*, in New York) may sometimes stay arbitration until the validity of the clause is determined by a tribunal in the country whose law was selected (*e.g.*, Venezuela). *See* *Pepsico v. Oficina Central de Asesoría y Ayuda Técnica*, 945 F. Supp 69 (S.D.N.Y. 1996). The court ultimately granted Pepsico's motion to compel arbitration after a decision on the validity of the arbitration clause by a court in Caracas. *See* *Pepsico v. Ayuda Técnica*, No. 96-CIV-7817 (S.D.N.Y. Feb. 25, 1997), *reprinted in* 12 (No. 3) MEALEY'S INT'L ARB. REPS. 16 (March 1997). The arbitral tribunal awarded Pepsico \$94 million for breach of contract. *See* 8 World Arb. & Mediation Rep. (BNA) 210 (1997). *See also* *Volt Info Sciences, Inc. v. Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468 (1989) (holding that California state law applies to both the merits of the dispute and the arbitration procedure, thereby staying an arbitration under California state law pending resolution of related court proceedings).

¹³² *See* Appendix I.

Chamber of Commerce ("ICC") and the London Court of International Arbitration ("LCIA"). Other useful arbitration rules include those of the Geneva Chamber of Commerce and Industry ("GCCI"), the International Center for the Settlement of Investment Disputes ("ICSID") and the United Nations Commission on International Trade Law ("UNCITRAL").

B. The Arbitral Situs

In international arbitration, the choice of an arbitral situs may be the most important component of the arbitration agreement other than the process for selecting the arbitrators. The significance of the place of arbitration rests on a twofold reality. First, national arbitration statutes usually provide some grounds for setting aside awards made within their territory. Second, annulment at the arbitral situs gives the loser an argument for resisting the award's enforcement under the New York Arbitration Convention.

As the place where the award is considered "made" for purposes of the Convention's enforcement scheme,¹³³ the arbitral situs can by vacatur of an arbitral award impair¹³⁴ (but not necessarily destroy¹³⁵) an award's international currency. For example, an award rendered in Boston might be presented for enforcement against the loser's assets in London. If set aside by a court in

¹³³ Occasionally there may be divergence between the arbitral seat and the place the award is deemed made. See *Hiscox v. Outhwaite*, [1992] 1 App. Cas. 562 (Eng.) (concluding that an award signed in Paris was considered made in France under the New York Convention, while the seat of the arbitration remained in England for purposes of appeal). The result of this case has been overruled by the Arbitration Act, 1996 (Eng.).

¹³⁴ New York Convention, art. V(1)(e) provides that an award may be refused recognition and enforcement if set aside "by a competent authority of the country in which . . . that award was made."

¹³⁵ New York Convention, art. VII preserves the right to rely on awards under the local law of the enforcement forum, whatever that law might be. Although rare, it does sometimes happen that courts recognize awards set aside at the arbitral situs. See, e.g., *Chromalloy Aeroservices v. Egypt*, 939 F. Supp. 907 (D.D.C. 1996) (award set aside in Egypt recognized in the United States); and *Hilmarton Ltd. v. Omnium de traitement et de valorisation*, *Cour de Cassation* (June 10, 1997) (Fre.) (award set aside in Switzerland recognized in France). Both decisions are discussed in Ch. 28 of W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION* (3d ed. 1998).

Massachusetts, the award would no longer benefit from the New York Convention's enforcement obligation.

Although the New York Convention permits a court to refuse recognition to an award annulled where rendered, the Convention sets forth no particular grounds for such annulment. For better or for worse, each country is free to establish grounds for annulment as it sees fit.¹³⁶

Judicial review of awards under national law at the place where rendered (as contrasted with the enforcement forum) falls into several categories. The first model allows appeal on the legal merits, as well as for procedural irregularities such as arbitrator bias and excess of authority. The second limits courts to review of procedural fairness only. Under a third but less popular paradigm, the arbitral situs provides no grounds at all on which an award may be set aside.¹³⁷ Under the arbitration law of many countries, grounds for judicial review are hybrids of the above paradigms. For example, English law allows judicial review on the legal merits of an award, but permits the parties to contract out of such court intervention.¹³⁸ Switzerland's federal conflict-of-laws code provides for courts to review the basic procedural integrity of the arbitral process, but in some circumstances permits waiver of the right to challenge an award.¹³⁹

The best place for arbitration is normally in a country where the judiciary will safeguard the procedural integrity of the arbitral process, but not insist on correcting an arbitrator's honest mistake on the substantive merits of the dispute. A right of appeal on points of law tends to maximize judicial certainty,

¹³⁶ *But see* European Convention on International Arbitration, art. IX (Geneva 1961) (permitting nonrecognition of an award annulled where rendered only if annulment was for one of the treaty-enumerated reasons, which include an invalid arbitration agreement, inability to present one's case, an arbitrator's excess of authority and irregular composition of the arbitral tribunal) [hereinafter European Convention]. *See also*, William W. Park, *National Law and Commercial Justice*, 63 TUL. L. REV. 647, 686-689 (1989). The European Convention applies only as to disputes between nationals of different contracting countries. *See id.*

¹³⁷ *Compare* Code Judiciaire, art. 1717 (Belg.), with *Loi fédérale sur le droit international privé*, art. 192 (Switz.) (conflict-of-laws code permitting, but not mandating, a similar exclusion of all judicial review in some cases).

¹³⁸ *See* Arbitration Act, 1996, § 69 (Eng.).

¹³⁹ *See* *Loi fédérale sur le droit international privé*, arts. 190, 192 (Switz.) (permitting waiver only when no Swiss party is involved, and even then only through an explicit agreement (*déclaration expresse*)).

but only at the price of finality. In arbitration the parties assume some risk of a "bad award," where an arbitrator gets it wrong on the facts or the law. However, the parties do not usually (if ever) agree to arbitrator excess of authority, bias, or departure from fundamental procedural fairness.

Courts in France,¹⁴⁰ Switzerland,¹⁴¹ and the United States,¹⁴² as well as countries that follow the UNCITRAL Model Arbitration Law,¹⁴³ all provide for judicial monitoring of an arbitration's procedural regularity, but do not allow appeal on the award's substantive legal merits.¹⁴⁴ England's recently adopted Arbitration Act allows review of jurisdictional matters and procedural fairness,¹⁴⁵ but also permits appeal on points of law unless otherwise agreed by the parties.¹⁴⁶

C. Unilateral Clauses¹⁴⁷

From the perspective of litigation strategy, a lending institution would normally want to reserve an option either to elect arbitration or to go to court.¹⁴⁸ Such a unilateral right to arbitrate permits significant flexibility with respect to elements that are hard to forecast when a contract is signed. For example, a

¹⁴⁰ See NOUVEAU CODE DE PROCÉDURE CIVILE [N.C.P.C.], art. 1502 (Fre.).

¹⁴¹ See *Loi fédérale sur le droit international privé*, art. 190 (Switz.). In some cases parties may opt to exclude any judicial review. See *id.*, at art. 192. Under cantonal law, however, arbitral awards may be set aside for "evident violation of law or equity." See Intercantonal Concordat, art. 36(f) (Switz.).

¹⁴² See 9 U.S.C. §10 (1994).

¹⁴³ See generally, HOWARD M. HOLTZMANN AND JOSEPH E. NEUHAUS, A GUIDE TO THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION: LEGISLATIVE HISTORY AND COMMENTARY (1989).

¹⁴⁴ France and Switzerland, as well as the UNCITRAL Model, also list "public policy" (*ordre public*) as a ground for challenge to awards. The appropriateness of public policy as a basis for setting aside an award where rendered (as opposed to refusal to enforce the award at the asset situs) is open to question.

¹⁴⁵ See Arbitration Act, 1996, §§ 67-68 (Eng.) (discussing substantive jurisdiction and serious irregularity, respectively).

¹⁴⁶ See *id.* at § 69.

¹⁴⁷ See generally Laurent A. Niddam, *Unilateral Arbitration Clauses in Commercial Arbitration*, 1996 ARB. DISP. RESOL. L.J. 147 (1996).

¹⁴⁸ For an example, see private sector lending practice of European Bank for Reconstruction and Development.

lender may want to assess, after a dispute arises, whether extensive documentary discovery is in its interest. If not, the lender would elect arbitration, with the concomitant likelihood of less discovery.

Whether such optional clauses will be enforceable is not entirely certain. Rightly or wrongly, some courts have sometimes invoked the principle of "mutuality" (of remedy or obligation) to invalidate a one-sided arbitration agreement, under the theory that if both parties are not bound, then neither is bound.¹⁴⁹ Other courts have been willing to enforce optional clauses.¹⁵⁰

Looking to choice-of-court clauses for analogies, it has long been commonplace for financial institutions to impose a double standard in forum selection.¹⁵¹ In such arrangements the bank reserves the right to sue customers at their domiciles, but requires litigation against the bank to be brought only in the contractually chosen forum, usually the place of the bank's headquarters or designated branch office. The Bruxelles and Lugano Conventions seem to admit

¹⁴⁹ See, e.g., *Hull v. Norcom, Inc.*, 750 F.2d 1547 (11th Cir. 1985) (holding that arbitration clause in employment agreement subject to New York law was not enforceable because employer retained right to go to court). This result would probably be different today in light of *Sablosky v. Gordon Co.*, 73 N.Y.2d 133, 138-39 (N.Y. 1989). See also *R.W. Roberts Construction v. St. John's River Water Mgt. Dist.*, 423 So.2d 630 (Fla. Dist. Ct. App. 1982) (holding unenforceable an arbitration clause requiring arbitration of sub-contractor's claims against the general contractor); *Lopez v. Plaza Finance*, 1996 WL 210073 (N.D. Ill. 1996) (holding arbitration clause unenforceable in installment loan agreement where debtor could not arbitrate disputes related to events of default); *Stirlen v. Supercuts*, 60 Cal. Rptr. 2d 138 (Cal. App. Ct. 1997) (employment contract); *Stevens, Leinweber, Sullens Inc. v. Holm Dev. and Management, Inc.*, 795 P.2d 1308 (Ariz. Ct. App. 1990) (holding unenforceable an arbitrator's provision granting one party a unilateral option to arbitrate).

¹⁵⁰ See *Doctor's Assoc. v. Distajo*, 66 F.3d 438, 451 (2d Cir. 1995); *Becker Autoradio v. Becker Autoradiowerk GmbH*, 585 F.2d 39, 42 (3d Cir. 1978); *Cindy's Candle Co. v. WNS Inc.*, 714 F. Supp. 973 (N.D. Ill. 1989); *W.L. Jorden & Co. v. Blythe Industries, Inc.*, 702 F. Supp. 282 (N.D. Ga. 1988); *Sablosky v. Gordon Co.*, 73 N.Y.2d 133, 138-39 (N.Y. 1989); *Willis Flooring v. Howard S. Lease Const. Co.*, 656 P.2d 1184 (Alaska 1983); *Kalman Floor Co. v. Jos. L. Muscarelle Inc.*, 481 A.2d 553 (N.J. Super. 1984). See also *Cole v. Burns Intern. Sec. Serv.*, 105 F.3d 1465 (D.C. Cir. 1997) (accepting the validity of an arbitration clause in an employment contract exercisable at the employer's option, but on condition that employer pay the arbitration fees), discussed *infra* at note 172.

¹⁵¹ See discussion of exclusive and non-exclusive court selection clauses, *supra* note 65 and accompanying text.

unilateral jurisdiction selection,¹⁵² as does case law enforcing a contractual right to choose between several different courts.¹⁵³

The principle of mutuality can work both ways. In at least one case mutuality was pressed into service to justify enforcement of a forum selection clause for the benefit of a defendant who was not a party to the agreement.¹⁵⁴

V. UNCERTAINTIES IN FINANCIAL ARBITRATION

A. The International Monetary Fund Agreement

The Articles of Agreement of the International Monetary Fund ("IMF") may in some cases circumscribe an arbitrator's power to hear a dispute. The IMF Articles prohibit member states from imposing exchange controls on current transactions, absent IMF approval.¹⁵⁵ However, controls which do comply with the IMF Agreement must be respected.¹⁵⁶

Certain countries have given the IMF restrictions a broad interpretation, applying them to any contract that affects international balance of payments, including loan agreements between residents and non-residents.¹⁵⁷ By contrast,

¹⁵² See *Bruxelles Convention*, art. 17(4).

¹⁵³ See, e.g., *Medoil Corp. v. Citicorp*, 729 F. Supp. 1456 (S.D.N.Y. 1990) (customer could sue Citibank only at location of branch managing account, while bank could bring action also at customer's residence).

¹⁵⁴ See *Frietsch v. Refco, Inc.*, 56 F.3d 825, 827-28 (7th Cir. 1995). The defendant brokerage firm, who was not a party to contracts between investors and promoters of a commodities investment pool, was permitted to rely on the contractual choice of a German forum in order to preclude action in the United States for allegedly operating a Ponzi scheme. Judge Posner rejected the "asymmetry of procedural choices." *Id.*

¹⁵⁵ See Articles of Agreement of the International Monetary Fund, Jul. 22, 1944, art. VIII, § (2)(a) [hereinafter I.M.F. Agreement]. Current transactions include interest on loans and payments of moderate amounts for loan amortization.

¹⁵⁶ See I.M.F. Agreement, *supra* note 155, art. VIII, § (2)(b) (providing that "exchange contracts" contrary to valid exchange controls shall be unenforceable). Debate has focused on whether to interpret "exchange contract" broadly to cover all agreements affecting balance of payments, including cross-border loans.

¹⁵⁷ See, e.g., *De Boer, Widow Moojen v. Von Reichert*, 1962 J. DROIT INT'L 718 (Paris, June 20, 1961) (Fre.); *Lessinger v. Mirau*, 22 I.L.R. 725 (1955) (Ger.); *Société Filature et Tissage X Jourdain v. Epous Heynen-Bintner*, 22 I.L.R. 727 (Lux.). See also P. CRESSWELL ET AL., *ENCYCLOPEDIA OF BANKING LAW* § F1604(b) (London 1987);

a narrower interpretation of the IMF Articles limits its application to contracts that involve the swap of one currency for another.¹⁵⁸

The broad application of the IMF Articles has two consequences for cross-border financial arbitration. First, exchange controls (if properly imposed) arguably apply regardless of the applicable law chosen by the parties. Like other mandatory norms of international public policy (often referred to as *lois de police*), legitimate exchange controls would seem to be non-waivable.¹⁵⁹ Second, national courts might refuse to enforce arbitration agreements implicating exchange controls, on the ground that the subject matter is "not capable of settlement by arbitration" under the New York Convention.¹⁶⁰ Some authors, however, have taken the position that the IMF Articles ought *not* to constitute such a bar to the arbitrability of international loan disputes.¹⁶¹

Of course, if an arbitrator interprets an agreement in a way that violates the IMF Agreement, courts might later refuse recognition to the award. But this does not mean that the arbitrator should be prohibited *ab initio* from interpreting the IMF Articles. The need for a level playing field on which to resolve disputes over transnational loans argues for allowing arbitrators to hear the merits of cross-border credit controversies, and leaving courts to deal with public policy implications after the award is rendered.

Joseph Gold, *Article VIII, Section 2(b) of the I.M.F. Articles in its International Setting*, 6 LAW OF INTERNATIONAL TRADE FINANCE 65, 86 (1989); Bernard Audit, Note, 1966 J. DROIT INT'L 102 (commenting on two judgments by the French Cour de cassation).

¹⁵⁸ See, e.g., *Libra Bank, Ltd. v. Banco Nacional de Costa Rica*, 570 F. Supp. 870 (S.D.N.Y. 1983); *United City Merchants v. Royal Bank of Canada*, [1983] App. Cas. 168 (U.K.).

¹⁵⁹ See, e.g., BERNARD AUDIT, DROIT INT'L PRIVÉ §§ 92-113 (1991); Pierre Mayer, *Mandatory Rules of Law in International Arbitration*, 2 ARB. INT'L 274 (1986); Pierre Mayer, *Les Lois de Police Étrangères*, 1981 J. DROIT INT'L 277 (1981).

¹⁶⁰ See New York Convention, *supra* note 18, arts. II(1), V(2)(a).

¹⁶¹ See Otto Sandrock, *Internationale Kredite und die Internationale Schiedsgerichtsbarkeit*, 48 (Nos. 10,11) ZEITSCHRIFT FÜR WIRTSCHAFTS UND BANKRECHT (Mar. 12, 1994); William W. Park, *L'arbitrage et le recouvrement des prêts consentis à des débiteurs étrangers*, 37 REVUE DE DROIT DE L'UNIVERSITÉ MCGILL 375 (1992). These authors note that courts have shown an increasing tendency to recognize arbitration of other public-law issues and to enforce arbitration agreements in international contracts even if the subject matter would make the agreement unenforceable in a purely domestic context.

B. Consumers, Employees and Informed Consent¹⁶²

Like any freedom, the right to choose a dispute resolution mechanism justifies itself by the values it furthers. Arbitration in some cases promotes fairer and more efficient adjudication, while in others it can deprive an unsophisticated party of basic procedural safeguards.

Arbitration against banks and securities firms has been subject to special scrutiny.¹⁶³ Some courts have refused to enforce arbitration clauses in consumer loan contracts.¹⁶⁴ Others have upheld consumer finance arbitration agreements.¹⁶⁵ The heart of the matter seems to be whether such arbitration agreements are genuinely consensual.¹⁶⁶

¹⁶² See also discussion of "separability" and *compétence-compétence*, *infra* at Section V.E., which deals with the timing of how courts consider issues of consent and unconscionability.

¹⁶³ In at least one case the judge ordered discovery into the adequacy of the New York Stock Exchange arbitration rules to resolve claimants' discrimination claims and the circumstances surrounding claimant's agreement to arbitration (phrased as "waiver of her rights to a federal forum"). See *Rosenberg v. Merrill Lynch Pierce*, 965 F. Supp. 190 (D. Mass. 1997) (discussed *supra* note 79).

¹⁶⁴ See *Bell v. Congress Mortgage Co.*, 24 Cal. App. 4th 1675 (Cal. App. 1st Dist., May 17, 1994), *ordered depublished* 30 Cal. Rptr. 2d 205 (1994) (refusing to compel arbitration absent a "clear and informed" waiver of the right to a jury trial when a homeowner claims against mortgage lenders for fraudulent business practices). See also *Lopez v. Plaza Finance Co.*, 1996 WL 210073 (N.D.Ill. 1996) (no enforcement of arbitration agreement in installment loan); *ITT Cons. Fin. Corp. v. Patterson*, 18 Cal. Rptr. 2d 563 (1993) (arbitration clause used in documentation for relatively small loans was an unconscionable limit on the borrower's opportunity to be heard).

¹⁶⁵ See, e.g., *Badie v. Bank of America*, 1994 WL 660730 (Cal. Super. 1994); *discussed in* 63 Banking Rep. (BNA) 293 (Aug. 29, 1994) and 5 World Arb. & Mediation Rep. (BNA) 231 (Oct. 1994); *McCarthy v. Providential Corp.*, 1994 WL 387852 (N.D. Cal. 1994) (senior citizen "reverse mortgage"); *Meyers v. Univest Home Loan*, 1993 WL 307747 (N.D. Cal. 1993) (consumer loan).

¹⁶⁶ In one case, borrower's counsel remarked that arbitration "is like sex: it's great if both parties consent, but can't be allowed if one party is forced into taking part." See *Consumer Arbitration*, 4 World Arb. & Mediation Rep. (BNA) 192, 193 (1993) *quoting* Patricia Sturdevant, attorney for the plaintiffs in *Badie v. Bank of America*, 1994 WL 660730 (Cal. Super. 1994); *discussed in* 63 Banking Rep. (BNA) 293 (Aug. 29, 1994) and 5 World Arb. & Mediation Rep. (BNA) 231 (Oct. 1994). Attorney Sturdevant applied her comment generally to "ADR" (alternative dispute resolution), a broad category that includes arbitration as well as other alternatives to judicial dispute

Courts have looked to see that the contractually designated arbitral process is fundamentally fair. A self-administered dispute resolution system allowing for inordinate delay,¹⁶⁷ and an arbitral regime requiring a disproportionately high filing fee,¹⁶⁸ have been held unenforceable.

Courts struggling with arbitration in non-banking consumer transactions have reached similarly inconsistent results, sometimes holding arbitration clauses void for lack of informed consent,¹⁶⁹ while other times recognizing the clause.¹⁷⁰ At least two cases have enforced arbitration clauses packaged in boxes

resolution.

¹⁶⁷ See *Engalla v. Permanente Med. Group*, 938 P.2d 903 (Cal. 1997) (subjecting a malpractice claim against a health care provider in the Kaiser group to an arbitration clause). The *ad hoc* nature of the arbitration, which left administration to the parties rather than an independent institution, resulted in delay that caused a procedural asymmetry favoring the defendant health care provider. See *id.* The trial court found fraud in the inducement, and thus allowed the deceased patient's heirs to rescind the agreement to arbitrate. See *id.* The Court of Appeals decision to reverse the trial court was itself reversed by the Supreme Court of California, which remanded the case back to the trial court after finding that the habitual delays in the process constituted evidence of fraud by Kaiser. See *id.*

¹⁶⁸ See *Teleserve Sys. v. MCI*, 659 N.Y.2d 658 (N.Y. App. Div. 1997). Teleserve entered into an agreement to serve as MCI's agent in marketing MCI services. The court found unconscionable an agreement that included a clause providing for arbitration under the rules of the "Endispute" organization (in Washington, D.C.), which required a filing fee based on the amount in dispute, which in the case at bar would have amounted to \$ 204,000 on claimant's request for \$ 40,000,000 in compensatory damages.

¹⁶⁹ See *Renteria v. Prudential Ins. Co.*, 113 F.3d 1104 (9th Cir. 1997), and *Prudential Ins. Co. v. Lai* 42 F.3d 1299 (9th Cir. 1994). Both cases involved sexual harassment and discrimination claims by employees who signed "U-4" form (Uniform Application for Securities Industry Registration) on taking employment at securities firm. Both courts held that no knowing waiver of the right to litigate statutory claims occurred, notwithstanding the arbitration clauses contained in the form.

¹⁷⁰ See *Wilson v. Kaiser Found. Hosp.*, 190 Cal. Rptr. 649 (1983) (arbitration clause in medical agreement enforceable in claim for prenatal injuries by child who became member of health plan at birth). See also *Rojas v. TK Communications*, 87 F.3d 745 (5th Cir. 1996) (sexual harassment claim held arbitrable); *Stedor Enter. v. Armtex, Inc.*, 947 F.2d 727 (4th Cir. 1991) (enforcement of arbitration agreement in fabric sale confirmation even though document unread and unsigned); *Johnson v. Hubbard Broad., Inc.*, 940 F. Supp. 1447 (D. Minn. 1996) (arbitration agreement enforceable against former employee who brought race discrimination claim); *Golenia v. Bob Baker*

of mail-order goods.¹⁷¹ Employment contracts, particularly when implicating charges of discrimination, have supplied a particularly fertile ground to test the validity of arbitration agreements.¹⁷² Likewise, malpractice claims against hospitals and other health care organizations have fertilized legal development

Toyota, 915 F. Supp. 201 (S.D. Cal. 1996) (holding arbitrable a claim under Americans with Disabilities Act).

¹⁷¹ See, e.g., *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1148 (7th Cir. 1997) (arbitration clause in box containing computer ordered by mail and not returned within thirty days; court stated that "[a] contract need not be read to be effective."), *cert. denied*, 118 S. Ct. 47 (1997); *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996) (terms of arbitration clause inside software box).

¹⁷² See *Pryner v. Tractor Supply Co.*, 109 F.3d 354 (7th Cir. 1997) (holding discrimination claims related to race and age are arbitrable only if a worker explicitly consents; union cannot through collective bargaining agreement contract away an individual member's right to litigate statutory rights claims), *cert. denied*, 1997 WL 275009; *Cole v. Burns Int. Sec. Serv.*, 105 F.3d 1465 (D.C. Cir. 1997) (racial discrimination claim subject to arbitration, but employer may not require employee to pay arbitrators' fees). See also *Renteria v. Prudential Ins. Co.*, 113 F.3d 1104 (9th Cir. 1997); *Prudential Ins. Co. v. Lai* 42 F.3d 1299 (9th Cir. 1994); *Rosenberg v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 96-12267-NG, 1998 U.S. Dist. LEXIS 877 (D. Mass. Jan. 26, 1998) (discussed *supra* note 79). For background on arbitration of employment claims, see *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (allowing arbitration of age discrimination claims); *Alexander v. Gardner-Denver*, 415 U.S. 36 (1974) (employee may litigate discrimination claim notwithstanding arbitration clause in collective bargaining agreement). Among the grounds on which the Supreme Court in *Gilmer* distinguished *Gardner-Denver* was that the latter case involved a collective bargaining agreement (rather than an individual employment contract) which did not authorize the union to resolve statutory discrimination claims; in other words, consent to arbitration of the claim was lacking. The U.S. Equal Employment Opportunity Commission has also issued a policy statement taking the position that agreements which, as a condition of employment, impose binding arbitration of employment discrimination claims are "contrary to the fundamental principles evinced in" American employment discrimination laws. See EEOC Notice No. 915.002 (July 10, 1997).

in this area.¹⁷³ In all events, the voluntary nature of forum selection agreements tends to be a highly fact-specific matter.¹⁷⁴

In Europe, consumer protection regulations¹⁷⁵ have been applied to both pre-dispute and post-dispute arbitration agreements.¹⁷⁶ These regulations invalidate unfair contract terms which, depending on the circumstances, can include provisions that were not individually negotiated and which, to the consumer's detriment, cause a "significant imbalance in the parties' rights and obligations."¹⁷⁷ Similar restrictions designed to protect consumers have been written into jurisdiction and judgments treaties¹⁷⁸ and some national statutes.¹⁷⁹

¹⁷³ See, e.g., *Colorado Permanente Med. Group v. Evans*, 926 P.2d 1218 (1996) (Colo. 1996) (holding HMO arbitration clause unenforceable for failure to comply with statutory form requirement); *Madden v. Kaiser Found. Hosp.*, 17 Cal. 3d 687 (Cal. 1976) (reversing order denying arbitration and remanding for further proceedings); *Wheeler v. St. Joseph Hosp.*, 133 Cal. Rptr. 775 (Cal. Ct. App. 1976) (arbitration agreement not enforced). See also *supra* note 167, discussing *Engalla v. Permanente Med. Group*, 938 P.2d 903 (Cal. 1997), and *supra* note 170, discussing cases which found arbitration agreements enforceable.

¹⁷⁴ On consent in contract, see generally Randy E. Barnett, *Conflicting Visions: A Critique of Ian MacNeil's Relational Theory of Contract*, 78 V. L. REV. 1175 (1992); Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269 (1986). On consent to arbitration agreements in a labor contract, see Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83 (1996).

¹⁷⁵ See Council Directive 93/13/EEC, 1993 O.J. (L95) 29 (Apr. 21, 1993).

¹⁷⁶ For the extension of these regulations to arbitration in England, see Arbitration Act, 1996, § 89 (Eng.).

¹⁷⁷ U.K. Unfair Terms in Consumer Contracts Regulations (1994) §§ 3 & 4. Consumers include individuals acting for purposes outside their business. *Id.* § 2. One schedule to these Regulations contains an illustrative list of contract terms that may be regarded as unfair, and therefore non-binding. This list includes an oddly worded reference to terms that require consumers to "take disputes exclusively to arbitration not covered by legal provisions." Sched. 3, § 1(g). It is not immediately clear what is meant by this curious phraseology, lifted verbatim from the European Directive whose mandates were implemented by the British rules.

¹⁷⁸ See, e.g., *Bruxelles Convention on Jurisdiction and Enforcement of Judgments in Civil and Commercial Matters*, arts. 13-17, Sept. 27, 1968, as amended, 1990 O.J. (C 189) 1; and *Lugano Convention on Jurisdiction & Enforcement of Judgments in Civil & Commercial Matters*, 1988 O.J. (L 319) 9 (Sept. 16, 1988).

¹⁷⁹ Swiss statute provides for restricted enforcement of court selection clauses that "abusively" deny the protection of Swiss law, and gives consumers a right (not waivable until after a dispute has arisen) to sue a supplier either at the consumer's residence or

Moreover, some nations further restrict the use of both arbitration agreements¹⁸⁰ and court selection clauses¹⁸¹ in contracts not concluded between "merchants," a term of art including persons contracting in a commercial capacity.

The United States lags behind its European trading partners in addressing the matter of arguably abusive arbitration clauses. This lack of any statutory anti-abuse regime for arbitration in the United States¹⁸² has led to a lively dialogue among scholars concerning how fair and voluntary arbitration agreements really are,¹⁸³ particularly in securities transactions¹⁸⁴ and employ

the supplier's place of business. See *Loi fédérale sur le droit international privé*, arts. 5(2), 114 (Switz.).

¹⁸⁰ See, e.g., CODE CIVIL [C.CIV.], art. 2061 (Fr.) (generally prohibiting a pre-dispute arbitration clause (*clause compromissoire*)). Compare provisions allowing post-dispute agreements to arbitrate (*compromis*), C.CIV., art. 2060 (Fr.), as well as pre-dispute arbitration between merchants (*commerçants*), CODE DE COMMERCE [C.COM.], art. 631 (Fr.).

¹⁸¹ See NOUVEAU CODE DE PROCÉDURE CIVILE [N.C.P.C.], art. 48 (Fr.) (prohibiting court selection clauses unless concluded between merchants). Similar legislation exists in Germany with respect to forum selection clauses (*Gerichtsstandsklausel*) except between merchants (*Kaufleute*). See ZIVILPROZESSORDNUNG § 38 (Ger.).

¹⁸² In both the House and the Senate, however, bills are currently being considered to curb "involuntary application of arbitration" to employment discrimination claims. See Civil Rights Procedures Protection Act of 1997, S. 63 and H.R. 983, 105th Cong., 1st Sess., making, *inter alia*, the Federal Arbitration Act, 9 U.S.C. §§ 1-15 (1994), inapplicable to any claim of discrimination based on race, color, religion, sex, national origin, age or disability.

¹⁸³ See THOMAS CARBONNEAU, CASES & MATERIALS ON COMMERCIAL ARBITRATION, Ch. 7 (1997); Thomas Carbonneau, *Arbitration as Contract: One More Word About First Options v. Kaplan*, 12 (No. 3) MEALY'S INT'L ARB. REPS. 21 (March 1997); Thomas Carbonneau, *Le Torumoi of Academic Commentary On Kaplan: A Reply to Professor Rau*, 12 (No. 4) MEALY'S INT'L ARB. REPS. 35 (April 1997); Paul Carrington & Paul Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331 (1997); Thomas Carbonneau, *Arbitral Justice: The Demise of Due Process in American Law*, 70 TUL. L. REV. 1945 (1996); Thomas Carbonneau, *Beyond Trilogies: A New Bill of Rights and Law Practice through the Contract of Arbitration*, 6 AM. REV. INT. ARB. 1 (1995); Thomas Carbonneau, *Arbitration and the U.S. Supreme Court: A Plea for Statutory Reform*, 5 J. DISP. RESOL. 231 (1990).

¹⁸⁴ See, e.g., G. Richard Shell, *Fair Play, Consent and Securities Arbitration: A Comment on Speidel*, 62 BROOK. L. REV. 1365 (1996); Richard E. Speidel, *Contract Theory and Securities Arbitration: Whither Consent?*, 62 BROOK. L. REV. 1335 (1996); Jeffrey W. Stempel, *Bootstrapping and Slouching Toward Gomorrah: Arbitral*

ment contracts.¹⁸⁵ Some scholars have referred to proceedings under pre-dispute arbitration agreements as "compelled" arbitration,¹⁸⁶ implying lack of consent, notwithstanding that the contract was signed. And at least one Supreme Court Justice has labeled arbitration as "despotic decision making."¹⁸⁷ These thinkers thus resist limitations on judicial discretion to refuse enforcement of such litigation control devices, arguing that only mischief comes from recognizing a dispute resolution mechanism that may impose a forum predisposed toward the stronger contracting party, or facilitate avoidance of mandatory public policies.

When the rhetoric is moderated, the real terms of the debate might best be framed as whether public policy should allow *pre-dispute* consent to arbitration. The opportunity to seek justice in otherwise competent courts, it might be argued, is more fundamental than other contract terms, and thus should be non-waivable until *after* a controversy has arisen, when parties better understand specifically what is at stake. Under this approach, when a contract contains both an 8.75% mortgage rate and a renunciation of the mortgagee's right to her day in court, the latter term is so much more vital than the former as to be arguably incapable of abandonment until the contours of a precise dispute appear on the near horizon.

Complicating matters in the United States is a Supreme Court decision holding that state law may not impose on arbitration agreements requirements inapplicable to other contracts.¹⁸⁸ Consumer finance agreements, particularly credit card contracts, often provide that they may be altered upon written mailed notice to the consumer unless objection is made within a specified period, such as thirty days. A state law requiring an arbitration clause to be signed by both parties would arguably subject arbitration agreements to greater restrictions than

Infatuation and the Decline of Consent, 62 BROOK. L. REV. 1381 (1996).

¹⁸⁵ See Stephen J. Ware, *Employment Arbitration and Voluntary Consent*, 25 HOFSTRA L. REV. 83 (1996).

¹⁸⁶ See David S. Schwartz, *Enforcing Small Print to Protect Big Business: Employee and Consumer Rights Claims in an Age of Compelled Arbitration*, 1997 WIS. L. REV. 33 (1997).

¹⁸⁷ See *Mitsubishi Motors v. Soler Chrysler-Plymouth*, 473 U.S. 614, 657 (1985) (Stevens, J. dissenting).

¹⁸⁸ See *Doctor's Assoc. v. Casarotto*, 116 S. Ct. 1652 (1996) (holding that the Federal Arbitration Act preempts a state notice requirement requiring arbitration clauses to be on the first page of a contract), discussed *infra* at note 198.

applicable to other contracts, and thus run afoul of the Supreme Court ruling.¹⁸⁹

C. Multi-party and Multi-contract Problems¹⁹⁰

The rules of some arbitral institutions allow voluntary consolidation of related arbitrations.¹⁹¹ For better or for worse, however, the Federal Arbitration Act does not authorize forced consolidation of different arbitration proceedings, even if they present similar questions of law and fact.¹⁹² Therefore, a company may be whipsawed by inconsistent results in connected financial disputes, unless arbitration takes place in a state that does provide for forced joinder of related claims.¹⁹³ And when a dispute implicates a party that has not signed any arbitration clause at all, consolidation of claims may be not just difficult, but completely impossible.

An arbitration may occasionally include several parties on one side of the proceedings. For example, in a contractual relationship involving three companies, two entities might be co-defendants. In such a procedural configuration, particular care must be taken in establishing the arbitral tribunal. Conflict or stalemate may occur if two defendants must agree to share one party-

¹⁸⁹ This is exactly what happened in *Christine Williams v. Direct Cable and Beneficial National Bank*, a decision in which an Alabama Circuit Court granted a motion to compel arbitration pursuant to a "mail out change" to a credit agreement on the theory that to refuse enforcement to the modification would "place arbitration contracts in an inferior position to other contracts." See *Christine Williams v. Direct Cable and Beneficial National Bank*, No. CV-97-009 (Ala. Cir. Ct. for Henry County, Aug. 13, 1997).

¹⁹⁰ See generally Philippe Leboulanger, *Multi-Contract Arbitration*, 13 J. INT'L ARB. 43 (1996); Michael Mustill, *Multipartite Arbitrations: An Agenda for Lawmakers*, 7 J. INT'L ARB. 393 (1991).

¹⁹¹ See Arbitration Rules, London Court of Int'l Arb., art. 13.1 (1985) (Eng.).

¹⁹² See *United Kingdom v. Boeing Co.*, 998 F.2d 68 (2d Cir. 1993).

¹⁹³ See, e.g., MASS. GEN. LAWS, ch. 251, § 2A (1988) (calling for consolidation, as provided in the Massachusetts Rules of Civil Procedure, which permits joinder of actions "involving a common question of law or fact"). See also *New England Energy, Inc. v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988) (holding that federal courts sitting in Massachusetts may order consolidation of related arbitrations pursuant to state statute). Compare CAL. CIV. PROC. CODE § 1281.3 (West 1971), with ARBITRATION ORDINANCE, Ch. 351, § 6B (H.K.) (applicable to domestic arbitration), and CODE OF CIVIL ARBITRATION LAW PROCEDURE § 1046 (Neth.).

nominated arbitrator. Attempts to impose one arbitrator on two parties have sometimes been resisted as a denial of "equality of treatment."¹⁹⁴

D. Federal-State Conflicts

In the United States, federal arbitration law will usually preempt application of more restrictive state rules.¹⁹⁵ However, it is often unclear exactly which state laws will be considered restrictive, particularly when they have no analogue in the Federal Arbitration Act. For example, some courts refuse pre-award attachment in non-maritime arbitration, reasoning that by agreeing to arbitration parties have implicitly excluded intervention by national courts until an award is rendered.¹⁹⁶ Other courts view pre-award attachment as a way to maximize the efficiency of the arbitral process.¹⁹⁷

With respect to the initial formation of arbitration agreements, state law cannot discriminate against arbitration by erecting obstacles to the validity of arbitration clauses that do not apply to other contractual commitments. The United States Supreme Court recently struck down a state "notice requirement" calling for arbitration clauses to be in capital letters on the first page of the

¹⁹⁴ See, e.g., *Siemens and BKMI v. Dutco*, French Cour de Cassation, Ch. Civile No. 1 (Jan. 7, 1992), 1992 REV. ARB. 470.

¹⁹⁵ See *Doctor's Assocs. v. Casarotto*, 116 S. Ct. 1652 (1996); *Allied-Bruce Terminex Co. v. Dobson*, 513 U.S. 265 (1995). Preemption will not only occur in federal courts, but also in state court actions involving interstate commerce. See *Southland v. Keating*, 465 U.S. 1 (1984). For a study of federal-state conflicts engendered by state adoption of the UNCITRAL Model Law, see Alan S. Rau, *The UNCITRAL Model Arbitration Law in State and Federal Courts: The Case of Waiver*, 6 AM. REV. INT'L ARB. 223 (1995).

¹⁹⁶ See *McCreary Tire & Rubber Co. v. CEAT*, 501 F.2d 1032, 1038 (3d Cir. 1974) (denying pre-award attachment); *Cooper v. Ateliers de la Motobecane S.A.*, 442 N.E.2d 1239 (N.Y. 1982). See generally David Wagoner, *Interim Relief in International Arbitration*, DISP. RESOL. J. 68, 70 (Oct. 1996).

¹⁹⁷ See *Carolina Power & Light Co. v. Uranex*, 451 F. Supp. 1044 (N.D. Cal. 1977) (pre-award attachment allowed).

contract.¹⁹⁸ The Court found such threshold limitations on arbitration agreements undermined the goals and policies of the Federal Arbitration Act.¹⁹⁹

Aside from this limitation, state law generally governs whether, and what, two contracting parties agreed to arbitrate.²⁰⁰ Some authorities, however, argue that international arbitration agreements are subject to the law agreed upon by the parties, or to a supra-national standard that incorporates only "internationally recognized defenses" to contract enforcement, such as duress, fraud and waiver.²⁰¹

More rather than less conflict between federal and state law is likely, as some states attempt to implement consumer protection measures, and others enact their own international arbitration statutes in the form of the UNCITRAL

¹⁹⁸ See *Doctor's Assocs. v. Casarotto*, 116 S. Ct. 1652 (1996). For an application of *Doctor's Assocs.*, see *Huntington International v. Armstrong World Industries*, No. 97-CV-699, available in 1997 U.S. Dist. LEXIS 17514 (E.D.N.Y. Oct. 22, 1997) (arbitration clause in manufacturer's Terms and Conditions of Sale binding on plaintiff sales agent although not signed by sales agent), and *Little v. Allstate Ins. Co.*, 1997 WL 622739 (Vt. Oct. 10, 1997) (arbitration clause contained in insurance contract valid notwithstanding Vermont statute making arbitration clauses in insurance contracts revocable). For a critique of *Doctor's Assocs.*, see Stephen J. Ware, *Arbitration and Unconscionability After Doctor's Associates v. Casarotto*, 31 WAKE FOREST L. REV. 1001 (1996). A similar approach was taken in *Securities Ind. Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989).

¹⁹⁹ For a case applying this principle to a credit agreement, see *Christine Williams v. Direct Cable and Beneficial National Bank*, No. CV-97-009 (Ala. Cir. Ct. for Henry County, Aug. 13, 1997), discussed *supra* note 189.

²⁰⁰ See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995) (the Court, however, added a qualification to the effect that "courts should not assume that the parties agreed to arbitrate arbitrability [i.e., existence and scope of arbitrators jurisdiction] unless there is 'clear and unmistakable' evidence that they did so."). See also, *dicta* in *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). Analysis of the role of state law generally turns on the "savings clause" in Federal Arbitration Act § 2. See 9 U.S.C. § 2 (1994) (limiting enforcement of arbitration agreements by the qualification "save upon such grounds as exist at law or in equity for the revocation of any contract."). It is unclear from the text of § 2 whether federal or state law should supply the grounds "at law or in equity" for invalidating the arbitration clause. See *id.*

²⁰¹ See generally *Rhone Poulenc v. Achille Lauro*, 712 F.2d 50, 53 (3d Cir. 1983) (recognizing an arbitration clause notwithstanding possible invalidity under the peculiarities of Italian law); GARY BORN, *INTERNATIONAL COMMERCIAL ARBITRATION IN THE UNITED STATES* 269-77 (1994).

Model Law. The Federal Arbitration Act, unlike the arbitration law of several European countries, does not distinguish between domestic and international arbitration, nor does it shelter consumers from abusive arbitration agreements.

E. Arbitral Jurisdiction

1. The Consensual Foundation

An arbitrator's power derives from the consent of the parties to a dispute.²⁰² Absent this consent, commercial arbitrators will normally have no connection to the controverted events sufficient to justify deference to their authority.²⁰³ While parties to arbitration assume the risk that the arbitrator may get it wrong on the merits of the dispute, this does not mean that arbitrators – or would-be arbitrators – should have power to decide matters never submitted to them.

Judges get involved in determining the contours of arbitrator jurisdiction for the simple reason that the arbitral process exists in the shadow of public coercion. Directly and indirectly the state lends its power to enforce the agreement to arbitrate. Court proceedings are stayed; arbitral awards are given *res judicata* effect; and the loser's assets may be seized.

The integrity of the judicial system that enforces the arbitral process will of necessity require courts to examine arbitrator jurisdiction comprehensively and independently of the arbitrators' own ruling on their jurisdiction. There may be nothing wrong with a bit of decorative hypocrisy designed to show

²⁰² The state may, of course, supplement the parties' express mission to the arbitrator with standards of fairness and procedural regularity that are imposed as a condition for recognition of the arbitral award. But the origin of the arbitrator's power lies in an act evidencing the parties' intent to waive the otherwise applicable rules of judicial jurisdiction in favor of private adjudication.

²⁰³ So-called court-annexed arbitration within the United States rests on a different footing, of course. In reality this process usually constitutes conciliation more than arbitration, since the parties normally retain a right to a *de novo* trial. See 28 U.S.C. § 655 (1994). Also misleading is the label given to "arbitration" of minor claims mandated by some state statutes, whereby the state delegates (or maybe franchises?) its adjudicatory function to an organization such as the American Arbitration Association. See, e.g., Minn. Stat. § 65B.525 (1996) (requiring arbitration of motor vehicle accident claims not in excess of ten thousand dollars).

sensitivity to an arbitrator's pride. "Needless to say," a judge might write in his opinion, "we must give serious consideration to the distinguished arbitrator's views" – while all the time the judge is thinking that this is one of those awards that has to be seen to be believed. Such formal courtesies aside, however, judges must make up their own minds on jurisdictional matters. Shallow judicial examination of an arbitrator's jurisdiction can make little sense either in logic or in sound arbitration policy.²⁰⁴

The parties' intent must be the lodestar for allocating tasks between judges and arbitrators. Controversy over who decides what should be resolved by asking the question: "Did (or should) the parties expect that the particular issue would be decided by a court or by the arbitral tribunal?" Sometimes the right answer will be clear,²⁰⁵ while at other times reasonable people may differ.²⁰⁶ In no event, however, should a blanket presumption of arbitrability take the place of an inquiry into what exactly the parties agreed to arbitrate as interpreted in the context of the relevant transaction.

²⁰⁴ The type of limited inquiry that verifies only the "*prima facie* existence" of the arbitration clause may be fine for an arbitral institution deciding only whether to allow a claim to go to the arbitrator. But national courts reviewing arbitral awards should not confuse their role with that of the arbitral institution. Consider the problematic approach taken by the court in *Apollo Computer v. Berg*, 886 F.2d 469 (1st Cir. 1989). See also the case's sequel in *Hewlett-Packard v. Berg*, 61 F.3d 101 (1st Cir. 1995).

²⁰⁵ For example, it would be hard to imagine that an arbitrator would have power to determine the validity of his or her own appointment. If the contract says: "Arbitration under the rules of the International Chamber of Commerce," few if any courts would want to enforce an award rendered by arbitrators appointed by the American Arbitration Association. Likewise, arbitrators would not normally have the final word on whether an arbitration clause binds related entities. See, e.g., *Marathon Oil v. Ruhrgas*, 115 F.3d 315 (5th Cir. 1997).

²⁰⁶ Time bars to arbitration present the quintessential ambiguity about who decides a jurisdictionally-related issue. A brokerage firm might say that the stock purchase giving rise to the customer's complaint occurred in 1989, thus depriving the arbitrator of power to hear the case under a rule requiring claims to be brought within six years from the relevant event. The customer, however, might maintain that the relevant purchase occurred in 1990, thus making the claim eligible for arbitration. There is nothing inherently absurd about having the date of the securities purchase be decided either by an arbitrator or by a court. See discussion of time bars and *PaineWebber v. Elahi*, 87 F.3d 589 (1st Cir. 1996), *supra* notes 86-92.

2. Loan Workouts: A Case Study

How, when and by whom an arbitrator's jurisdiction is determined can have a critical impact on an arbitration. The United States Supreme Court has recently addressed this matter in *First Options of Chicago v. Kaplan*,²⁰⁷ a case that arose from an investment company's loan restructuring. The company, but not its shareholders, signed a workout agreement providing for arbitration of any disputes arising from the debt rescheduling. Nevertheless, an arbitral tribunal pierced the corporate veil to render an award against the owners as well as their company.

In considering the allocation of functions between judges and arbitrators, a unanimous Supreme Court affirmed a lower court ruling that the owners had not agreed to be bound to arbitration. The arbitrator's jurisdiction was a question for the courts.

The court in *First Options*, however, also suggested in *dicta* that in some cases courts must defer to the arbitrators' decision on their own jurisdiction.²⁰⁸ If the scope of arbitral jurisdiction was itself submitted to arbitration, the Court said, arbitrators' jurisdictional determination would be shielded from independent judicial scrutiny.²⁰⁹

While this *dicta* may make sense in some contexts, in most situations it says either too much or too little. If awards may still be reviewed for excess of

²⁰⁷ 514 U.S. 938 (1995). See generally William W. Park, *The Arbitrability Dicta in First Options v. Kaplan*, 12 ARB. INT'L 137 (1996).

²⁰⁸ The potentially troublesome *dicta* (which in some situations may eclipse the holding of the case) reads as follows:

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

514 U.S. 938, 943 (emphasis in original) (citations omitted).

²⁰⁹ The Court stated that, in such cases, review must be conducted according to the "narrow" standard found in Federal Arbitration Act § 10. See 9 U.S.C. § 10 (1994) (listing grounds for vacatur that include fraud, excess of authority, partiality or corruption, and arbitrator misbehavior prejudicing the rights of any party). See also 514 U.S. at 942.

authority under the Federal Arbitration Act, judicial deference to arbitrators' decisions on jurisdiction may be an illusion. On the other hand, lawyers straining to give meaning to the *dicta* might interpret the pronouncement so liberally (and incorrectly) to permit an inappropriate degree of arbitral autonomy.²¹⁰ On balance, this *dicta* on "arbitration of arbitrability" may lend itself to a series of misunderstandings that open the door to more problems than it resolves.

It has always been problematic to draw the thin line between an arbitrator's simple (and non-reviewable) error of fact or law, and an arbitrator's excess of authority (normally subject to judicial review). After *First Options*, however, judges will ask not only whether arbitrators exceeded their jurisdiction, but also whether the excess of jurisdiction deserves judicial deference.

An agreement giving arbitrators sole competence to rule on their own jurisdiction would make sense principally (perhaps only) when contained in a subsequent contract that provided for arbitration of a dispute about jurisdiction that had arisen under a pre-existing arbitration agreement. For example, a bank might assert that an arbitration clause bound a borrower's parent corporation as well as the subsidiary, on the theory that the subsidiary had contracted the loan as agent for the parent. Nothing would prevent the parent from agreeing, after the dispute arose, to ask an arbitrator to determine whether it was in fact bound by the arbitration clause. The arbitral tribunal to whose authority the parent has consented under the second agreement would be convened to determine whether the parent bound itself under the first agreement.²¹¹

²¹⁰ See, e.g., Kevin Flowers, *Note on First Options v. Kaplan*, 12 OHIO ST. J. ON DISP. RESOL. 801, 809 (stating that the *dicta* "may simply lead parties with powerful bargaining positions [like *First Options*] to include clearly worded clauses conferring jurisdictional decision-making authority on the arbitral tribunal."). The implication here is that the contract language would work to insulate from judicial review an arbitrator's arrogation of power over the Kaplans, notwithstanding lack of their signature on the relevant agreement. Yet it is hard to see how any change in contract language would bind shareholders to an arbitration agreement they never signed.

²¹¹ This is exactly what happened in *Astro Valiente Compania Naviera SA v. Pakistan Min. of Food & Agriculture (The Emmanuel Colocotronis)* [1982] (No. 2) 1 All E.R. 823 (1982).

3. Jurisdiction to Decide Jurisdiction

The question of who determines an arbitrator's jurisdiction is sometimes analyzed by reference to a much-misunderstood concept referred to as *compétence-compétence* (literally "jurisdiction on jurisdiction"), which links together a constellation of disparate notions about arbitrators' rulings on the limits of their own power. In its simplest form, "jurisdiction to decide jurisdiction" means only that there is no need to stop an arbitration in order to seek court review of jurisdictional matters arising during the proceedings.²¹² If a parent corporation objects to being joined to an arbitration on the theory that its subsidiary signed an agreement on its behalf, the arbitral tribunal can examine the agency question for itself. However, if the arbitrators decide they have power over the parent, this determination would normally be subject to *de novo* judicial review. Moreover, in most countries a court could examine the agency question even before an award is rendered, for example if a motion is made to stay litigation and/or to compel arbitration.

In France *compétence-compétence* is linked with a rule requiring delay of judicial review of arbitral jurisdiction until *after* an award is rendered. If an arbitral tribunal has not yet been constituted, court litigation can go forward only if the alleged arbitration agreement is clearly void (*manifestement nulle*).²¹³ And once an arbitral tribunal has begun to hear a matter, courts must wait to look at jurisdictional questions until the arbitrators have rendered their award.²¹⁴

Swiss law provides that an arbitral tribunal shall rule on its own jurisdiction, normally through an interlocutory decision,²¹⁵ and that objections to arbitral jurisdiction must be raised prior to any defense on the merits.²¹⁶ However, Swiss law contains nothing equivalent to Article 1458 of the French *Nouveau Code de Procédure Civile*, requiring courts to refrain from hearing challenges to the validity of the arbitration clause until the end of the arbitration. On the contrary, Swiss courts will verify the existence of an arbitration clause, at least in a summary fashion (*l'existence prima facie*), when asked to hear a dispute allegedly covered by an agreement to arbitrate.²¹⁷ Moreover, when the arbitral

²¹² See Christopher Brown v. Genossenschaft Österreichischer Waldbesitzer, [1954] 1 Q.B. 8, 12 (1984).

²¹³ See NOUVEAU CODE DE PROCÉDURE CIVILE [N.C.P.D.], art. 1458 (Fr.).

²¹⁴ See *id.*

²¹⁵ *Loi fédérale sur le droit international privé*, art. 186 (Switz.).

²¹⁶ See *id.*, art. 186(2).

²¹⁷ See *id.*, arts. 7 and 176.

seat lies outside of Switzerland, the Swiss *Tribunal fédéral* has recently called for a full examination of the validity of the arbitration agreement,²¹⁸ an inquiry which would generally occur at the time the clause is invoked in a Swiss court action on the merits of the dispute brought in disregard of the alleged arbitration clause.²¹⁹

To some extent, the issue here is one of timing. Court inquiry into arbitral jurisdiction at the beginning of the proceedings can save expense for a defendant improperly joined to the arbitration on the basis of a clause that is either invalid or too limited in scope. On the other hand, judicial resources may be conserved by delaying review until the end of the process, when the parties may have settled. In this connection, Article 16 of the UNCITRAL Model Arbitration Law gives the arbitral tribunal an explicit right to determine its own jurisdiction in the form of an interim award subject to challenge within thirty (30) days.

German courts and scholars in the past used the expression *Kompetenz-Kompetenz* to describe a type of "jurisdiction to decide jurisdiction" quite different from that known in the rest of the world, often leading to a considerable amount of confusion. *Kompetenz-Kompetenz* contemplated a situation not

²¹⁸ See *Compagnie de Navigation et Transports S.A. v. MSC Mediterranean Shipping Company S.A.*, ATF 121 III 38, 42 (Tribunal fédéral, Jan. 16, 1995) (Fr.) (stating "si le tribunal arbitral à son siège à l'étranger, le juge étatique suisse, devant lequel une exception d'arbitrage est soulevée, doit statuer sur ce moyen de défense avec plein pouvoir d'examen quant aux griefs soulevés, et en particulier celui déduit de l'article II al. 3 de la Convention de New York, sans pouvoir se limiter à un examen prima facie."). See also Jean-François Poudret and Gabriel Cottier, *Remarques sur l'Application de l'Article II de la Convention de New York*, 13 ASA BULL. 383 (1985). The authors question the decision, writing "Si cette solution doit certes être approuvée, la motivation qui la soutient repose toutes fois sur une distinction peu convaincante et même infondée" *Id.* at 387.

²¹⁹ The logic of this distinction seems to be that when arbitration occurs abroad, Swiss courts may not later get a chance to correct an arbitrator's erroneous decision about jurisdiction under the questionable agreement. For the attitude of Swiss courts towards post-award review of arbitrator jurisdiction, see *Transport-en Handelsmaatschappij "Vekoma" B.V. v. Maran Coal Company* (Civil Division I, Aug. 17, 1995) [hereinafter *Vekoma*], reprinted in 14 (No. 4) ASA BULL. 673 (1996) (commentary by Philippe Schweizer). The *Vekoma* decision is discussed in W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, *INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION* (3d ed. 1998).

unlike the *dicta* of *First Options v. Kaplan*,²²⁰ in which a contract might empower arbitrators to rule on their own jurisdiction in a binding way, without subsequent judicial review.²²¹ The proposed reform of German arbitration law (adopting the UNCITRAL Model Arbitration Law), however, is expected to eliminate this form of *Kompetenz-Kompetenz*.²²²

4. Separability²²³

Compétence-compétence analysis has sometimes been confused with the concept of "separability." Both legal doctrines deal with arbitral jurisdiction, but they remain functionally quite distinct.

The notion that an arbitration clause is "separable" or autonomous from the commercial agreement in which it is encapsulated permits arbitrators to invalidate the main contract (*e.g.*, for illegality or fraud in the inducement) without the risk that their decision will also invalidate the source of their power.²²⁴

The doctrine of separability does not, however, give the arbitrator the right to pass bindingly upon alleged infirmities in the arbitration clause itself. Courts can still hear arguments that the arbitration clause is invalid (whether *ab initio* or due to subsequent events such as rescission), and such arguments may

²²⁰ See *supra* text accompanying notes 207-11.

²²¹ See decisions of the Bundesgerichtshof discussed in PETER SCHLOSSER, *DAS RECHT DER INTERNATIONALEN PRIVATEN SCHIEDSGERICHTSBARKEIT* § 556 (1989).

²²² See *Entwurf eines Gesetzes zur Neuregelung des Schiedsverfahrensrechts*, July 1995, at 132 (commentary) (stating that after adoption of draft law § 1040 (the equivalent of UNCITRAL Model Law Art. 16), courts will always have the last word on arbitral jurisdiction).

²²³ For a recent codification of the separability doctrine, see Arbitration Act, 1996, § 7 (Eng.). The English Act carefully avoids the type of confusion that has arisen in some minds between separability and the doctrine of *compétence-compétence*, by also providing that English courts will not enforce an arbitration agreement that is "null and void, inoperative, or incapable of being performed." *Id.*, § 9(4).

²²⁴ Occasionally one hears suggestions that an estoppel doctrine could achieve the same goal, by deeming a party who participated in the arbitration to have waived the right to challenge the award. Such an approach, however, would not deal adequately with the common situation in which an arbitrator rules on several claims and/or counterclaims, but has jurisdiction only over some of them. Moreover, an estoppel or waiver doctrine would likely encourage boycott of arbitral proceedings.

usually be presented either at the beginning of the arbitration in a competing court action or after the award is rendered in an action to set the award aside.²²⁵

To illustrate the difference between separability and *compétence-compétence*, assume that an arbitration clause has been included in a "Consulting Agreement" entered into by an American bank seeking to obtain a license to operate in a foreign country. If the bank wished to resist arbitration, it might offer two defenses: (i) the person who signed the agreement was not authorized to do so, and (ii) the agreement was void because payments thereunder were earmarked to bribe government officials.

Separability notions would permit the arbitrators to find the main contract void for illegality without destroying their power to do so under the arbitration clause, but would not permit the arbitrators to decide whether the individual who signed the agreement was authorized to do so. On the other hand, *compétence-compétence* principles would permit the arbitrators to examine the validity of the signature, but would not save an award declaring the contract void for illegality.

Unfortunately, not all lawyers take care to distinguish separability from notions about the arbitrators' power to determine their own jurisdiction. One occasionally hears scholarly attacks on separability suggesting that the doctrine facilitates enforcement of agreements that are unconscionable or not based on informed consent.

Properly understood, however, separability should not prevent a party from resisting arbitration on the grounds of duress, unconscionability, lack of informed consent or arbitrator excess of authority. Notwithstanding the separability doctrine, courts can and do refuse to enforce an arbitration agreement tainted by duress, unconscionability, or a signatory's lack of

²²⁵ With respect to the timing of judicial review, France is the only major legal system that says courts must wait until the end of the arbitration to look at arbitral jurisdiction. See NOUVEAU CODE DE PROCÉDURE CIVILE [N.C.P.C], art. 1458 (Fr.).

authority,²²⁶ which render the clause itself void, voidable or otherwise inoperative.²²⁷

CONCLUSION

The identity of the person who will decide a financial controversy often matters as much as, or more than, the legal standards that purport to govern the merits of the dispute. Rules by themselves have little power to prevent an unjust decision by an antagonistic jury or a xenophobic judge. Neither will the fairest and most favorable decision mean much in practice unless it can be enforced against the loser's assets.

Against these twin concerns – biased adjudicators and unenforceable judgments – lawyers in the financial service industry increasingly are called to evaluate the relative reliability of arbitration agreements as contrasted to court selection clauses. The effectiveness of each of these dispute resolution mechanisms will depend largely on its context, both geographic and transactional.

²²⁶ See, e.g., *Three Valleys Mun. Water Dist. v. E.F. Hutton*, 925 F. 2d 1136 (9th Cir. 1991) (court determined whether individual who signed arbitration clause had requisite authority to do so); *Engalla v. Permanente Medical Group*, 938 P.2d 903 (Cal. 1997) (permitting customer of health care provider to rescind contract for fraud in the inducement after finding that care provider's self-administered arbitral system is inherently subject to delays favoring provider-defendant); *Teleserve Sys. v. MCI Telecomm.*, 659 N.Y.S.2d 659 (App. Div. 1997) (deciding claims of unconscionability and duress, in case involving a \$204,000 arbitral filing fee found unjust and unconscionable on its face). See also *Nicaragua v. Standard Fruit*, 937 F. 2d 469 (9th Cir. 1991) (involving a motion to compel arbitration of a dispute arising out of a Memorandum of Intent to produce and distribute bananas). The court stated that "although it was the court's responsibility to determine the threshold question of arbitrability, the district court improperly looked to the validity of the contract as a whole." *Id.* at 471. In other words, the lower court erred in not finding the arbitration clause valid because it considered the Memorandum non-binding with respect to the substantive obligations concerning banana production, and the binding effect of the Memorandum as a whole was for the arbitrators. For a discussion of consent and consumer contracts, see *supra* notes 169-89 and accompanying text.

²²⁷ The concept of an "inoperative" arbitration clause, while perhaps unfamiliar to American contract lawyers, is drawn from the language of Article II of the New York Arbitration Convention and some national arbitration statutes.

In some countries, court judgments will not benefit from enforcement treaties, nor will jurisdiction clauses receive dispositive effect from any statute. Moreover, court selection agreements may prove ineffective when judges are unable or unwilling to allow the parties to thrust a case upon the court, due either to limits on subject matter jurisdiction or to *forum non conveniens* notions.

On the other hand, the New York Convention, now in force in over one hundred countries, mandates enforcement of arbitration agreements and awards throughout the world. And *forum non conveniens* and subject matter jurisdiction limits are unlikely to prevent arbitrators from hearing a case, assuming their fees can be paid.

Arbitration, of course, suffers from its own sources of uncertainty. For example, in many jurisdictions there exists no easy way to consolidate related claims. And in some countries judicial decisions have unfortunately obscured the process for monitoring arbitrator excess of jurisdiction.

Before drafting a forum selection clause, therefore, counsel will need to focus on several questions. Can a judgment be rendered in a location where the debtor has assets? If not, will an international treaty enforce the judgment of a court with jurisdiction to hear the dispute? Is the debtor's country likely to impose exchange controls? Will the courts entertain lender liability or punitive damage claims against the banker? How costly and time consuming will a court action prove to be? Will summary judgment procedure be available to the lender?

Depending on the answers to these questions, an arbitration clause can sometimes prove more reliable and efficient than a court selection agreement. First, when a borrower's assets are located in countries that have not concluded judgment treaties with the expected litigation forum, the New York Arbitration Convention may be a more effective enforcement mechanism than local rules about enforcement of foreign judgments. Second, when loans are subject to possible exchange controls, an arbitration clause reduces the likelihood of an Act of State defense to loan enforcement. Third, an arbitrator may be more reasonable than a jury in considering a punitive damages claim, or a lender liability action against a banker who has refused to advance additional funds or extend the term of a loan. Finally, arbitration occasionally commends itself in resolving documentary credit disputes more efficiently, and with more expertise, than would a judicial proceeding.

The interplay of these diverse elements in financial transactions makes it dangerous to rely on a "one size fits all" dispute resolution clause, based on habit rather than informed analysis. Financial lawyers will need to learn to relish

a substantial amount of nuance in crafting dispute resolution clauses appropriate to the contours of each particular type of transaction. Solutions adopted now, when financial arbitration remains embryonic, will create a path of dependency that will affect reliability in financial transactions for years to come.

Appendix I: Model Arbitration Clauses

I-1. Commercial Loan Agreement

1. All differences, controversies or claims arising in connection with, or questions related to the present Loan Agreement shall be finally settled under the Rules of Arbitration of the London Court of International Arbitration (LCIA)²²⁸ by an arbitral tribunal composed of three arbitrators appointed in accordance with said Rules.
2. In all cases the Presiding Arbitrator shall be a lawyer fluent in English [and/or alternate language], experienced in international financial matters and not of the same nationality as either party.
3. The place of arbitration shall be [].
4. The language of the arbitration shall be [].
5. The parties hereby exclude any right of appeal to any court on the merits of the dispute.
6. Judgment on the award may be entered in any court having jurisdiction over the award or any of the parties or their assets.
7. This Agreement shall be governed and construed according to the laws of [legal system to govern merits of the dispute and/or reference to UCP 500 for documentary credit disputes], provided that any dispute relating to this arbitration agreement or its implementation, including any challenge to the arbitral award, shall be governed by the laws of [the arbitral situs].²²⁹ The arbitral tribunal shall not decide in *amiable composition*, *ex aequo et bono* or according to any other principles that substitute equitable considerations and

²²⁸ Alternative arbitral institutions include, by way of illustration, the International Chamber of Commerce, the American Arbitration Association and the *Chambre de Commerce et d'Industrie de Genève*.

²²⁹ For difficulties that can arise from failure to specify an appropriate law applicable to the arbitration agreement and procedure, particularly in a federal system, see *Volt v. Stanford*, 489 U.S. 468 (1989), and *Pepsico v. Oficina Central de Asesoría*, 945 F. Supp. 69 (S.D.N.Y. 1996).

fairness for the substantive law and/or rules applicable to the merits of the dispute.

8. Nothing contained in this arbitration clause shall prevent either party from seeking interim measures of protection in the form of pre-award attachment of assets, or from seeking injunctive relief to enforce in courts of competent jurisdiction rights related to pledges, mortgages and other security interests.

9. In the event that disputes arise under both this present Agreement and any other document or instrument executed in connection with the transactions contemplated hereby, or in the event any dispute arises implicating more than two parties, such disputes shall be resolved in a consolidated arbitral proceeding by a single arbitrator appointed by the LCIA.

Appendix I-2: World Bank General Conditions

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT GENERAL CONDITIONS APPLICABLE TO LOAN AND GUARANTEE AGREEMENTS

Article X, Section 10.04. Arbitration

(a) Any controversy between the parties to the Loan Agreement or the parties to the Guarantee Agreement, and any claim by any such party against any other such party arising under the Loan Agreement or the Guarantee Agreement which has not been settled by agreement of the parties shall be submitted to arbitration by an Arbitral Tribunal as hereinafter provided.

(b) The parties to such arbitration shall be the Bank on the one side and the Borrower and the Guarantor on the other side.

(c) The Arbitral Tribunal shall consist of three arbitrators appointed as follows: one arbitrator shall be appointed by the Bank, a second arbitrator shall be appointed by the Borrower and the Guarantor or, if they shall not agree, by the Guarantor; and the third arbitrator (hereinafter sometimes called the Umpire) shall be appointed by agreement of the parties or, if they shall not agree, by the President of the International Court of Justice or, failing appointment by said President, by the Secretary-General of the United Nations. If either side shall fail to appoint an arbitrator, such arbitrator shall be appointed by the Umpire. In case any arbitrator appointed in accordance with this Section shall resign, die or become unable to act, a successor arbitrator shall be appointed in the same manner as herein prescribed for the appointment of the original arbitrator and such successor shall have all the powers and duties of such original arbitrator.

(d) An arbitration proceeding may be instituted under this Section upon notice by the party instituting such proceeding to the other party. Such notice shall contain a statement setting forth the nature of the controversy or claim to be submitted to arbitration and the nature of the relief sought and the name of the arbitrator appointed by the party instituting such proceeding. Within thirty days after such notice, the other party shall notify to the party instituting the proceeding the name of the arbitrator appointed by such other party.

(e) If within sixty days after the notice instituting the arbitration proceeding, the parties shall not have agreed upon an Umpire, any party may request the appointment of an Umpire as provided in paragraph (c) of this Section.

(f) The Arbitral Tribunal shall convene at such time and place as shall be fixed by the Umpire. Thereafter, the Arbitral Tribunal shall determine where and when it shall sit.

(g) The Arbitral Tribunal shall decide all questions relating to its competence and shall, subject to the provisions of this Section and except as the parties shall otherwise agree, determine its procedure. All decisions of the Tribunal shall be by majority vote.

(h) The Arbitral Tribunal shall afford to all parties a fair hearing and shall render its award in writing. Such award may be rendered by default. An award signed by a majority of the Arbitral Tribunal shall constitute the award of such Tribunal. A signed counterpart of the award shall be transmitted to each party. Any such award rendered in accordance with the provisions of this Section shall be final and binding upon the parties to the Loan Agreement and the Guarantee Agreement. Each party shall abide by and comply with any such award rendered by the Arbitral Tribunal in accordance with the provisions of this Section.

(i) The parties shall fix the amount of the remuneration of the arbitrators and such other persons as shall be required for the conduct of the arbitration proceedings. If the parties shall not agree on such amount before the Arbitral Tribunal shall convene, the Arbitral Tribunal shall fix such amount as shall be reasonable under the circumstances. The Bank, the Borrower and the Guarantor shall each defray its own expenses in the arbitration proceedings. The costs of the Arbitral Tribunal shall be divided between them, borne equally by the Bank on the one side and the Borrower and the Guarantor on the other. Any question concerning the division of the costs of the Arbitral Tribunal or the procedure for payment of such costs shall be determined by the Arbitral Tribunal.

(j) The provisions for arbitration set forth in this Section shall be in lieu of any other procedure for the settlement of controversies between the parties to the Loan Agreement and Guarantee Agreement or of any claim by any such party against any other such party arising thereunder.

(k) If, within thirty days after counterparts of the award shall have been delivered to the parties, the award shall not be complied with, any party may: (i) enter judgment upon, or institute a proceeding to enforce, the award in any court of competent jurisdiction against any other party; (ii) enforce such judgment by execution; or (iii) pursue any other appropriate remedy against such other party for the enforcement of the award and the provisions of the Loan Agreement or the Guarantee Agreement. Notwithstanding the foregoing, this Section shall not authorize any entry of judgment or enforcement of the award against any party that is a member of the Bank except as such procedure may be available otherwise than by reason of the provisions of this Section.

(l) Service of any notice or process in connection with any proceeding under this Section or in connection with any proceeding to enforce any award rendered pursuant to this Section may be made in the manner provided in Section 11.01. The parties to the Loan Agreement and the Guarantee Agreement waive any and all other requirements for the service of any such notice or process.

Appendix I-3: European Bank Standard Terms

EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT STANDARD TERMS AND CONDITIONS

Article VIII, Section 8.04. Dispute Resolution

(a) The parties to the Loan Agreement and the Guarantee Agreement shall endeavor to settle amicably any dispute or controversy between them arising out of such agreements or in connection therewith. To this end, at the initiative of any party to either such agreement, the other party or parties shall meet promptly with the initiating party to discuss the dispute or controversy and, if requested by the initiating party in writing, shall reply in writing to any written submission made by the initiating party concerning the dispute or controversy.

(b) If any such dispute or controversy, or any claim relating thereto, cannot be amicably settled as provided for in subsection (a), it shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules in force at the time the arbitral proceedings commence, subject to the following:

(i) The number of arbitrators shall be three (3);

(ii) The appointing authority for the purposes of the UNCITRAL Arbitration Rules shall be the President of the International Court of Justice;

(iii) The place of arbitration shall be The Hague;

(iv) The language to be used in the arbitral proceedings shall be English;

(v) The law to be applied by the Arbitral Tribunal shall be public international law, the sources of which shall be taken for these purposes to include:

(A) any relevant treaty obligations that are binding reciprocally on the parties;

(B) the provisions of any international conventions and treaties (whether or not binding directly as such on the parties) generally recognized as having codified or ripened into binding rules of customary law applicable to states and international financial institutions, as appropriate;

(C) other forms of international custom, including the practice of states and international financial institutions of such generality, consistency and duration as to create legal obligations; and

(D) applicable general principles of law;

(vi) Notwithstanding the provisions of the UNCITRAL Arbitration Rules, the Arbitral Tribunal shall not be authorized to take any interim measures of protection or provide any pre-award relief against the Bank and none of the parties to the Loan Agreement or Guarantee Agreement may address to any judicial authority a request for any interim measures of protection or pre-award relief against the Bank; and

(vii) The Arbitral Tribunal shall have authority to consider and include in any proceeding, decision or award, any dispute or controversy properly brought before it by the Bank, the Borrower, the Guarantor or the Project Entity, insofar as such dispute or controversy arises out of the Loan Agreement or the Guarantee Agreement; but subject to the foregoing no other parties or other disputes shall be included in, or consolidated with, the arbitral proceedings.

(c) Notwithstanding the provisions of this Section, nothing contained in these Standard Terms and Conditions shall operate or be regarded as a waiver, renunciation, or other modification of any right, privilege, or immunity of the Bank under Chapter VIII of the Agreement Establishing the Bank or under any applicable laws.

(d) In any arbitral proceeding arising out of the Loan Agreement or the Guarantee Agreement, the certificate of the Bank as to any amount due to the Bank under this Agreement shall be *prima facie* evidence of such amount.

Appendix I-4: Multilateral Investment Guarantee Agency

GENERAL CONDITIONS OF GUARANTEE FOR LOANS

Article 3. Dispute Resolution and Applicable Law

3.1 Any dispute between the Guarantee Holder and MIGA arising out of or in connection with the Contract (other than disputes regarding the determination of the Reference Rate of Exchange under Article 15) shall be settled by arbitration in accordance with the Arbitration Rules.²³⁰ Arbitration proceedings shall be held in Washington, D.C.

3.2 No award may require MIGA to pay to the Guarantee Holder more than the Maximum Aggregate Liability plus interest under Article 22, and the cost of the arbitral proceeding.

3.3 The award of the Arbitral Tribunal shall be final and binding on the parties and enforceable in any court of competent jurisdiction. The parties shall carry out the award without delay.

3.4 Subject to Section 3.5, the Arbitral Tribunal shall apply the Contract and Convention, and to the extent that issues in dispute are not covered by the Contract or the Convention, general principles of law.

3.5 All provisions of the Contract shall be presumed to be consistent with the Convention and Operational Regulations. Such presumption may not be challenged by either MIGA or the Guarantee Holder.

²³⁰ The "Rules of Arbitration for Disputes under Contract of Guarantee of the Multilateral Investment Guarantee Agency" ("MIGA") provide for appointment of one arbitrator by each party, and the appointment of the president of the tribunal either on concurrence of both parties or by the Secretary General if concurrence is not possible. See MIGA Rules of Arbitration, arts. 10-11.

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