Arbitration in Banking and Finance

William W. Park

Boston University School of Law

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* Professor of Law, Boston University School of Law. Counsel, Ropes & Gray. Vice President, London Court of International Arbitration.

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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.”

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, or to courts of a major money center such as London or New York.

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 commercial and insurance 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.
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. 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.

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. 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-

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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. By contrast, neither mediation nor conciliation is legally binding; both may end up being little more than foreplay to litigation.

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

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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 Bruxelles\textsuperscript{11} and Lugano\textsuperscript{12} 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.\textsuperscript{13} While some countries might as a matter of “comity” enforce a foreign judgment,\textsuperscript{14} not all legal systems will be so generous.\textsuperscript{15}

\textsuperscript{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. \textit{See generally} \textsc{William W. Park, International Forum Selection} 46-49 (1995).
In contrast, a worldwide network of bilateral and multilateral treaties provides for the enforcement of arbitral awards. The most important of these treaties is the New York Arbitration Convention, which requires courts of over one hundred contracting states to enforce written arbitration agreements and the resulting awards, 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.

Many Latin American countries have adopted the Inter-American Arbitration Convention (often referred to as the Panama Convention), 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.

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”), covering disputes arising out of

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17 See infra notes 18-25 for discussion of the New York, Panama and Washington Conventions.
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.
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.
investment contracts between a host state and a foreign national. Investment treaties frequently contain consent to ICSID jurisdiction, and many define investment to include "all categories of assets," including claims to money.

B. Lender Liability

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," 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). 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 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 law or statute. Analogous regimes have been imposed in some Continental legal systems.

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.


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.").

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.

Article 60 of France's Loi No. 84-46, Jan. 27, 1984, provides "Tout concours à durée indeterminée, 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 Entreprise (1994) (unpublished thesis, Univ. of Paris) (on file with author).

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

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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.


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. 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.

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. Dufierco, 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, borrowers sometimes invoke these exchange controls as defenses to loan recovery, 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. Sometimes explained as a limit on judicial interference with the conduct of foreign affairs, 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.

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


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).


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

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.

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
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, with the character of an act determined by its nature rather than its purpose. 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.

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

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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. 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, 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.

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. 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, others do not. In particular, no American jurisdiction except

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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).
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;\textsuperscript{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.\textsuperscript{56}

Several United States Supreme Court decisions are often cited for the proposition that court selection clauses will be recognized.\textsuperscript{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.\textsuperscript{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.\textsuperscript{59}

Swiss law applies to the dispute.\textsuperscript{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).

\textsuperscript{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.").


\textsuperscript{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, which allows courts to refuse to enforce court selection clauses either in general or with respect to particular types of contracts. 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. 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. Whether a clause is exclusive (mandatory)

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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.


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. 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. The need for predictability in international business argues for the presumptive exclusivity of a court selection clause, 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, while others have taken the opposite view. 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.


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),\textsuperscript{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.\textsuperscript{71} This risk is particularly significant in a transaction between two foreign entities, when the controversy lacks sufficient connection with the state.\textsuperscript{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.

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

\textsuperscript{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).

\textsuperscript{72} See Universal Adjustment Corp. v. Midland Bank, Ltd. (Eng.), 184 N.E. 152 (Mass. 1933).
II. SECURITIES

A. Broker Misbehavior

Securities-related disputes involving broker-dealers now provide one of the most frequent occasions for arbitration in the financial services industry. 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. In Britain, by contrast, courts never displayed the same hostility toward arbitration of securities claims, probably because awards in domestic cases could traditionally be challenged on their legal merits.

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73 See generally Symposium, SEcurities Arbitration: A DEcade AFTer McMahaon, 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. CorporaL. 363 (1996); David E. Robbins, Seven Deadly Sins that Lead to Arbitration Disaster, in SECURITIES ARBITRATION 489, 489-96 (photo. reprint 1993).


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).

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. 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.

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).

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. Arbitration provides one way to reduce the risk of such damages.

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. In Mastrobuono v. Shearson Lehman Hutton 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.


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].


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

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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.


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 in 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).


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.

in the applicable substantive law. In some cases, of course, the applicable law itself might reserve to courts the matter of timeliness.\(^\text{92}\) 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 guarantees\(^\text{93}\) often find themselves bound by the dispute resolution clause in the principal contract.\(^\text{94}\) 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.\(^\text{95}\)

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. 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 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

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. 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. 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 SCHIEDSGERICHTE UND LEX MERCATORIA: RECHTSVERGLEICHENDER BEITRAG ZUR 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. 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. 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

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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

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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.


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.\textsuperscript{109} Arbitrators will generally benefit from immunity from suit for errors or omissions, while experts will not.\textsuperscript{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,\textsuperscript{111} while decisions of experts would fall outside the scope of such appellate schemes.\textsuperscript{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.\textsuperscript{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

\textsuperscript{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.


\textsuperscript{111} See, e.g., Arbitration Act, 1996, § 69 (Eng.).


\textsuperscript{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 Dominque Hascher discussing the award rendered in ICC Case No. 6535, involving a construction contract).
basic attributes of a judicial proceeding. In the United States,\textsuperscript{114} Britain,\textsuperscript{115} and on the Continent,\textsuperscript{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.\textsuperscript{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:


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


\textsuperscript{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

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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.\textsuperscript{122}

IV. DRAFTING THE ARBITRATION CLAUSE\textsuperscript{123}

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.\textsuperscript{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.\textsuperscript{125} In some cases defective clauses can be repaired by courts presuming the parties' intent

\textsuperscript{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. Republique 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.

\textsuperscript{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).

\textsuperscript{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).

\textsuperscript{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 missing or self-contradictory. The indeterminacy of the dispute resolution mechanisms, however, adds an unpleasant layer of contention to business relationships.

Some lawyers advocate pre-arbitration negotiation and mediation. 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.

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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).


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 procedural[131]), 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
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 ("GCCCI"), 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, the arbitral situs can by vacatur of an arbitral award impair (but not necessarily destroy) 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.  

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. 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. 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.

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

C. Unilateral Clauses

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. 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 féderale 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.).
143 See generally, HOWARD M. HOLTZMANN AND JOSEPH E. NEUHAUS, A GUIDE TO THE
UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION: LEGISLA-
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
148 For an example, see private sector lending practice of European Bank for Recon-
struction and Development.
lender may want to assess, after a dispute arises, whether extensive document-
tary 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.\textsuperscript{149} Other courts have been willing to enforce optional clauses.\textsuperscript{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.\textsuperscript{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

\textsuperscript{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.
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
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
arbiter's provision granting one party a unilateral option to arbitrate).

\textsuperscript{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,
39 (N.Y. 1989); Willis Flooring v. Howard S. Lease Const. Co., 656 P.2d 1184 (Alaska
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.

\textsuperscript{151} See discussion of exclusive and non-exclusive court selection clauses, supra note 65
and accompanying text.
unilateral jurisdiction selection, as does case law enforcing a contractual right to choose between several different courts.

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.

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. However, controls which do comply with the IMF Agreement must be respected.

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. 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.
a narrower interpretation of the IMF Articles limits its application to contracts that involve the swap of one currency for another.\textsuperscript{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 \textit{lois de police}), legitimate exchange controls would seem to be non-waivable.\textsuperscript{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.\textsuperscript{160} Some authors, however, have taken the position that the IMF Articles ought \textit{not} to constitute such a bar to the arbitrability of international loan disputes.\textsuperscript{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 \textit{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.

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\textsuperscript{159} See, \textit{e.g.}, \textsc{Bernard Audit}, \textit{Droit Int'l Privé} §§ 92-113 (1991); \textsc{Pierre Mayer}, \textit{Mandatory Rules of Law in International Arbitration}, 2 \textsc{ Arb. Int'l} 274 (1986); \textsc{Pierre Mayer}, \textit{Les Lois de Police Étrangères}, 1981 \textsc{J. Droit Int'l} 277 (1981).

\textsuperscript{160} See New York Convention, \textit{supra} note 18, arts. II(1), V(2)(a).

\textsuperscript{161} See Otto Sandrock, \textit{Internationale Kredite une die Internationale Schiedsgerichtsbarkeit}, 48 (Nos. 10,11) \textsc{Zeitschrift für Wirtschafts und Bankrecht} (Mar. 12, 1994); \textsc{William W. Park}, \textit{L'arbitrage et le recouvrement des prêts consentis à des débiteurs étrangers}, 37 \textsc{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 Consent\textsuperscript{162}

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.\textsuperscript{163} Some courts have refused to enforce arbitration clauses in consumer loan contracts.\textsuperscript{164} Others have upheld consumer finance arbitration agreements.\textsuperscript{165} The heart of the matter seems to be whether such arbitration agreements are genuinely consensual.\textsuperscript{166}

\textsuperscript{162} See also discussion of “separability” and \textit{compétence-compétence}, infra at Section V.E., which deals with the timing of how courts consider issues of consent and unconscionability.

\textsuperscript{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”). \textit{See} Rosenberg v. Merrill Lynch Pierce, 965 F. Supp. 190 (D. Mass. 1997) (discussed \textit{supra} note 79).


\textsuperscript{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.” \textit{See} Consumer Arbitration, 4 World Arb. & Mediation Rep. (BNA) 192, 193 (1993) \textit{quoting} Patricia Sturdevant, attorney for the plaintiffs in Badie v. Bank of America, 1994 WL 660730 (Cal.Super. 1994); \textit{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,\textsuperscript{167} and an arbitral regime requiring a disproportionately high filing fee,\textsuperscript{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,\textsuperscript{169} while other times recognizing the clause.\textsuperscript{170} At least two cases have enforced arbitration clauses packaged in boxes resolution.

\textsuperscript{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.

\textsuperscript{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.

\textsuperscript{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.

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


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).

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 all events, the voluntary nature of forum selection agreements tends to be a highly fact-specific matter.\textsuperscript{174}

In Europe, consumer protection regulations\textsuperscript{175} have been applied to both pre-dispute and post-dispute arbitration agreements.\textsuperscript{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."\textsuperscript{177} Similar restrictions designed to protect consumers have been written into jurisdiction and judgments treaties\textsuperscript{178} and some national statutes.\textsuperscript{179}


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

\textsuperscript{177} U.K. Unfair Terms in Consumer Contracts Regulations (1994) §§ 3 & 4. Consumers include individuals acting for purposes outside their business. \textit{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.


\textsuperscript{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 agreements and court selection clauses 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 States has led to a lively dialogue among scholars concerning how fair and voluntary arbitration agreements really are, particularly in securities transactions 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.


Some scholars have referred to proceedings under pre-dispute arbitration agreements as "compelled" arbitration, implying lack of consent, notwithstanding that the contract was signed. And at least one Supreme Court Justice has labeled arbitration as "despotic decision making." 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. 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


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

C. Multi-party and Multi-contract Problems

The rules of some arbitral institutions allow voluntary consolidation of related arbitrations. 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. 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. 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-

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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).


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

The Court found such threshold limitations on arbitration agreements undermined the goals and policies of the Federal Arbitration Act.\(^9\)

Aside from this limitation, state law generally governs whether, and what, two contracting parties agreed to arbitrate.\(^0\) 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.\(^1\)

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

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\(^{199}\) 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. Absent this consent, commercial arbitrators will normally have no connection to the controverted events sufficient to justify deference to their authority. 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

\footnotetext{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.}

\footnotetext{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.\(^\text{204}\)

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,\(^\text{205}\) while at other times reasonable people may differ.\(^\text{206}\) 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, 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. If the scope of arbitral jurisdiction was itself submitted to arbitration, the Court said, arbitrators’ jurisdictional determination would be shielded from independent judicial scrutiny.

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

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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. 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 jurisdic-
tion, 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. 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*). 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.

Swiss law provides that an arbitral tribunal shall rule on its own jurisdiction, normally through an interlocutory decision, and that objections to arbitral jurisdiction must be raised prior to any defense on the merits. 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. Moreover, when the arbitral

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, 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. 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

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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 statutaire 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 Article II de la Convention de New York*, 13 ASA BULL. 383 (1985). The authors question the decision, writing "Si cette solution doit certainement 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,\textsuperscript{220} in which a contract might empower arbitrators to rule on their own jurisdiction in a binding way, without subsequent judicial review.\textsuperscript{221} The proposed reform of German arbitration law (adopting the UNCITRAL Model Arbitration Law), however, is expected to eliminate this form of Kompetenz-Kompetenz.\textsuperscript{222}

4. Separability\textsuperscript{223}

\textit{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.\textsuperscript{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\textit{ab initio} or due to subsequent events such as rescission), and such arguments may

\textsuperscript{220} See \textit{supra} text accompanying notes 207-11.
\textsuperscript{221} See decisions of the BundesGerichtshof discussed in PETER SCHLOSSER, DAS RECHT DER INTERNATIONALEN PRIVATEN SCHIEDSGERICHTSBARKEIT § 556 (1989).
\textsuperscript{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).
\textsuperscript{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." \textit{Id.}, § 9(4).
\textsuperscript{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.\textsuperscript{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

\textsuperscript{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,\textsuperscript{226} which render the clause itself void, voidable or otherwise inoperative.\textsuperscript{227}

\textbf{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.

\textsuperscript{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) (invoking 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." \textit{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.

\textsuperscript{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) 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]. The arbitral tribunal shall not decide in amiable composition, ex aequo et bono or according to any other principles that substitute equitable considerations and

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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. Officina Central de Asesoria, 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. 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.

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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.
Appendix II: Selected Bibliography


CITY DISPUTES PANEL HANDBOOK (London 1994).


Dwight Golann, Taking ADR to the Bank: Arbitration and Mediation in Financial Services Disputes, 44 ARB. JOURNAL 3 (December 1989).


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