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TAX LIABILITY AND INARBITRABILITY IN INTERNATIONAL COMMERCIAL ARBITRATION

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I. INTRODUCTION

THE U.S. Supreme Court's case law on the arbitrability of claims has undermined the central function of the inarbitrability defense. The combined effect of the holdings in *Scherk v. Alberto-Culver Co.*[1] and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[2] on the international side, along with *Shearson/American Express, Inc. v. McMahon*,[3] *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[4] and *Gilmer v. Interstate/Johnson Lane Corp.*,[5] on the domestic side, has been to eliminate any identifiable boundary between the realm of contract and the domain of regulatory law, between private mercantile interests and the public interest of nation-states. The U.S. Supreme Court's position on the inarbitrability defense is influencing other jurisdictions to consider an equally unrestrictive view on the matter.[6] This evolution in the law of arbitrability seems to sustain the necessary autonomy of international arbitration and commerce, but also, it amounts to a misguided redefinition of the mission and function of arbitral adjudication.[7]

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1. 417 U.S. 506 (1974).
2. 473 U.S. 614 (1985).
3. 482 U.S. 220 (1987).
4. 490 U.S. 477 (1989).
5. 111 S. Ct. 1647 (1991).
6. On January 27, 1992, the French Committee on Arbitration held a conference on the topic of "Perspectives of Evolution in the French Law of Arbitration" in which major French experts in arbitration debated the continued viability of the inarbitrability defense. The proceedings of the conference will be published in *La Revue de L'Arbitrage* (forthcoming June 1992). Pierre Bellet, formerly Chief Judge of the French Court of Cassation and an organizer of the conference, appears to have advocated for aligning the French law of arbitrability with the developments in U.S. federal law. Although a progressive attitude toward international commerce in some respects, such a position deviates from the traditional commerce civilian approach to this issue.
7. For a thorough discussion of this development, see Richard E. Speidel, *Arbitration of Statutory Rights Under the Federal Arbitration Act: The Case for Reform*, 4 OHIO ST. J. ON DISP. RESOL. 157 (1989).

This essay engages in a narrow but crucial inquiry into the limits the inarbitrability defense may now impose upon the exercise of arbitral jurisdiction. While it is assumed that matters relating directly to status and capacity, testamentary dispositions, and title to immovable property fall outside the jurisdictional reach of international arbitrators, the question becomes whether any national regulatory laws, such as tax laws, benefit from the same status of inviolability.

The issue is far from abstract. The applicability of tax law and the allocation of its burden may significantly affect the economic viability of a contract for one or possibly both parties. However, with the increasing complexity of national tax laws, particularly as applied to international transactions, it is no longer practical to expect the parties fully to anticipate the impact of current legislation, let alone future enactments. In certain areas, such as financial products, tax law is unable to keep pace with developments in the market, thereby adding to the uncertainty.

The following hypothetical facts illustrate the problem with greater particularity. Assume a Japanese company licenses a patent to a U.S. manufacturer located in New Jersey; the companies enjoy successful commercial dealings for several years. Sometime thereafter, the U.S. Congress enacts an additional withholding tax on certain classes of royalty payment. The tax arguably applies to the payments being made by the New Jersey entity. The New Jersey company notifies the Japanese party of its intention to withhold the additional tax. The Japanese company refuses to accept any deduction, arguing that the new tax does not apply and, even were it applicable, it should be the responsibility of the payor. The New Jersey company cancels the contract pursuant to a "bad faith dealings" provision in the contract. The Japanese company then invokes the International Chamber of Commerce (ICC) arbitration clause contained in the contract, alleging an unjustifiable breach. The New Jersey party counters that the issue falls within the exclusive jurisdiction of the United States Internal Revenue Service (IRS). Furthermore, the New Jersey company requests that the arbitral tribunal stay the arbitration until the IRS or a federal court has ruled dispositively on the applicability of the tax. Should the tax law matter, inextricably linked to the would-be contract breach, be deemed inarbitrable and lead to a stay of the arbitration proceedings?

Throughout the following discussion, the U.S. law on arbitration and arbitrability is compared and contrasted to its French counterpart. Prior to the recent surge in arbitration cases before the U.S. Supreme Court,[8] the French law of arbitration was perhaps the most

8. *See supra* text accompanying notes 1-5.

liberal and advanced national law on arbitration.[9] It also appeared to maintain a sensible balance between the juridical order and the arbitral process, and a necessary distinction between the application of arbitral principles in matters of domestic and international commerce.[10] Finally, the discipline of the civilian edifice for the law left little doubt about the domain of the non-judicial process even in the context of international commerce. The contradistinctive French and American approaches illustrate not only the indeterminacy of solution to the problem posed by the hypothetical case, but also the significance of the problem to the integrity of arbitration law.

II. ARBITRATION GENERALLY

A well-settled principle of arbitration law is that arbitral tribunals, whether domestic or international, have the authority and right to rule upon challenges made to their jurisdictional capacity. As stated in Article 1466 of the French Code of Civil Procedure,[11] an arbitral tribunal may—pursuant to the *Kompetenz-Kompetenz* doctrine,[12] rule upon a claim that the arbitration agreement is invalid or that the issues submitted to arbitration fall outside the scope of the arbitration agreement. The conferral of such court-like powers upon arbitral tribunals is seen as necessary to protect arbitral proceedings from dilatory tactics and thereby preserve the adjudicatory autonomy of the arbitral process. Otherwise, parties whose interests were antagonistic to arbitration would attempt to delay the process by compelling court action on jurisdictional issues.[13]

It should be underscored, however, that *Kompetenz-Kompetenz* and other doctrines[14] establishing the autonomy of the arbitral process do not alter the basic mission of arbitration which is to serve as a mechanism for resolving contractual disputes. Furthermore, these

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9. THOMAS E. CARBONNEAU, ALTERNATIVE DISPUTE RESOLUTION 68-72 (1989).

10. *Id.* at 71.

11. Code de procédure civile [C. PR. CIV.] art. 1466 (Fr.).

12. Expressed variously as *compétence sur la compétence* or jurisdiction on jurisdiction, this concept describes the arbitral's authority to rule on jurisdictional challenges; this is a well-settled principle of arbitration law. *See* JEAN ROBERT, L'ARBITRAGE DROIT INTERNE DROIT INTERNATIONAL PRIVE (1983). It should be noted, however, that the doctrine of *Kompetenz-Kompetenz* is noticeably absent from the U.S. law of arbitration. Under section three of the Federal Arbitration Act, a court must decide whether a valid agreement to arbitrate exists, thereby allowing non-complying parties to delay the arbitration for six months to a year. 9 U.S.C. § 3 (1988).

13. *See generally* RENE DAVID, L'ARBITRAGE DANS LE COMMERCE INTERNATIONAL (1982); ROBERT, *supra* note 12.

14. One example is the separability doctrine under which the invalidity of the main contract does not necessarily affect the validity of the arbitral clause. *See also supra* note 12.

doctrines do not eliminate all legal restrictions upon the recourse to and exercise of arbitral justice. Indeed, under French law[15] and the 1958 New York Arbitration Convention,[16] the inarbitrability defense and the public policy exception are vital and indispensable legal barriers to an untoward expansion or assertion of arbitral jurisdiction. Article 2060 of the French Civil Code[17] provides: "One cannot agree to arbitrate matters of the status and capacity of persons, those relating to divorce and separation, or disputes involving public entities and establishments, and more generally on all matters touching public policy."[18]

Article II(1) and Article V(2)(a), (b) of the New York Convention provide:

> Article II
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> 1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.[19]
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> . . . .
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> Article V
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> . . . .
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> 2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
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> (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
>
> (b) The recognition or enforcement of the award would be contrary to the public policy of that country.[20]

III. CONTRACTUAL BORDER OF ARBITRATION

As represented by French law, the origin and culmination of arbitral jurisdiction is anchored in the right of contract. Arbitration is a

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15. *See* Bernard Audit, *A National Codification of International Commercial Arbitration: The French Decree of May 12, 1981*, *in* RESOLVING TRANSNATIONAL DISPUTES THROUGH INTERNATIONAL ARBITRATION 117 (Sixth Sokol Colloquium, Thomas E. Carbonneau ed., 1984); CARBONNEAU, *supra* note 9; ROBERT, *supra* note 12.

16. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 (codified at 9 U.S.C. §§ 201-208 (1982)) [hereinafter *New York Convention*]. *See generally* ALBERT VAN DEN BERG, THE NEW YORK ARBITRATION CONVENTION OF 1958 (1981).

17. CODE CIVIL [C. CIV.] art. 2060 (Fr.).

18. *See id.*; 22 J.O. 10190(1), 1986 D.S.L. 444 (repealing part relating to public entities).

19. *New York Convention*, *supra* note 16.

20. *Id.*

legitimate exercise of contractual freedom to establish a private form of justice and adjudication. Moreover, when freely entered into by parties of equal position, arbitration can be used to solve problems of contractual performance, breach, and interpretation.

As a standard part of arbitration law, the inarbitrability defense reinforces the fundamentally contractual character of the arbitral process. It provides that non-contractual issues, regardless of their implications for the transaction, cannot be submitted to arbitration because they impinge upon or involve directly matters of public law. By its very conception in the French Code, arbitration is seen as a product and tool of contract, as inapplicable to claims generated by regulatory law. The specific enumeration contained in Article 2060[21] (referring to the status and capacity of persons), when read in pari materia with the broad language of Article 2059[22] (referring to rights that persons freely dispose), demonstrates that inarbitrability appears to cover a broad range of rights created by statute to protect classes of persons and to safeguard the public interest.

It is difficult to picture how the regulation of arbitration could be otherwise. Arbitration must be protected from judicial interference to maintain its integrity as a process for resolving contractual disputes. However, its principal adjudicatory features make it entirely inapposite as a mechanism for resolving claims involving important social issues. These issues arise from statutes meant to reflect a societal consensus, to eradicate general social problems, or to protect disadvantaged parties. Arbitral justice is completely private; its decisions are never subject to a substantive review or appeal; and arbitrators are accountable basically to no one but the contracting parties. The public discussion and information, so vital to the content and effect of regulatory statutes, and to the norms they eventually generate, are completely absent from arbitration.

As a civil law statutory enactment, the French law on arbitration is comprehensive and thorough; it serves as a model law on arbitration in many parts of the civil law world. Nonetheless, it is a national law designed to regulate arbitrations that come solely within the orbit of French jurisdiction. However, the inarbitrability defense and public policy exception have been made a functional part of the international arbitral process through the provisions of the 1958 New York Arbitration Convention.[23] A signatory state is not obligated to enforce arbitration agreements or awards when they violate its public policy or

21. C. civ. art. 2060 (Fr.).
22. C. civ. art. 2059 (Fr.).
23. *See New York Convention*, *supra* note 16, art. V(2)(a), (b), 21 U.S.T. at 2520.

pertain to a subject matter deemed inarbitrable under its law.[24] French law on international arbitration endorses this reference to national law by recognizing the application of the public policy exception, while adapting it to the particular context of application by referring to "French *international* public policy."[25] Presumably, a foreign or an international arbitral award would be unenforceable in France if it dealt with an inarbitrable subject matter under French law, i.e., a matter covered by vital French regulatory statutes or *ordre public*.

In any event, the inarbitrability defense and other legal restrictions on the jurisdictional scope of arbitration are a recognized and functional part of the French civil law on arbitration and of the U.N. "universal charter" on international arbitration. The precise content of either restriction appears difficult to define (although clearly an arbitral award pronouncing a divorce between French parties or disposing of a French decedent's estate would be unenforceable in France). The general and most meaningful guide is the contractual rights restriction on Article 2059. Parties can agree to arbitrate those rights validly born of contract, but presumably not those conferred by the state through statutes or involving the public interest.

IV. THE EXPANDED SCOPE OF ARBITRAL JURISDICTION UNDER U.S. LAW

The statutory form of the American law of arbitration is less systematic and organized than its French analogue.[26] The U.S. Arbitration Act of 1925 (the "Act") contains no reference to either the inarbitrability defense or the public policy exception.[27] The grounds for the judicial supervision of awards is less complete than those contained either in French law or in the New York Convention. Section two of the Act contains only an oblique reference to the contractual character of arbitration.[28] In this regard, the Act is typical of the traditional distinction between common law and civil law statutory enactments in that the federal statute has a meager regulatory scope and leaves much of its content to be elaborated subsequently through case law.[29]

In fact, the case law accompanying the American statute has added significantly to the content of the federal legislation. The federal

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24. *Id.*

25. *See* CARBONNEAU, *supra* text accompanying note 9.

26. *See* CARBONNEAU, *supra* note 9, at 105-6.

27. Federal Arbitration Act, ch. 213, §§ 1-15, 43 Stat. 883-86 (1925)(current version at 9 U.S.C. §§ 1-14 (1988)).

28. *Id.* at § 2.

29. *See generally* CARBONNEAU, *supra* note 9, at 107-39.

courts have created a "strong [and emphatic] federal policy favoring arbitration."[30] The separability doctrine is a product of judicial construction.[31] Moreover, the courts have recognized a common law public policy exception, but limited its application essentially to labor arbitrations.[32] Finally, decisions pertaining to inarbitrability have only dealt with defining circumstances in which the defense is inapplicable.[33] The initial cases involved matters of international arbitration; subsequent cases have eradicated any distinction between international and domestic arbitration and proclaimed a rule of broad application of arbitrability for all forms of disputes.[34]

Under American law, regulatory disputes or statutory claims that attend contracts containing an arbitration clause can be submitted to arbitration. Specifically, courts have held the following matters arbitrable under U.S. law: antitrust disputes,[35] claims arising under the 1933 Securities Act and the 1934 Securities and Exchange Act,[36] civil violations of RICO,[37] and age discrimination claims.[38] Moreover, a bankruptcy proceeding will not impede the reference to arbitration.[39] Congressional legislation allowing the arbitration of patent disputes and the enactment of the two sections fifteen of the U.S. Arbitration Act[40] appear to lend Congressional support for and approval of the

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30. *Id.* at 110-14.

31. *Id.* at 107-10.

32. *See, e.g.*, Thomas E. Carbonneau, *Arbitration and the U.S. Supreme Court: A Plea for Statutory Reform*, 5 OHIO ST. J. ON DISP. RESOL. 231 (1990); *see also* Thomas E. Carbonneau, *The Reception of Arbitration in United States Law*, 40 ME. L. REV. 269 n.27 (1988).

33. *See* Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).

34. *See* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989); Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987).

35. *Mitsubishi*, 473 U.S. at 629.

36. Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974).

37. *McMahon*, 482 U.S. at 232-33.

38. Arnulfo P. Sulit, Inc. v. Dean Witter Reynolds, Inc., Fed. Sec. L. Rep. 92, 775 (1986), *rev'd*, 847 F.2d 475 (8th Cir. 1988).

39. Sonatrach v. Distrigas Corp., No. 86-2014-Y (D. Mass. Mar. 17, 1987).

40. 9 U.S.C. §§ 15-16 (1988). There were two sections enacted in 1988 with the number 15. The present one, on the Act of State doctrine, remains § 15. A 1990 amendment separated the second one, on appeals, and makes it § 16:

> § 15. Inapplicability of the Act of State doctrine.
>
> Enforcement of arbitral agreements, confirmation of arbitral awards, and execution upon judgments based on orders confirming such awards shall not be refused on the basis of the Act of State doctrine.
>
> § 16. Appeals.
>
> (a) An appeal may be taken from—
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> (1) an order—
>
> (A) refusing a stay of any action under section 3 of this title,
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> (B) denying a petition under section 4 of this title to order arbitration to proceed,
>
> (C) denying an application under section 206 of this title to compel arbitration,

work of the federal courts in the area of arbitration. The chief motivation for the judicial liberality in regard to arbitration appears to lie less in an understanding of the arbitral process than in a desire to clear the federal dockets and achieve efficient factual judicial management.

Notwithstanding the problems the federal court position on arbitration portends for the U.S. legal system, it remains unclear whether any subject areas are inarbitrable under U.S. law. It is also unclear what influence the American position should have upon international arbitration practice. However it is gauged ultimately, the U.S. position ignores the contractual origin and mission of the arbitral process and, as a consequence, restricts and perhaps eliminates a vital institutional and definitional barrier between the legal system and arbitration. Federal court enthusiasm for unfettered arbitration is expressly founded upon the mistaken view that any legal restriction of arbitration is tantamount to judicial hostility. Historically, the success of arbitration in specialized areas has been linked to its adjudicatory attributes: the provision of expertise, neutrality, privacy, flexibility, and finality. None of these attributes are as functional in the context of adjudicating regulatory disputes. In fact, some of them may be contraindicated.

Justice Stevens' dissents in several of the U.S. Supreme Court opinions on arbitrability illustrate the magnitude of the Court's misunderstanding of the process and attest to the dangers of overweening arbitral jurisdiction.[41] Arbitration is not a "formula for world peace;" it has its primary application in matters of contract. As to international arbitration specifically, Professor Hans Smit,[42] an authority in the area and himself an international arbitrator, has strongly argued that the virtual elimination of the inarbitrability defense in *Mitsubishi* and the extension of arbitral jurisdiction to include statutory claims

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(D) confirming or denying confirmation of an award or partial award, or
(E) modifying, correcting, or vacating an award;
(2) an interlocutory order granting, continuing, or modifying an injunction against an arbitration that is subject to this title; or
(3) a final decision with respect to an arbitration that is subject to this title.
(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order—
(1) granting a stay of any action under section 3 of this title;
(2) directing arbitration to proceed under section 4 of this title;
(3) compelling arbitration under section 206 of this title; or
(4) refusing to enjoin an arbitration that is subject to this title.

41. *See* CARBONNEAU, *supra* note 9, at 294-297.

42. Fuld Professor of Law and Director, Parker School of Foreign and Comparative Law, Columbia University.

could significantly hinder the arbitration of international contract claims. Smit recognizes that international arbitrators are not judges vested with the political authority to guard a national public interest; they are commercial experts whose task is to discover and implement commercial justice in disrupted transactions. The incorporation of regulatory claims arising under national law into international arbitral jurisdiction simply exceeds the rationale for the process and is likely to frustrate its functional operation and underlying gravamen.[43]

However, other international experts have endorsed the emerging hegemony of arbitration.[44] They have argued variously that: claims of national statutory violations could be an attempt to delay the day of reckoning; international arbitrators are often distinguished jurists, able to acquaint themselves with and understand foreign statutory law; and bifurcating issues or staying arbitral proceedings might reduce the general efficacy of international arbitration. It is further argued that a commercial divorce is as unpleasant and as contentious as its personal counterpart and requires a unitary tribunal that can rule upon all the relevant issues.

V. A Critique and Recommendation

None of these arguments carries the weight of conviction. They sustain a perspective on arbitral jurisdiction that privileges the factor of functionality and ignores the fundamental issue of legitimacy. Working together, courts and arbitral tribunals could surely unmask the specious statutory claim. The resolution of regulatory disputes involves not only jural and commercial expertise, but also the exercise of political judgment and the making of value choices. International arbitrators, often alien to the political culture that gave rise to the enabling statutes, would not in a larger sense be accountable for the choices they make. Finally, international commercial arbitrations are no longer simple and efficient proceedings. The formality and complexity of ordinary litigation practices have begun to inform the arbitral trial. Increasing sophistication could well command the reference of certain claims to another, more appropriate forum for decision.

To some extent in both domestic and international arbitrations, the issue of arbitrability is parallel to the question of whether arbitrators

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43. Hans Smit, *Mitsubishi: It Is Not What It Seems To Be*, 4 J. Int'l Arb. 7 (1987).

44. *See* Andreas F. Lowenfeld, *The Mitsubishi Case: Another View*, 2 Arb. Int'l 178 (1986); William W. Park, *National Law and Commercial Justice: Safeguarding Judicial Integrity in International Arbitration*, 63 Tul. L. Rev. 647 (1989).

can award extraordinary relief in the form of punitive damages.[45] Both problems implicate the contractual character of arbitration and illustrate the tendency to expand the reach of arbitral jurisdiction. The basic rule under U.S. law is that arbitrators may award punitive damages provided they are authorized to do so specifically in the arbitration agreement.[46] In other words, unless the parties to the arbitration agree to an exceptional grant of authority, the awarding of non-contractual relief is prohibited in arbitration because the arbitrators have a purely contractual authority. The rule intermediates between the concern for the legitimacy of arbitration and the popular trend of expanding willy-nilly the province of arbitral jurisdiction. It remains difficult to reconcile even this moderate rule with the civil law view that the parties' right to arbitrate is circumscribed to the legal rights over which they have free legal disposition. Granted exceptionally by courts, punitive damages have always been seen as a type of public law sanction and emanating from the judiciary's sovereign political authority to impose legal penalties upon particularly egregious individual behavior.[47]

A similar rule could be adopted for purposes of resolving the arbitrability question. When a valid agreement to arbitrate exists, arbitrators would have jurisdiction to rule upon contractual disputes falling within the scope of the submission to arbitration. Non-contractual claims, such as those arising from national statutes, could not be submitted to arbitration unless the parties in their agreement specifically authorized the arbitrators to rule upon such issues. In fact, the reaction to the U.S. Supreme Court's rulings on arbitrability, national and international, is likely to include a more careful drafting of arbitration agreements, the avoidance of standard clauses, and a specific or relatively specific determination of the extent of the arbitral tribunal's jurisdiction as to damages and subject matter jurisdiction.

The removal of arbitrability determinations from the purview of courts and arbitral tribunals and their placement within the contractual bargaining authority of the parties makes contract negotiations and deal-making more onerous, but, on the other hand, allows some leeway for imposing necessary restrictions, albeit purely transactional, upon the exercise of arbitral subject matter jurisdiction. The integration of such a rule into international arbitral practice would be part of

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45. Willis v. Shearson/Am. Express, Inc., 569 F. Supp. 821 (M.D.N.C. 1983); Garrity v. Lyle Stuart, Inc., 40 N.Y.2d 354, 353 N.E.2d 831 (1976). *See* CARBONNEAU, *supra* note 9, at 292-294. *But see Punitives Not Available in N.Y. Arbitration*, 6 INT'L ARB. REP. 12 (Nov. 1991).

46. Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc., 598 F. Supp. 353 (N.D. Ala. 1984); *see also* CARBONNEAU, *supra* note 9, at 292-294.

47. *See* CARBONNEAU, *supra* note 9, at 292.

a general trend toward privatizing many aspects of transnational commerce and toward having the exercise of contractual freedom replace the usual role of conflict of laws. Such a development has been in evidence for some time in international arbitration and is now surfacing in the context of the extraterritorial application of securities laws.[48]

VI. A Further Critique

As applied to the circumstances of the hypothetical case involving the Japanese and New Jersey companies, this rule argues for a stay of the arbitral proceeding pending action by the U.S. tax courts or tax agency, provided the arbitral tribunal deemed the issue of tax liability to be material to the resolution of the contractual issues. In their arbitration agreement, the parties did not authorize the arbitrators specifically to rule on regulatory or non-contractual claims that surfaced in the transaction. Such a determination would pay due heed to the party autonomy principle and to the contractual nature of the arbitral tribunal's jurisdictional investiture.

However, despite its salutary results, such a solution is too muffled and evasive a response to the central problem posed by the arbitrability issue in this case. No matter how successful and essential international arbitration may have been to transnational commerce, it cannot derogate from all aspects of national law. National sovereignty and its acquiescence to private adjudication remain indispensable to the legitimacy and continued vitality of arbitration. It is one thing to allow contracting parties to create their own justice systems to resolve their private contractual disputes and to permit arbitrators to rule as *amiable compositeurs*[49] and generally to fabricate a new law merchant on a completely ad hoc and de facto basis.[50] It is quite another matter to eradicate completely the relevance of national law in the international arbitral process and to allow a purely private form of adjudication, which is not accountable to national legal communities, to interpret and implement mandatory provisions of national public law. The point is simple: national regulatory law, imbued with political content

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48. *See* Michael P. Malloy, *Internationalization of the Securities Markets*, 12 Md. J. Int'l L. & Trade 103 (1987) (book review); *see also* J. Arthur Urciuoli, *Major Markets and Financing Mechanisms*, *in* Financing in the International Capital Markets Seventh Annual Fordham Corporate Institute 18-20 (Howard T. Sprow, ed., 1980).

49. *See* E. Loquin, L'amiable Composition en Droit Compare et International: Contribution a L'etude du Non-Droit Dans L'arbitrage Commercial (1980); *see also* Jean Robert & Thomas E. Carbonneau, The French Law of Arbitration § 6.02 (1983).

50. For a thorough discussion of the development of modern lex mercatoria, *see generally* Lex Mercatoria and Arbitration (Thomas E. Carbonneau ed., 1990).

and choices and embedded in the *sui generis* character of particular national societies, is simply beyond the purview of private, contractual justice. Until sovereign states agree through the framework of an international treaty either that international arbitrators have expanded subject matter jurisdiction or provide for truly international regulatory laws (relating to antitrust, securities transactions, corporate bribery, or RICO-like problems), national courts should retain exclusive jurisdiction over matters that trigger bona fide claims based upon the provisions of national regulatory law. Otherwise, international arbitrators would be not only the architects of a new law merchant, but a self-appointed and unaccountable community of international legislators.

VII. A Final Recommendation

The U.S. Supreme Court has advocated for a wide concept of arbitrability, making essentially all claims arising in the context of an international transaction arbitrable.[51] The Court has also advocated for court supervision of the arbitral resolution of statutory claims at the enforcement stage of the award.[52] The second-look doctrine,[53] articulated by the Court, is dysfunctional in the context of international arbitration for a number of reasons. First, it provides national judicial scrutiny of statutory claims arising under national law by pure happenstance. The assets of the award-debtor whose statutory claim was misconstrued, discounted, or eliminated by the arbitral tribunal, may not be located in the country of the law giving rise to the claim. Further, the doctrine assumes the arbitration will proceed to finality and will then be challenged by the relevant party.

Second, if judicial supervision is available and forthcoming, its exercise at this late stage of the arbitral process is likely to render it unrigorous and fairly meaningless. Courts are not likely to overturn an adjudication that is basically concluded. Third, the Court's second-look doctrine amounts to a merits review of those aspects of the award that deal with statutory claims. The prospect of any judicial supervision of the merits of arbitral awards is manifestly against the spirit and letter of the New York Convention and the modern development of international commercial arbitration. It amounts to recom-

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51. *See* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477 (1989); Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220 (1987); Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985).

52. *Mitsubishi*, 473 U.S. at 626.

53. Thomas E. Carbonneau, *Arbitration and the U.S. Supreme Court: A Plea for Statutory Reform*, 5 Ohio St. J. on Disp. Resol. 231, 269-272 (1990).

mending an untoward judicial intrusion that clearly undermines the autonomy of the arbitral process. Finally, it is unlikely the Court's suggestion of a second-look doctrine was intended as a serious solution to the Court's evisceration of the inarbitrability defense and the concomitant demise of national law in international commercial arbitration. Rather, it was integrated into the opinion to allay concern about the consequences of the Court's ruling.[54]

A more feasible means of achieving a necessary balance between the autonomy of arbitration and the integrity of national law is to institute a certification procedure between arbitral tribunals and national courts when the arbitral tribunal determines a legitimate claim has been stated under national statutory law and is material to its ruling on the contract claims. Alternatively, the arbitral tribunal could request the national court to rule on whether a valid statutory claim has been raised under the applicable law. This eliminates the criticism that parties could raise false statutory claims in a dilatory end simply to frustrate the recourse to arbitration and complicate the adjudication. When a valid statutory claim is raised, the matter should be referred to the national court and the arbitral tribunal should evaluate the impact of the reference upon the adjudication of the contractual claims.

The certification of statutory claims to national courts by international arbitral tribunals would avoid the destructive consequences upon national sovereign authority. It also would further the spirit of mutuality between national law and the international arbitral process that has been at the heart of the arbitral process' success and legitimacy. A certification procedure would establish a type of federalism relationship between the state judicial process and the international arbitral process. This procedure, akin to the one existing between state and federal courts, would simultaneously maintain the autonomy of the arbitral process and the legitimate position of national sovereigns. Also, it would have the considerable benefit of attributing clear definition to the jurisdictional mandate of international arbitrators and maintaining the private, consensual, and fundamentally contractual character of arbitral adjudication.

VIII. Actual Practice

A few of the reported or summarized ICC awards focus upon the question of arbitrability.[55] The general rule in these awards does not

54. *See* Thomas E. Carbonneau, *The Exuberant Pathway to Quixotic Internationalism: Assessing the Folly of Mitsubishi*, 19 VAND. J. TRANSNAT'L L. 265, 284-285 (1986).

55. *See, e.g.*, Editrice Giochi Srl (Italy) v. CTG Products Corp. (U.S.A.), Int'l Comm.

exhibit a high level of sophistication in dealing with the arbitrability of disputes. The consideration appears to center upon elaborating a few reasons to justify the foregone conclusion of arbitral jurisdiction because to determine otherwise would impair the autonomy of arbitration. According to the leading treatise on ICC arbitration,[56] a trend exists among ICC awards holding that arbitrators can maintain their jurisdiction when one of the parties argues that the transaction violates a public policy provision of national law or of an international treaty. The reason advanced in the awards is that the arbitrator's contractual jurisdiction remains intact to resolve the consequences of an alleged public policy violation.[57] A negative ruling here, it is alleged, would imperil the efficacy of the arbitral clause, be contrary to good faith bargaining in some instances, and might violate the principle of *pacta sunt servanda*. According to these awards, the national interest asserted through regulatory law is sufficiently protected by the limited right of review afforded to national courts under the New York Convention. These rulings have surfaced in awards dealing with state concession contracts over natural resources,[58] bankruptcy,[59] and the application of EEC anti-competition law.[60]

Like the rulings of the U.S. Supreme Court, these determinations exhibit a pathological concern for the frailty of arbitral jurisdiction and of the institution of arbitral adjudication. The slightest deviation from an unyielding, absolute, and exclusive reference to arbitration perforce will result in the entire dismantling of the arbitral process. Accordingly, the reach of national law must always succumb to the hegemony of the arbitral institution and the arbitral jurisdictional mandate. In the context of a public policy allegation, arbitrators (to reinforce this position) have attempted to draw an elusive distinction between the parties' agreement to submit to arbitration (regulated by contract) and the rules to be applied in the resolution of disputes that attend the contract (always falling within the arbitrator's discretion). Following this reasoning, it appears that all disputes become arbitrable once the parties have agreed to arbitrate (even before the content

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Arb. Binder ** bk. 11A at 8 (W. Laurence Craig, et al. eds., 1986); French Construction Consortium v. Atomic Energy Organization of Iran, Int'l Comm. Arb. Binder ** bk. 11A at 11; *see also* RECUEIL DES SENTENCES DE LA CCI [Collection of ICC Arbitral Awards] 217-224, 341-346, 530-536 (Sigvard Jarvin & Yves Derains eds., 1990); 8 ICC Y.B. COM. ARB. 94-117 (Pieter Sanders ed. 1983).

56. *See* W. LAURENCE CRAIG ET AL., ICC ARBITRATION (2d ed. 1990).

57. *Id.* at 86-91.

58. *See* ICC Y.B. COM. ARB., *supra* note 55, at 89.

59. *See* RECUEIL DES SENTENCES ARBITRALES DE LA CCI, *supra* note 55, at 530.

60. *Id.* at 341.

of any dispute is known). National courts have rarely been so extravagant in deciding the reach of their own authority. One arbitrator, ruling on the issue of arbitrability in the context of EEC anti-competition law, did, however, make the sensible suggestion that such matters should be submitted as an interlocutory question to the European Court of Justice in order to allow for uniform interpretation and application of the law.[61]

Most of the available ICC arbitral rulings on arbitrability have been rendered in the context of state concession agreements, bankruptcy, and anti-competition law. These issues typically arise in the setting of commercial transactions and involve legal dispositions and processes which are familiar to commercial parties and lawyers. Allowing sovereign parties to abrogate contracts at will, upon a change of government or of the economic climate, is obviously antithetical to the interests of international commerce. Moreover, the law of the state in question can hardly be deemed an acceptable predicate by which to assess the rights and obligations of the parties. In this setting, the arbitral tribunal is the purveyor of an objective and disinterested commercial and legal perspective. Filing for bankruptcy, like alleging that the transaction violates anti-competition law, can be a relatively facile way of attempting to frustrate the exercise of the arbitral mandate and to avoid or postpone the day of reckoning. In a similar vein, the shield of bankruptcy in domestic American law has become, in some sense, the most effective defense to strict product liability of enterprises.

When the objective of the legal procedure appears dilatory, a part of purely litigious strategy, it is appropriate to favor and protect the institutional integrity of arbitration and allow the arbitrator to rule upon the subsidiary consequences of a possible statutory violation. Trustees in bankruptcy can join the arbitral proceeding and perform their function of protecting the interests of creditors during the proceeding. The tribunal can receive and assess the evidence in regard to violations of anti-competition law.

When the statutory claim appears well-founded and not part of a litigious strategy, less justification exists to allow the arbitrators to rule on the statutory claim. Assuming the national law governs, the arbitrators have little expertise to justify their jurisdiction. Moreover, the issue is one of public law, affecting the interests of third parties and society at large. The arbitrators are neither invested with authority to rule nor accountable for their rulings. In the private setting of

61. *Id.* at 342.

arbitration, an additional concern exists for uniformity of interpretation and the evasion of national law. Awards often go unreported or are available only in summary. The point is that statutory law is outside the province of arbitration. A legitimate statutory controversy must result in a stay of the arbitral proceeding and a reference to national courts. Such a result would not hinder or demean the contractual authority of the tribunal.

Therefore, instead of simply having arbitrators declare in every instance that they have jurisdiction to rule on all issues no matter what their character, we propose that arbitrators should engage in a "first look" of the statutory claims presented. When national regulatory law is properly invoked and material to the resolution of the contractual claims, the tribunal should stay the proceeding or submit these claims during a preliminary phase to a national court for an advisory ruling or disposition of the matter. To avoid making this procedure an opportunity for dilatory tactics, the tribunal could be authorized by the governing institutional rules or by the agreement of the parties or by a "common law" arbitral precept to sanction the making of a frivolous statutory claim with the imposition of damages. Such conduct would be in violation of the duty to arbitrate in good faith and the damage award would correspond to the federal court practice of imposing Rule 11[62] sanctions for frivolous appeals against arbitral awards. Such a procedure could only enhance the legitimacy of international arbitration and its complementary relationship with national judicial tribunals.

IX. Resolution of Tax Issues

In particular, the resolution of statutory claims involving tax issues is unsuitable for arbitral determination. Of the statutory issues that can surface in the context of a commercial transaction (antitrust, bankruptcy, etc.), it is the least susceptible to resolution by reference to commercial good sense. Basic familiarity with tax regulations reveals such regulations and the problems they raise have a truly *sui generis* character. The resolution of tax problems is a specialty. Often, the provisions of the tax laws are ambiguous; it is always a challenge to determine even whether they apply. The content of the provisions usually gain real meaning only in the context of the IRS process. Tax disputes involve the exercise of discretion by a variety of individuals and the operation of a number of processes: in addition to the parties themselves, an auditor, a supervisor, the recourse to an internal settle-

62. Fed. R. Civ. P. 11.

ment process, and finally an appeal to the tax courts. It would be foolhardy to maintain that any non-specialist could determine the content and application of the relevant tax laws.

Therefore, an intimate professional acquaintance with the content of U.S. tax laws is not required to conclude that the question of the applicability of relevant tax provisions on withholding tax from the payments made under an international contract raises the type of interpretative problems that are completely inapposite for submission to the commercial and juridical expertise of international commercial arbitrators. Even assuming regulatory claims pertaining to antitrust, securities, RICO, or bankruptcy laws are arbitrable, none of these laws depends upon an administrative agency akin to the IRS for their implementation or definition. Not only is the content of tax law unusually complex, but the process designed to give practical content and implementation to the regulatory provisions is also intricate, complicated, and elusive to the dictates of common sense. The individual discretion of members of this vast bureaucracy often lead to inconsistent and unpredictable results. Supervisors are not bound by the determinations of the initial auditors, and the parties may reach yet another result through a settlement conference prior to appeal to tax court. The agency can take the position that each tax case or problem is *sui generis* and commands a singular interpretation of the law. Therefore, there may be little room for predictable outcomes and accurate prophecies of potential tax liability outside the perimeters of the IRS.

The facts of the hypothetical case present an additional complication in light of the international character of the transaction and the foreign nationality of some of the implicated companies. Presumably, this is not the usual fare of the IRS's supervision of the tax consequences of business conduct. For example, in the circumstances of the case, the IRS must determine whether the royalty payments were subject to the newly-imposed tax. The applicable provisions may be far from clear. To the extent the character of the parties' relationship raises a *res nova* for tax purposes, the ambiguity of the law will be exacerbated, making the IRS bureaucracy and the attendant appeals procedure the sole mechanism for achieving a certain result as to tax liability.

An arbitral award ruling on this matter would certainly not be binding upon the IRS in subsequent similar disputes and might not resolve the tax liability issue that divides the parties. Because the IRS and the appellate court process have exclusive jurisdiction to determine the application of tax provisions to individual cases, a determination of a tax issue by a private, non-national adjudicatory body can only be

binding on the arbitrating parties. A valid arbitral award can be rendered enforceable by judicial judgement; to that extent, the arbitral determination of the tax liability issue may be binding upon the IRS. However, in this regard the award is likely to be challenged by one of the parties or the IRS under Article V of the 1958 New York Arbitration Convention on the basis of inarbitrability, violation of U.S. public policy, and/or excess of arbitral authority. The award could also be subject to the "second-look" doctrine as to its ruling on the issue, thereby making it subject to a merits review by the U.S. courts. This result would not only confound the attempt to resolve the dispute, and threaten the legitimacy of the award, but it would also create a jurisdictional conflict between the IRS and the process of international arbitration. These complications and destructive conflicts could be avoided simply by an advisory reference to the IRS or a tax court at a preliminary stage of the arbitral proceeding.[63]

Finally, in the hypothetical case, an undeniable duplication of issues exists between the action brought before the federal district court in New Jersey and the issues submitted to the arbitral tribunal. If part of the basic purpose for submission to arbitration is to achieve efficiency and expertise in international commercial adjudication, neither rationale of the arbitral process is served in these circumstances. The federal court has jurisdiction over a case involving basically identical issues arising from an integrated commercial transaction between corporate parties. Moreover, these issues require a national court's particular and special expertise. There must be some value for international commercial parties to engage in an efficient and competent adjudication of claims before the court.

X. CONCLUSION

The recommended solution corresponds to the determination reached by the U.S. Supreme Court in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*.[64] In this case, the Court allowed a stay of an arbitral proceeding on the basis of a provision of the California Code of Civil Procedure meant to avoid duplicative proceedings.

Allowing a U.S. federal tribunal to decide the matter of tax liability would be efficient and sensible, and would reflect a judicious appraisal of the issues involved. It also would act as a source for giving

63. *See* Anon, *Arbitration for Apple*, in NAT'L L. J., Mar. 23, 1992, at 17. In this case, however, the Internal Revenue Service was a party to the dispute and decided, in this circumstance, to delegate its jurisdictional authority to an agreed-upon arbitral tribunal.

64. 489 U.S. 468 (1989).

renewed and necessary meaning to the inarbitrability defense under U.S. law and international commercial practice.