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Prima Facie Review of Existence, Validity of Arbitration Agreement

The requirement that the parties to an arbitration agreement honor their undertaking to submit to arbitration any disputes covered by their agreement entails the consequence that the courts of a given country are prohibited from hearing such disputes. If seized of a matter covered by an arbitration agreement, the courts will often be required, under the applicable rules, to refer the parties to arbitration.

This principle has been recognized in most modern arbitration statutes (notably at Article 8 of the UNCITRAL Model Law), as well as in international conventions. In particular, Article II, paragraph 3, of the New York Convention provides that the court of a contracting state, "when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."

The principle that the courts are entitled to review—the existence and validity of the arbitration agreement—is widely recognized, the debated question being the standard to be applied by the courts, in order to refer the parties to arbitration, in determining that the arbitration agreement is not "null and void, inoperative or incapable of being performed." Are the courts required to inquire into the merits of the existence and validity of the arbitration agreement or must they restrict their control to a prima facie verification that the arbitration agreement exists and is valid, being understood that the courts will entertain a full review at the stage of the setting aside or the enforcement of the award?

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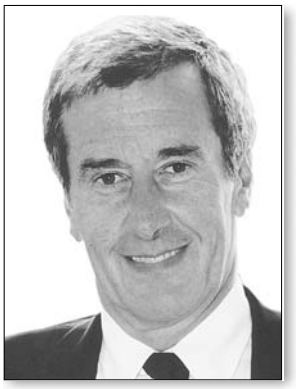

Dual Function of Competence-Competence

The rules governing the question of the review by the courts of the existence and validity of an arbitration agreement are to be found in international arbitration law. The core principle of "competence-competence" empowers the arbitrators to rule on their own jurisdiction, which means that challenging the existence or the validity of the arbitration agreement will not prevent the arbitral tribunal from proceeding with the arbitration.

Accepting this "positive effect" of the rule of competence-competence and the arbitrators' inherent power to determine their jurisdiction on the basis of the arbitration agreement entails the consequence that domestic courts should not, in parallel and with the same degree of scrutiny, rule on the same issue, at least at the outset of the arbitral process. In other words, the courts should limit, at that stage, their review to a prima facie determination that the agreement is not "null and void, inoperative or incapable of being performed." The arbitrators' power to rule on their own jurisdiction would otherwise be, in practice, negated.

Recognizing for the arbitrators the power of first determination of their jurisdiction by no means suggests that domestic courts relinquish their power to review the existence and validity of an arbitration agreement. The acceptance by the legal systems—by way of rules incorporated in arbitration statutes or in international conventions—that the courts refer the parties to arbitration simply means that the courts, when making a prima facie determination that there exists an arbitration agreement and that it is valid, leave it to the arbitrators to rule on the question and recover their power of full scrutiny at the end of the arbitral process, after the award is rendered by the arbitral tribunal.

This principle is known as the "negative effect of competence-competence," which means that the arbitrators must be the first (as opposed to the sole) judges of their own jurisdiction and that the courts' control is postponed to the stage of any action to enforce or to set aside the arbitral award rendered on the basis of the arbitration agreement. As a result, a court that is confronted with the question of the existence or validity of the arbitration agreement must refrain from hearing substantive arguments as to the arbitrators' jurisdiction until such time as the arbitrators themselves have had an opportunity to do so. In that sense, the negative effect of competence-competence ties in closely with the requirement that domestic courts apply a prima facie standard to the question of the existence and validity of the arbitration agreement (on the notion of competence-competence generally, see E. Gaillard, J. Savage (eds.), Fouchard Gaillard Goldman on International Commercial Arbitration, 1999, at paras. 650 et seq. On the negative effect of competence-competence and the prima facie review more particularly, see E. Gaillard, "L'effet négatif de la compétence-compétence," Etudes en L'Honneur de Jean-Francois Poudret, 1999, at 387 et seq.; "La reconnaissance, en droit suisse, de la seconde moitié du principe d'effet négatif de la compétence-compétence," Global Reflections on International Law, Commerce and Dispute Resolution. Liber Amicorum in Honour of Robert Briner, 2005, at 311).

India Supreme Court Decision

These questions are perfectly illustrated by the recent decision rendered by the Supreme Court of India in *Shin-Etsu Chemical Co. Ltd. v. Aksh Optifibre Ltd.* and another, Aug. 12, 2005,

in (2005) 7 SCC 234 (hereinafter *Shin-Etsu*). The Court had to rule on the interpretation of §45 of the Indian Arbitration and Conciliation Act of 1996, which reads in pertinent part that: "…a judicial authority, when seized of an action in a matter in respect of which the parties have made an agreement referred to in Section 44, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."

The main issue to be decided by the Court concerned "whether the finding of the court made under Section 45…that the arbitration agreement…is or is not 'null and void, inoperative or incapable of being performed' should be a final expression of the view of the court or should it be a prima facie view formed without a full-fledged trial?" (para. 65).

The minority opinion, on the basis of a textual analysis, was opposed to what it characterized as a "liberal approach" and observed that adopting such an approach and "restricting the determination by the judicial authority of the validity of the agreement only from a prima facie angle, would amount to adding words to §45 without there being any ambiguity or vagueness therein" (Sabharwal dissenting opinion, at para. 39). It further emphasized that "the Indian Legislature has consciously adopted a conventional approach" (id., para. 56).

Majority Opinion

In the opinion of the majority of the Court, however, the correct approach at the prereference stage is one of a prima facie finding that there exists an arbitration agreement that is not null and void, inoperative or incapable of being performed. The key rationale for the Court's holding that the courts' review of the arbitration agreement should be limited to a prima facie standard is the rule of competence-competence. The majority decided that, were the courts to be empowered to fully scrutinize the arbitration agreement, an arbitral proceeding would have to be stayed until such time that the court renders a decision on the arbitration agreement. In that sense, "[i]f it were to be held that the finding of the court under §45 should be a final, determinative conclusion, then it is obvious that, until such a pronouncement is made, the arbitral proceedings would have to be in limbo. This evidently defeats the credo and ethos of the act, which is to enable expeditious arbitration without avoidable intervention by the judicial authorities" (Opinion by Judge Srikrishna, para. 72). As a result, "the approach to be adopted is whether it is 'plainly arguable' that the arbitration agreement was in existence" (id., para. 97).

This analysis is based on three types of considerations. First and foremost, the Court refers to the language and to the object and purpose of the Indian Arbitration and Conciliation Act. On the basis of a textual reading, it holds that interpreting §45 as entailing a final finding having a res judicata effect, rather than a prima facie review, would make redundant part of §48(1)(a) which provides for post-award review (see paras. 84-85). As importantly, the Court examines the purpose of the Act:

> …the object of the Act would be defeated if proceedings remain pending in the court even after commencing of the arbitration. It is precisely for this reason that I am inclined to the view that at the pre-reference stage contemplated by Section 45, the court is required to take only a prima facie view for making the reference, leaving the parties to a full trial either before the Arbitral Tribunal or before the court at the post-award stage. (para. 105).

The Court also finds support in the comparative law approach, notably by reference to the French Code of Civil Procedure and the 1987 Swiss Private International Law Statute—both systems applying a prima facie standard—as well as the case law of common-law jurisdictions such as Ontario and Hong Kong, both systems being based on the UNCITRAL Model Law (see paras. 88-101). Finally, the Court finds support in the writings of authors endorsing the prima facie approach (reference is made in particular, at para. 106 of the Judgment, to E. Gaillard, J. Savage (eds.), Fouchard Gaillard Goldman on International Commercial Arbitration, Kluwer, 1999, at paras. 412 et seq. and to J. Lew et al., Comparative International Commercial Arbitration, 2003, at 346).

In effect, the findings of the Supreme Court of India show that the restriction of the power of the courts to a prima facie review of the existence and validity of an arbitration agreement is nothing more than the recognition of the negative effect of the principle of competence-competence.

Negative Effect

Recognizing for the arbitrators a power of first determination of their own jurisdiction is clearly the method adopted by the Supreme Court of India in *Shin-Etsu*. The Court held in particular that the arbitrators' power to rule on their own jurisdiction is counterbalanced by the courts' power to review the existence and validity of the arbitration agreement under §48(1)(a) of the act relating to the review of the awards:

> Even if the court takes the view that the arbitral agreement is not vitiated or that it is not invalid, inoperative or unenforceable, based upon purely a prima facie view, nothing prevents the arbitrator from trying the issue fully and rendering a final decision thereupon.…Even after the court takes a prima facie view that the arbitration agreement is not vitiated on account of factors enumerated in Section 45, and the arbitrator upon a full trial holds that there is no vitiating factor in the arbitration agreement and makes an award, such an award can be challenged under Section 48(1)(a). The award will be set aside if the party against whom it is invoked satisfies the court inter alia that the agreement was not valid under the law to which the parties had subjected it or under the law of the country where the award was made. The two basic requirements, namely, expedition at the prereference stage, and a fair opportunity to contest the award after full trial, would be fully satisfied by interpreting Section 45 as enabling the court to act on a prima facie view (paras. 74-75; see also paras. 103 and 105).

In a particularly modern approach, the Supreme Court of India establishes that safeguarding the arbitral tribunal's power to determine its own jurisdiction and postponing the control of such power to the postaward stage is consonant with "the ethos of the Act to avoid delay at different stages, to centralize the court review of all disputes relating to the arbitration at the post-award stage, and also carry forward the objectives of the Model Law." (para. 87).

Conclusion

The principles thus underlined by the Court as embodying the philosophy of the Indian Arbitration and Conciliation Act match the policy considerations underlying the negative effect of the competence-competence rule, namely the prevention of delaying tactics by a party alleging that the arbitration agreement is invalid or nonexistent and the centralization of the court review of disputes associated with arbitration (a simplification achieved in French and Swiss law as well as in the UNCITRAL Model Law). These objectives can indeed be satisfied only through the courts'—temporary—deference to the arbitrators rather than on the strength of a prima facie suspicion that the arbitrators will not be able, after full scrutiny, to determine whether they have been established on the basis of an existing and valid arbitration agreement to reach decisions that are fair and protect the interests of society as well as those of the parties to the dispute.