COMPÉTENCE-COMPÉTENCE À LA MEXICAINE ET À L´AMÉRICAINE: AN AWRY DEVELOPMENT

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I. INTRODUCTION

Recently, the Mexican and United States Supreme Courts issued decisions which impact one of the most important principles of arbitration law, *Compétence-Compétence*. I shall comment on such development by summarizing the recent cases (§II), proffering a view on the development (§III), to conclude with some final remarks (§VI).

II. THE CASES

A. MEXICO

The Mexican Supreme Court of Justice (the "Court") recently solved a contradiction between two Circuit Courts involving this topic. I shall summarize their background and rationale and then address the Court's decision.

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1. The (Conflicting) Criteria of the Circuit Courts

Two Circuit Courts stood in conflict. Whereas the Sixth Civil Court for the First Circuit (*Sexto Tribunal Colegiado en Materia Civil del Primer Circuito*) ("Sixth Circuit Court") held that the decision on the validity of the arbitration agreement fell under the jurisdiction of the arbitration tribunal;[1] the Tenth Civil Court for the First Circuit (*Décimo Tribunal Colegiado en Materia Civil del Primer Circuito*) ("Tenth Circuit Court") held otherwise: said decision belongs to the national court.[2]

Although I shall not dwell the procedural details of the decisions, it is noteworthy that both display a procedural zig-zag: all of the courts involved took different views.

The first case[3] began with an ordinary commercial suit before a Mexican Federal Court of first instance by L.D.C., S.A. de C.V. ("LDC") against ADT Security Services, S.A. de C.V. ("ADT") and the National Chamber of Commerce of Mexico City (*Cámara Nacional de Comercio de la Ciudad de México* — "CANACO"). Respondents challenged the jurisdiction of the court. In response, the Court[4] referred parties to arbitration.[5] The referral decision was challenged through a constitutional (*amparo*) suit and the District Court revoked holding that the referral could not take place when the suit involved the nullity of the arbitration agreement.[6] The Sixth Circuit Court on appeal revoked the determination of the lower court holding that the said decision fell within the authority of the arbitration tribunal.

In the second case, Servicio Electrónico Digital, S.A. de C.V. ("SED") filed an ordinary commercial suit against ADT and the CANACO.[7] The court referred the parties to arbitration. SED appealed and succeeded in having the referral

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1 *Amparo en revisión* 3836/2004.

2 *Amparo en revisión* 31/2005.

3 *Amparo en revisión* 3836/2004

4 Fiftieth Civil Court for the Federal District (*Juez Quincuagésimo de lo Civil del Distrito Federal*).

5 To be precise, the incompetence was decided by the Third Civil Chamber of the Superior Court of Mexico City (*Tercera Sala Civil del Tribunal Superior de Justicia del Distrito Federal*), ordering the lower court to refer the parties to arbitration.

6 Reasoning that if referral took place it would implicitly decide the validity of the arbitration agreement and submit the parties to the jurisdiction of a tribunal created by an agreement considered invalid by one of them.

7 *Amparo en revisión* 31/2005.

revoked.[8] The appeal decision was challenged through amparo. The District Court[9] revoked the challenged decision and, on appeal, the Tenth Circuit Court held that referral to arbitration should not take place when a question as to the validity of the arbitration agreement is raised, said authority lies with the court of origin (not the arbitrator).

The contradiction was escalated to the Mexican Supreme Court.[10]

2. The Mexican Supreme Court Solution

The Mexican Supreme Court took the view that the authority to rule on the validity of the arbitration agreement fell within the purview of the court, not the arbitrator. In so doing, it issued the following jurisprudence:[11]

> COMMERCIAL ARBITRATION. JURISDICTION TO TAKE COGNIZANCE OF THE NULLITY SUIT OF AN ARBITRATION AGREEMENT FORESEEN IN THE FIRST PARAGRAPH OF ARTICLE 1,424 OF THE COMMERCE CODE IS WITHIN THE JURISDICTION OF THE COURT AND NOT THE ARBITRATION TRIBUNAL. The possibility of opting out of state intervention in a dispute so as to submit it to commercial arbitration is a manifestation of the rights of parties to waive their subjective rights and establish legal provisions to which they wish to bind themselves; hence, an arbitration agreement may be included in an agreement as an arbitration clause which, as a general rule, and pursuant to article 1432 of the Commerce Code, grants jurisdiction to the arbitrators to intervene, take cognizance and decide as to the existence and validity of the agreement as well as the arbitration clause The contrary would breach the will of the parties. However, an exception to said rule exists. When, pursuant to article 1424 of the cited Code, a dispute is submitted before a jurisdictional organ, involving a contract which includes an arbitration clause and at the same time a suit to have the same declared as null, inoperative or incapable of being performed is initiated, in which case a prior judicial decision as to the said nullity action would be necessary. The foregoing because, on the one hand, the

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8 By the Tenth Civil Chamber of the Superior Court for the Federal District (*Décima Sala Civil del Tribunal Superior de Justicia del Distrito Federal*).

9 Eighth District Court for Civil Matters of the Federal District (*Juzgado Octavo de Distrito en Materia Civil del Distrito Federal*).

10 In Mexico, contradictions between Circuit Courts may be brought before the Supreme Court in a manner similar to the *certiorari* authority of the US Supreme Court. Technically, the issue is 'denounced' (*denunciada*) before the Court.

11 Contradiction 51/2005, First Chamber of the Supreme Court, 11 January 2006. (Jurisprudential Thesis 25/2006, Contradiction Thesis 51/2005-PS between the Sixth and Tenth Circuit Courts for Civil Matters of the First Circuit. Majority of three votes. Opposing votes cast by Olga Sánchez Cordero de García Villegas and José Ramón Cossío Díaz. Juan N. Silva Meza delivered the opinion of the court.)

> judicial control over the arbitration must not be forgotten, and, on the other, the jurisdiction of the arbitrators stems from the autonomy of the parties. Therefore, if, for example, the existence of a defect in the intent of the parties is alleged, it must be previously solved by the judicial authority, and the parties rights under article 1424 to arbitrate the matters involving the existence and validity of the contract, which are of the sole jurisdiction of the arbitration tribunal, remain intact.[12]

B. UNITED STATES

In *Buckeye Check Cashing, Inc. v. Cardegna et al*[13] the U.S. Supreme Court of Justice held that the jurisdiction to rule on the validity of the arbitration agreement is the arbitration tribunal's when the jurisdictional challenge stems from a nullity action against the contract in its entirety.

Subtleties of the reasoning are worth commenting. I shall therefore summarize the background of the case, and then discuss the decision and its reasoning.

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12 The Spanish version reads as follows:

> ARBITRAJE COMERCIAL. COMPETENCIA PARA CONOCER DE LA ACCIÓN DE NULIDAD DEL ACUERDO DE ARBITRAJE PREVISTA EN EL PRIMER PÁRRAFO DEL ARTÍCULO 1,424 DEL CÓDIGO DE COMERCIO, CORRESPONDE AL JUEZ Y NO AL TRIBUNAL ARBITRAL. La posibilidad de apartar la intervención de la justicia estatal en un conflicto, a fin de someterlo al arbitraje comercial, es una manifestación de la potestad de los particulares para renunciar a sus derechos subjetivos y establecer los dispositivos legales a los cuales desean someterse; de ahí, que un acuerdo de arbitraje pueda estar incluido en un contrato como cláusula compromisoria, lo que por regla general y en términos del artículo 1,432 del Código de Comercio, otorga su competencia a los árbitros para intervenir, conocer y decidir aún sobre la existencia o validez del propio contrato, así como de dicha cláusula compromisoria, lo contrario violaría la voluntad de las partes. Sin embargo, existe una excepción a dicha regla, cuando en términos del artículo 1,424 del citado Código, ante un órgano jurisdiccional se somete el diferendo, sobre un contrato que contenga una cláusula compromisoria, y se ejerza al mismo tiempo la acción para que la misma se declare nula, ineficaz o de ejecución imposible, la que en dicho supuesto haría necesaria una decisión judicial previa, sobre la acción de nulidad. Lo anterior porque, por un lado, no debe soslayarse la existencia del debido control judicial sobre el arbitraje y, por el otro, la competencia de los árbitros proviene de la autonomía de la voluntad de las partes, de manera que si se alega, por ejemplo, la existencia de algún vicio de la voluntad en el acto que otorga competencia al árbitro, la acción de nulidad debe resolverse previamente por el órgano jurisdiccional, quedando a salvo los derechos de las partes para que en términos del segundo párrafo del referido artículo 1,424 puedan iniciarse las actuaciones arbitrales relativas a la disputa sobre el cumplimiento e inclusive la existencia o validez del propio contrato que contiene la cláusula compromisoria, ya que a ese respecto el tribunal arbitral conserva su competencia exclusiva.

13 546 U.S. _____ (2006).

1. Background

A Florida court of first instance denied the referral to arbitration requested by Buckeye further to a suit brought by Cardegna against Buckeye, holding that the authority to rule on a claim that the contract is null and void *ab initio* is the national court's, not the arbitrator's.[14] (It was argued that the contract was null and void given that the interest charged was usurious.)

The State Court of Appeal reversed the decision, and was itself reversed by the Florida Supreme Court reasoning that the enforcement of the arbitration agreement in a contract which illegality was being claimed would breach local public policy and contract law. Its exact words were:[15]

> ...to enforce an agreement to arbitrate in a contract challenged as unlawful ...could breathe life into a contract that not only violates state law, but also is criminal in nature. ...

The Supreme Court granted *certiorari*[16] and revoked the decision of the Florida Supreme Court.

2. The Supreme Court decision

The Supreme Court of Justice of the United States overturned the Florida Supreme Court holding that

> ... a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause within it, must go to the arbitrator, not the court.

The conclusion was premised on a fact the court gave pivotal importance to: the claim was for the annulment of the contract *in its entirety*, not solely the arbitration clause.

Following *Prima Paint*[17] and *Southland*[18] (also Supreme Court precedents) the Court distinguished between two situations: (1) an annulment claim involving only the arbitration agreement; and (2) an annulment claim of

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14 In the U.S. referral to arbitration operates through a "motion to compel arbitration".

15 894 So. 2d. 860, 862 (2005), citing *Party Yards, Inc. v. Templeton*, 751 So. 2d 121, 123 (Fla. App. 2000).

16 545 U.S. ____ (2005).

17 *Prima Saint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 400 (1967). *Prima Paint* held that if the claim for nullity involved fraud in the inducement of the contract in its entirety and the arbitrator should thence rule on the matter. But if the claim involved only the arbitration agreement, the court had jurisdiction to rule on the same.

18 *Southland Corp. v. Keating*, 465 U.S. 1 (1984). This case holds that the *Federal Arbitration Act* created a body of federal substantive law that applied both in local and federal courts.

the contract in its entirety, whether because it affects the validity of the contract as a whole or because the illegality of a contract provision makes the entire agreement null. And *Buckeye* involved scenario 2. As the Court observed:

> ...because respondents challenge the Agreement, but not specifically its arbitration provisions, those provisions are enforceable apart from the remainder of the contract. The challenge should therefore be considered by an arbitrator, not a court.

The decision is grounded in three premises. The first is that the arbitration agreement is severable from the rest of the agreement.[19] The second is that, unless the claim involves the arbitration agreement itself, the issue of the validity of the contract must first be considered by the arbitrator. Finally, this case involved a nullity claim of the entire agreement (including the arbitration agreement).[20] Therefore, the Court determined that the arbitration agreement was enforceable independently of the rest of the agreement, and the claim should be considered by the arbitrator, not the court.

A noteworthy aspect is that not one line is dedicated to the (flipside) question that is begged by said reasoning: if the claim involves *only* the arbitration agreement, is the court —not the arbitrator— the competent organ to rule as to the same?

Although said holding could implicitly be read into the decision, it is important to note that it was never directly stated that way.

C. SIMILARITIES

The reasoning of the Mexican and US Supreme Courts of Justice are congruent —albeit inverse—: according to the Mexican Court, if what is claimed is the nullity of the arbitration agreement, no the contract as a whole, the challenge before the competent court must be exhausted before the arbitration proceedings take place. In the opinion of the US Supreme Court, when the nullity claim involves the entire agreement, it is the arbitrator, not the court, who is competent to decide the matter. The opposite enunciation of the principle was not advanced, only hinted: if the nullity suit involves only the arbitration agreement, the decision as to the matter falls upon the competent court.

The cases reflect an impressive parallelism. Not only are they decisions by the highest courts of each jurisdiction, they rely on the similar premises, where issued within one month of each other, and both were preceded by a procedural zig-zag: all the inferior courts arrived to opposite conclusions.

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19 *Prima Saint* was the authority. Literally "as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract".

20 The ground for challenge was the alleged existence of an usurious interest in deferred payment operations.

III. CRITIQUE

In my opinion, the new scope of *Compétence* as judicially crafted violates (a) the letter of the law; and (b) the purposes of the principle.

A. THE LETTER OF THE LAW

The first paragraph of article 1424 of the Commerce Code establishes that:[21]

> A court before which an action is brought in a matter which is the subject of an arbitration agreement shall refer the parties to arbitration at any time requested by any of them **unless if finds that the agreement is null and void, inoperative or incapable of being performed.**
>
> **[**El juez al que se someta un litigio sobre un asunto que sea objeto de un acuerdo de arbitraje, remitirá a las partes al arbitraje en el momento en que lo solicite cualquiera de ellas, **a menos que se compruebe que dicho acuerdo es nulo, ineficaz o de ejecución imposible.]**

The first paragraph of article 1432 of the Commerce Code provides that:[22]

> **The arbitral tribunal may rule on** its own jurisdiction, including any objections with respect to **the existence or validity of the arbitration agreement.** (...)
>
> **[**El **tribunal arbitral estará facultado para decidir** sobre su propia competencia, incluso **sobre las excepciones relativas a la existencia o validez del acuerdo de arbitraje.** (...)**]**

It is the highlighted text that gave place to the different interpretations.

In the Mexican case, while the Sixth Circuit Court considered that the authority of the arbitrator to rule on its jurisdiction[23] prevails over the authority of the court to determine the validity of the arbitration agreement before referring to arbitration,[24] the Tenth Circuit Court considered the opposite —and the Supreme Court agreed.

In the US case, the Supreme Court of Justice held that if the nullity claim involves the contract in its entirety, jurisdiction to rule on the matter falls within the purview of the arbitration tribunal. The textual point of departure is §4 of the Federal Arbitration Act, which provides that:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court ... for an order directing that such arbitration

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21 Which is almost a verbatim copy of Article 8 of the UNCITRAL Model Law on International Commercial Arbitration ("UNCITRAL Model Law").

22 Identical to article 16 of the UNCITRAL Model Law.

23 Under article 1432 of the Commerce Code (Art. 16 of the UNCITRAL Model Law).

24 Under article 1424 of the Commerce Code. (Art. 8 of the UNCITRAL Model Law).

> proceed in a manner provided for in such agreement ... [U]pon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. ...

In my opinion, both Courts misunderstood the thrust of the *Compétence* principle. *They confused the rule to which the exception exempts*: the exception to the duty to refer was used as an exception to the rule of *Compétence*. In doing so, they threw a monkey wrench into the mechanics the rule was designed to follow.

The new *Compétence à l'américaine* and *à la mexicaine* confuses exception for rule. In fact, it reverts the exception into the rule: the court decides upon the validity of the arbitration agreement, and the arbitrator of the contract in its entirety. It reduces the scope of *Compétence* – the arbitrator no longer decides the defenses involving the existence and validity of the arbitration agreement, only those involving the main contract.

Correctly understood *while compétence establishes the rule (the arbitrator decides on the validity of the contract and arbitration agreement), the determination of the validity of the arbitration agreement is an exception to the obligation to refer the parties to arbitration.* In other words, and using the Mexican Commerce Code to anchor the explanation, *while article 1432 establishes* ***who*** *shall decide on the validity of the contract and arbitration agreement, article 1424 establishes an exception to the obligation to refer the parties to arbitration.*[25] The first is upon the arbitrator, the second the court's.

B. *LEITMOTIF* OF *COMPÉTENCE-COMPÉTENCE* AND SEVERABILITY OF THE ARBITRATION AGREEMENT PRINCIPLES

The principles *Compétence-Compétence* and autonomy of the arbitration agreement are the two most typical arbitration institutions. To fully grasp their *raison d'être* they must be studied in conjunction.

Although originated in a common point of departure, they seek different ends. The point of departure is the desire to give effect to the parties' intent to use arbitration in lieu of litigation. To assess their impact, imagine for a moment a world where the principle of *Compétence* does not exist. In a given relation covered by an arbitration agreement, should a dispute arise and one of the parties question (challenge) the scope of the arbitrators' jurisdiction, recourse to a court would be necessary to determine whether the dispute in question is one which the arbitrator is legitimately entitled to rule upon. The irony is glaring: to *arbitrate*

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25 The verb "refer" ("remitirá") (to arbitration) in article 1424 of the Commerce Code is imperative. It does not give discretion; only obligation. The court must abstain from entertaining both the substance of the dispute as well as the jurisdiction of the tribunal (which would be a specific topic falling under the general heading of validity of the arbitration agreement).

you must *litigate*! To avoid going to court you need to go to court to compel arbitration.

Now assume the nonexistence of the autonomy principle. In a given dispute, should the relief sought by one of the parties include a claim that the contract is null and void, further to the *Compétence* principle, the matter would need to be submitted to arbitration, whereupon a final award would decide the issue. But again, an awkward result could follow: should the contract be found to be nonexistent or null and void, the arbitration agreement, as an accessory, would be helplessly impacted by said nullity. By now the reader has no doubt noticed that an ever more awry result would ensue: the award would lack legal effects —both a legal and logical consequence since *ex nihilo nil fit*. Again the result would be both ironic and against the intent of the parties; but it would also merit an additional adjective: ridiculous —it would imply the obligation to arbitrate in order to seek an award lacking legal effects.

In essence, both principles seek to give effect to the parties' desire to use arbitration, not litigation, to solve their disputes.

True, an overlapping exists. It is because of the principle of autonomy that a challenge to the validity of the contract or the arbitration agreement will not impact the jurisdiction of the arbitration tribunal; and it is because of *Compétence* that an arbitrator may assess the validity of both the arbitration agreement and the contract without reaching useless results. But each one provides a different added value: *Compétence* allows an arbitrator to analyze its jurisdiction and decide that it lacks it without incurring in an inherent contradiction; and *autonomy* allows for the determination that the contract is defective without destabilizing the legal foundation of the decision (the arbitration agreement). But —and here lies an important subtlety — whereas autonomy allows resisting a claim that the arbitration agreement is invalid given that the contract was found to be null and void, without *Compétence* said principle by itself would not allow that the arbitrator proceed when the claim involves an arbitration agreement. Such result is procured by *Compétence*.

As it may be observed, both principles are the foundation upon which a legal edification will be constructed that ensures effects of the arbitration agreement.[26] There are instances of legal creativity used to surmount an obstacle in the path of the desired goal. Legal engineering at its finest.

IV. FINAL COMMENT

Interestingly, the judicial debate that gave birth to *Compétence à la américaine et à la mexicaine* repeats that which took place many decades ago (who decides upon the jurisdiction of the arbitration tribunal? — the court or the arbitrator?)

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26 And said results flow, not from the arbitration agreement, but from the applicable arbitration law. If they stemmed from the arbitration agreement, a 'chicken and egg' problem would ensue.

and that gave rise to the *Compétence – Compétence* principle, as correctly understood.

In essence, this is the mistake of both the Mexican and United States Supreme Courts. They repeat a debate considered moot. It is for the arbitrator to decide first as to its jurisdiction, subject to the final decision by the competent court. Holding otherwise ignores the parties' intent in agreeing to arbitration. Whether the jurisdictional challenge involves the contract in its entirety or only the arbitration agreement is simply irrelevant.