

Choice of Forum Clauses in International Contracts: What Is Unjust and Unreasonable?†

Introduction

It is a common assumption that a forum selection clause in international commercial contracts is desirable and necessary, since it will promote stability of transactions, encourage trade by eliminating uncertainty of where a dispute would be resolved and give effect to the manifested intent of the parties.¹

The United States Supreme Court in *M/S Bremen v. Zapata Off-Shore Co.*² recognized the validity of this assumption and upheld a forum selection clause in an international maritime towing contract, which selected a London court as the place to resolve future disputes. C.J. Burger recognized that “we cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.”³

However, the Court did not give a blanket approval to all forum selection clauses, but limited its approval to just and reasonable clauses.⁴

This paper will discuss the reasonableness test as applied to forum selection clauses in international contracts, the related problem of choice of law and arbitration, and give a few examples of how foreign countries view forum selection clauses.

Discussion

*M/S Bremen v. Zapata Off-Shore Co.*⁵

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†For Professor V. Folsom, and Professor B. Kozolchyk in *International Commercial Transactions*, Spring of 1978.

¹*M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 32 L. Ed. 2d 513, 92 Sup. Ct. 1907 (1972); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 41 L. Ed. 2d 270, 94 Sup. Ct. 2449 (1974); Gilbert, *Choice of Forum Clauses in International and Interstate Contracts*, 65 Ky. L.J. 1 (1976) [hereinafter cited as Gilbert].

²407 U.S. 1 (1972).

³407 U.S. 1, 9 (1972).

⁴407 U.S. 1, 15 (1972).

⁵407 U.S. 1, (1972).

American courts have traditionally frowned upon forum selection clauses.⁶ The reasons for refusing to give effect to the parties agreement were that it ousted the court of its jurisdiction, the clause was usually found on adhesion contracts and it violated local public policy.⁷ This attitude is exemplified by *Carbon Black Export v. the S/S Monrosa*⁸ where the court held that it is "the universally accepted rule that agreements in advance of controversy whose object is to oust the jurisdiction of the courts are contrary to public policy and will not be enforced."

In recent years there has been an emerging consensus that the rule of reasonableness should govern the validity of forum selection clauses.⁹ The RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS § 80 (1971) states that "[T]he parties agreement as to the place of the action cannot oust a state of judicial jurisdiction, but such an agreement will be given effect unless it is unfair or unreasonable."

In *M/S Bremen v. Zapata Off-Shore Co.*¹⁰ the Court adopted the reasonableness test and upheld a forum selection clause in an international maritime towing contract which specified that all disputes should be litigated in the London Court of Justice.

The Zapata Off-Shore Co., an American corporation, had solicited bids for the towing of an oil drilling rig from Louisiana to Italy. A German corporation, the Unterweser Reeder, was the low bidder and submitted a draft contract which included the disputed choice of forum clause. Zapata suggested a few changes which Unterweser agreed to, but said nothing about the choice of forum and the exculpatory provisions. During the towing, the drilling rig was badly damaged by a storm on the Gulf of Mexico, in international waters, and the rig was taken to Tampa, Florida. Subsequently, Zapata sued Unterweser in federal district court, in contravention of the forum selection clause, alleging negligence and asking for \$3,500,000 in damages. Unterweser moved to dismiss and to have the court give effect to the contractual choice of forum. It also filed suit in the London Court of Justice where Zapata contested the court's jurisdiction, but the court ruled that the clause was effective consent to its jurisdiction. The federal district court and the Fifth Circuit court relied upon the *Carbon Black*¹¹ case, refused to dismiss Zapata's claim and enjoined Unterweser from litigating further in the London Court of Justice.¹²

⁶Note, *Arbitration and Forum Selection Clauses in International Business: The Supreme Court Takes an Internationalist View*, 43 FORDHAM L. REV. 424, 428 (1974) [hereinafter cited as Note].

⁷*Id.*

⁸254 F.2d 297, 300 (5th Cir. 1958).

⁹Note, at 429, note 38 and WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS, p. 163.

¹⁰407 U.S. 1 (1972), and 8-1 decision (J. Douglas dissent).

¹¹See note 8 above.

¹²407 U.S. 1. See Gilbert, at 24-26.

The Supreme Court reversed, adopted the reasonableness test and noted that:

For at least two decades we have witnessed an expansion of overseas commercial activities by business enterprises based in the United States. The barrier of distance that once tended to confine a business concern to a modest territory no longer does so. Here we see an American company with special expertise contracting with a foreign company to tow a complex machine thousands of miles across seas and oceans. The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts.

* * * *

in an era of expanding world trade and commerce, the absolute aspects of the doctrine of the *Carbon Black* case have little place and would be a heavy hand indeed on the future development of international commercial dealings by Americans. We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.¹³

These are indeed persuasive reasons for American courts to give effect to forum selection clauses in international contracts. Therefore, the Court concluded "that the forum clause should control absent a strong showing that it should be set aside."¹⁴

Thus, in light of this case, it can be concluded that a forum selection clause in an international contract presumptively is valid and the party challenging it carries a heavy burden of showing that it is unfair or unreasonable.

The Parameters of Reasonableness

Today, the question is: What are the parameters of the reasonableness test? The facts of *Zapata*, the Court's opinion and a number of cases since *Zapata* give several indications of what will not be considered fair and reasonable.

A. SUBSTANTIAL INCONVENIENCE¹⁵

The Model Choice of Forum Act¹⁶ directs the non-selected court to dismiss or stay the action unless "the other state would be a substantially less convenient place for the trial of the action than this state."

The Court in *Zapata* held that the party seeking to "escape his contract" carries a heavy burden to overcome the strong presumption that the contractual choice of forum is reasonable.¹⁷ The party must show that for all practical

¹³407 U.S. 1, 8-9 (1972).

¹⁴407 U.S. 1, 15 (1972).

¹⁵The following subdivisions of the reasonableness test are taken from the Model Choice of Forum Act and Gilbert, at 32 *et seq.* Note that there is a substantial overlap between the subdivisions.

¹⁶See Reese, *The Model Choice of Forum Act*, 17 AM. J. COMP. L. 292 (1969) [Hereinafter cited as Reese.].

¹⁷407 U.S. 1, 18 (1972).

purposes it will be denied of its day in court. If a party would lose his day in court due to the forum selection clause the choice would seem unreasonable and since the parties could not originally have intended to select such a seriously inconvenient forum the court would be justified in holding that the choice was unreasonable and not within the true intention of the parties.¹⁸ However, in a freely negotiated international commercial contract the parties ought to be able to foresee the amount of inconvenience which will result from litigating in the chosen forum.¹⁹ Therefore, it will be a rare international commercial contract where a party can "escape his contract" by clearly showing that it would cause it "substantial inconvenience" to litigate in the chosen forum.

There are a few cases where the courts have found the chosen forum to be so inconvenient as to be unfair and unreasonable. In *Hawaii Credit Card Corp. v. Continental Credit Card Corp.*,²⁰ involving a franchise agreement with a clause selecting California law and forum, the court held that the choice was unreasonable, because the target of the defendant's actions was the credit card business of Hawaii, many witnesses were residents of Hawaii and most of the evidence was to be found in Hawaii.²¹ It must be noted that this was a domestic contract and the party seeking to "escape the contract" did not clearly show that it was seriously inconvenienced. There were, however, elements of adhesion in this contract, but, assuming it was an international contract, under the standards of *Zapata* it would seem clear that the case would have to be decided the other way. The court is not supposed to weigh the convenience of the different forums. Instead the party seeking to avoid the chosen forum must carry the heavy burden of showing that it would be so substantially inconvenient to litigate in the chosen forum that it would lose its day in court.²²

A much stronger case for substantial inconvenience is presented by *Copperweld Steel Company v. Demag-Mannesmann-Boehler*.²³ This was an action by a United States corporation against a German corporation for breach of a contract involving the construction of a plant in Pennsylvania. The contract contained a clause which stipulated that:

Any disputes arising out of the terms of the contract shall be brought before the court of justice having jurisdiction in the area where the supplier has its main office. (i.e. West Germany).²⁴

The court refused to give effect to this clause and held that it would be

¹⁸See Model Choice of Forum Act, Comment to § 3(3).

¹⁹407 U.S. 1, 17 (1972).

²⁰290 F. Supp. 848 (D. Haw. 1968).

²¹*Id.* at p.851.

²²407 U.S. 1, 15 (1972).

²³54 F.R.D. 539 (W.D. Pa. 1972); 347 F. Supp. 53 (W.D. Pa. 1972); 354 F. Supp. 571 (W.D. Pa. 1973).

²⁴354 F. Supp. 571, 572 (W.D. Pa. 1973).

substantially inconvenient and unreasonable to require the American plaintiff to try the case in Germany, because:

[T]he casting plant, the performance of which is in dispute, is located here. We foresee the necessity to examine the plant in detail. The plant was constructed by a Pennsylvania firm, all of whose employees are here. Did the defect occur in construction? All of the people who operated the plant are here. Did they operate it improperly? All of the plant's customers are here. If they refused the product, why did they do so? How can these people be made available in Germany? There is no process there to compel their attendance at trial even if they could be transported to Germany. What of the language difficulties? Of course, the German engineers will be inconvenienced and they will have language difficulties we assume, but we think it will be of some advantage to them to have the contractor and the operating people available for obvious reasons.²⁵

Also, the court was careful to distinguish *Zapata* by pointing out that the chosen forum was not a neutral forum and that this was not a case of American business expanding overseas, but rather it was the German corporation which had come to the United States and still insisted on trying the case in its home forum.

Thus, despite a scarcity of cases since *Zapata* it seems clear that it will be the unusual case where a United States court will refuse to give effect to a forum selection clause in an international commercial contract.²⁶

B. DENIAL OF AN EFFECTIVE REMEDY

The second reason for denying enforcement of a forum selection clause is that "the plaintiff cannot secure effective relief in the other State . . ."²⁷ This situation may arise when the chosen state has not empowered its courts to hear this type of actions or if the defendant is not subject to its service of process. Also, the particular chosen court may lack subject matter jurisdiction over the claim.²⁸

It must be pointed out that the denial of an effective remedy argument overlaps with the other categories, since they are not mutually exclusive, but in most cases complement each other in the determination of reasonableness.²⁹

In *Roach v. Hapag-Lloyd*³⁰ the court felt the reasonableness of enforcing the forum selection clause to be an extremely close question. A California

²⁵347 F. Supp. 53, 54 (W.D. Pa. 1972).

²⁶*Zapata*, though involving an international contract, has been cited in a number of domestic contract cases, which have given different weight to the choice of forum clauses involved. See *Plum Tree, Inc. v. Stockmart*, 488 F.2d 754 (3d Cir. 1973): the court may still transfer the case for the convenience of the witnesses and in the interest of justice. *Fireman's Fund American Insurance Companies v. Puerto Rican Forwarding Co., Inc.*, 492 F.2d 1294 (1st Cir. 1974): the claim was small, but showing of loss of day in court still required.

²⁷Model Choice of Forum Act, § 3(2).

²⁸See *id.* comment to § 3(2). Gilbert, at 34.

²⁹See *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

³⁰358 F. Supp. 481 (N.D. Cal. 1973).

longshoreman sued the vessel owner, a German corporation, for personal injuries suffered while unloading allegedly improperly packaged goods. The vessel owner filed a third party complaint against the manufacturer and the packager, a German corporation, which moved to dismiss on grounds that the Bill of Lading, executed in West Germany, provided that "any dispute arising under this bill of lading shall be decided by the Hamburg courts." The court held that even though the complaint arose out of the defense to an action scheduled for trial in the same court, the accident and injury occurred in San Francisco and all the witnesses were residents of the Bay Area and not subject to process by German trial courts. The prima facie validity of the clause was buttressed by the facts that both corporations were German corporations, the Bill of Lading was signed in Germany and the alleged negligence in packaging took place in Germany. Therefore, the motion to dismiss the third party complaint based on the forum selection clause was granted.

In *Gaskin v. Stumm Handell GmbH*,³¹ the court, after quoting at length from *Zapata*, upheld and enforced a forum selection clause in an employment contract, between a New York resident and a German corporation, which "agreed that Essen [in the Republic of West Germany] shall be the forum to which any controversy must be submitted." The plaintiff alleged that he was unaware of the clause, since the contract was written in German and he did not understand German, and had he been aware of the clause he would not have entered into this contract. The court dismissed plaintiff's allegations stating that he could not rely upon his own negligence, in not having the contract translated before signing it, to escape the enforcement of the forum selection clause. This case mandates all Americans to be careful, when entering into international commercial contracts, and to make sure that an unfavorable choice of forum clause is not inserted into the contract without his or her knowledge and actual agreement, since the burden of overcoming the presumptive validity of forum selection clauses is heavy indeed.³²

C. UNCONSCIONABILITY

A third reason for denying enforcement to a forum selection clause is that it "was obtained by misrepresentation, duress, the abuse of economic power, or other unconscionable means."³³ This, of course, includes fraud, which is regularly used to invalidate agreements between parties.

³¹390 F. Supp. 361 (S.D.N.Y. 1975).

³²The plaintiff in *Gaskin* was apparently a sophisticated businessman and his claim amounted to \$306,260.40 plus interest. However, choice of forum clauses have been upheld even where the plaintiff lacked business sophistication and had a relatively small claim, see the long line of "passage contract" cases cited and discussed in *McQuillan v. "Italia" Societa Per Azione Di Navigazione*, 386 F. Supp. 462 (S.D.N.Y. 1974): summary judgment in favor of defendant carrier, since suits against the Carrier could be brought only before the judicial authority of Italy.

³³Model Choice of Forum Act, § 3(4).

The traditional fear of American courts has been that, in situations of unequal bargaining power, there is no real agreement between the parties. The weaker party is forced to take the unfavorable clause with his bargain or there would be no contract at all. This occurs in the so-called adhesion contract.³⁴ There are a large number of domestic contract cases where the courts have invalidated choice of forum and choice of law clauses to protect the weaker party, who is oftentimes a consumer. Furthermore, both federal and state legislations have been passed in recent years to protect weaker parties and consumers from overreaching by unscrupulous businesses.³⁵

In *Zapata*³⁶ the Court expressly pointed out that the choice of England as the forum was the result of arm's-length negotiations by experienced and sophisticated businessmen. In today's international commercial transactions this would be the case in most situations. It is a fair assumption that the great majority of American businesses entering into overseas contracts are both experienced and sophisticated. To the extent that small and inexperienced American businesses expand abroad it would be reasonable to require them to consult with businessmen or lawyers, who have expertise in this area. If they do not and, as a result of their inexperience, get stuck with an unfavorable choice of forum clause it would be argued that they have acted negligently and that American courts should not come to their rescue.³⁷ However, if the situation is reversed, the foreign corporations approach small and inexperienced American corporations and on strength of their superior bargaining position prevail upon a foreign choice of forum, it is fair to say that *Zapata* implied that such forum selection clauses may be held unreasonable.³⁸

Though it involved a domestic contract, *Leasewell, Ltd. v. Jack Shelton Ford, Inc.*,³⁹ is a good example of a forum selection clause which was found unjust and unreasonable under the circumstances. The plaintiff, a New York corporation, entered into a contract with the defendant, a West Virginia corporation, whereby plaintiff agreed to lease to defendant certain automotive repair equipment. The lease stipulated that it was governed by New York law and all disputes would be resolved in New York courts. Defendant received the equipment and made a number of payments before it ceased payments. Plaintiff sued in New York, obtained a default judgment of \$10,127.41 and sued in West Virginia to enforce the judgment. The court refused to give full faith and credit to the judgment and held that West Virginia will recognize such forum

³⁴See *Henningson v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960).

³⁵See UNIFORM COMMERCIAL CODE (1972), § 2-302 and Uniform Consumer Sales Practices Act, § 4.

³⁶407 U.S. 1 (1972).

³⁷See *Gaskin v. Stumm Handel GmbH*, note 31, above.

³⁸407 U.S. 1, 12 (1972); *Gilbert* at 37 note 202; note 32 above.

³⁹423 F. Supp. 1011 (S.D. W. Va. 1976).

selection clauses only when when found to be just and reasonable;⁴⁰ laying down the following tests:

In determining whether such a provision is reasonable and just in a given situation, various factors have been considered. These include:

- (1) The law which governs the formation and construction of the contract;
- (2) The residence of the parties;
- (3) The place of execution and/or performance of the contract;
- (4) The location of the parties and witnesses probably involved in the litigation;
- (5) The inconvenience to the parties; and
- (6) Whether the provision was equally bargained for.

Applying these factors to the instant case, this Court finds:

- (1) That the formation and construction of the contract, in the absence of the paragraph in controversy, would be governed by the West Virginia law;
- (2) That the Plaintiff is a resident of New York; The Defendant of West Virginia;
- (3) That the contract was executed and performed in West Virginia until the alleged breach;
- (4) That nearly all, if not all, the witnesses probably involved in the litigation are located in West Virginia;
- (5) That to require the Defendant to take all witnesses to New York would cause it great inconvenience;
- (6) That the provision was not the result of equal bargaining positions.

The court found that the provision was not the result of equal bargaining positions, because:

the provision in question is buried in a full page of small print in a standard form contract and . . . the contract contains a provision which states that no employee or agent may modify any term of the contract . . .⁴¹

The court noted that "conduct which does not rise to the level of unconscionability as a matter of contract law may well warrant consideration under the 'inequality' or 'overwhelming bargaining power' element of the reasonableness test."⁴² However, the court did not address the issue of whether unequal bargaining power itself is sufficient to render the forum selection provision unreasonable.⁴³ The courts rarely rest their decisions on one factor, but prefer to consider the various elements of unreasonableness together. Therefore, it is imperative that all elements be considered, since a finding of unreasonableness will rest on a combination of factors.

D. OTHER INDICATIONS OF UNREASONABLENESS

The final element of unreasonableness is if "it would for some other reason be unfair or unreasonable to enforce the agreement."⁴⁴

⁴⁰*Id.* at 1015.

⁴¹*Id.* at 1015-1016.

⁴²*Id.* at 1016.

⁴³*Id.* at 1017.

⁴⁴Model Choice of Forum Act, § 3(5).

This category could include a number of factors, not within the above categories, which would lead a court to conclude that the forum selection clause was unreasonable or unjust.⁴⁵

One example is where the selected state would apply its laws, but it had no contacts with the transaction and could not apply its laws consistent with due process.⁴⁶ Another example is where the selected state would apply its laws and this would violate the strong public policy of the nonselected state where suit has been filed. Otherwise the parties could by choice of forum do what they could not do by choice of law. The public policy exception to the application of a foreign state's law has been largely discredited.⁴⁷ At least, where it involved the application of sister states laws. However, the RESTATEMENT (SECOND) CONFLICT OF LAWS (1971), § 90 retains the exception and states that no action will be entertained on "a foreign cause of action the enforcement of which is contrary to the strong public policy of the forum." This public policy exception has been used by a Florida court to refuse enforcement of a Puerto Rican gambling debt, valid in Puerto Rico, against a Florida resident.⁴⁸ Furthermore, a court may be statutorily required to hear the case and a choice of forum clause to the contrary would be inoperative.⁴⁹ This is exemplified by *Boyd v. Grand Trunk Western R.R. Co.*,⁵⁰ where the United States Supreme Court held that an exclusive choice of forum agreement, which limited plaintiff to sue in the state where the cause of action arose, was void in light of the Federal Employers Liability Act which allowed an employee to bring suit in state or federal court where the defendant resides, the defendant is doing business, or the cause of action arose.

Another problem, which is only incidentally related to unreasonableness, is the fact that a choice of forum clause must be phrased in exclusive terms. In *Keaty v. Freeport Indonesia, Inc.*⁵¹ the court held that a contract provision, which read "This agreement shall be construed and enforceable according to the law of the State of New York and the parties submit to the jurisdiction of the courts of New York," meant that plaintiff submitted to the jurisdiction of New York, if sued there, not that New York would be the exclusive forum. Thus, the federal district court for the district of Louisiana was ordered to exercise jurisdiction over plaintiff's suit.

A final example of other indications of unreasonableness of a forum selec-

⁴⁵Gilbert at 38.

⁴⁶See *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930).

⁴⁷See Goodrich, *Foreign Facts and Local Fancies*, 25 VA. L. REV. 26 (1938); Paulsen and Sovrn, *Public Policy in the Conflict of Laws*, 56 COLUM. L. REV. 969 (1956).

⁴⁸*Dorado Beach Hotel Corp. v. Jernigan*, 202 So. 2d 830 (Fla. Dist. Ct. App. 1967), *appeal dismissed*, 209 So. 2d 669 (Fla. 1968).

⁴⁹See, Model Choice of Forum Act, § 3(1).

⁵⁰338 U.S. 263 (1949).

⁵¹503 F.2d 955 (5th Cir. 1974).

tion clause is *In re Fotochrome, Inc.*⁵² The case involved both local public policy and a court which is statutorily required to hear a case. Fotochrome, Inc., a New York corporation, fell into dispute with Copal Co., Ltd., a Japanese corporation, over the terms of a contract to manufacture special cameras in Japan. The contract contained an arbitration clause with the designated forum being Tokyo, Japan. Arbitration was begun, but before the issuance of the award Fotochrome filed a Chapter XI arrangement in bankruptcy court in New York. The bankruptcy judge issued an order which stayed all proceedings by creditors, including the pending arbitration. However, the Japanese arbitration association, over which the bankruptcy judge lacked personal jurisdiction, proceeded to award Copal \$624,457.80 and Copal sought to have the award enforced in the United States district court. In support of enforcement of the award Copal invoked two treaties⁵³ which compelled enforcement unless it would violate local public policy. The conflict boiled down to a choice between recognizing the foreign award at the expense of local creditors in contravention of the policies behind the Bankruptcy Act or refusing enforcement at the expense of certainty in international commerce and the strong presumption in favor of forum selection clauses expressed in the two treaties and *Zapata*.⁵⁴ The court did not find the choice an easy one, but held that "International commerce has grown too large and the world too small for American courts to disregard the law of nations, even in favor of the Bankruptcy Act."⁵⁵

Thus, an international commercial contract negotiated at arm's-length by sophisticated businessmen containing a forum selection clause which selects a foreign forum will be upheld by American courts even in the face of such strong public policy as is manifested in the United States Bankruptcy Act and its grant of exclusive jurisdiction over bankruptcy matters to the federal bankruptcy courts.⁵⁶

Choice of Forum and Arbitration

The common law hostility to arbitration agreements was even greater than its aversion to forum selection clauses.⁵⁷ However, increased recognition among businessmen of the many advantages of arbitration caused Congress to pass the Arbitration Act of 1925.⁵⁸ In light of this specific congressional ap-

⁵²377 F. Supp. 26 (E.D.N.Y. 1974), *affirmed*, 517 F.2d 512 (2d Cir. 1975).

⁵³Treaty with Japan on Friendship, Commerce and Navigation; United Nation's Convention on the Recognition and Enforcement of Foreign Arbitral Awards. *See id.* at 30.

⁵⁴407 U.S. 1 (1972); note 53 above.

⁵⁵*Ibid.* at 32.

⁵⁶*See* 11 U.S.C. §§ 11 *et seq.*

⁵⁷Note, at p. 430. *See* note 6 above.

⁵⁹U.S.C. §§ 1 *et seq.*

proval the courts increasingly have upheld arbitration agreements.

In 1974 the United States Supreme Court decided *Scherk v. Alberto Culver Co.*,⁵⁹ and upheld an arbitration clause in an international commercial contract. Four justices dissented arguing that the strong policies behind the Securities Exchange Act of 1934 should have allowed plaintiff to maintain the suit in federal district court despite the arbitration agreement.

Alberto Culver Co., an American corporation, entered into a purchase agreement with Scherk, a German national, whereby Alberto Culver Co. bought several of his European businesses and certain associated trademarks which Scherk expressly warranted to have sole and unencumbered rights to. The contract contained an arbitration clause providing for settlement of any and all disputes by arbitration before the International Chamber of Commerce in Paris with the laws of the state of Illinois controlling. One year later Alberto Culver Co. found out that the trademarks were seriously encumbered and therefore it sought to rescind the contract, which Scherk refused. Alberto Culver Co. then sued in federal district court claiming violations of section 10(b) of the Securities Exchange Act of 1934,⁶⁰ and relying upon *Wilko v. Swan*,⁶¹ where the Court upon similar domestic facts had held an arbitration agreement void under the Securities Act of 1933.⁶²

The Court initially pointed out that *Wilko* was not controlling since it involved the Securities Act of 1933 and this suit involved the Securities Exchange Act of 1934. Fortunately, the Court did not base its holding on this weak distinction, but held instead that the crucial distinction was the fact that this was a "truly international agreement."⁶³ Thus, in the interest of stability of international commercial transactions the Court was willing to "sacrifice" an important American domestic policy. It cited *Zapata* and held:

An agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that posits not only the situs of suit but also the procedure to be used in resolving the dispute. The invalidation of such an agreement in the case before us would not only allow the respondent to repudiate its solemn promise but would, as well, reflect a "parochial concept that all disputes must be resolved under our laws and in our courts. . . . We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts."

....

[w]e hold that the agreement of the parties in this case to arbitrate any dispute arising out of their international commercial transaction is to be respected and enforced by the federal courts in accord with the explicit provisions of the Arbitration Act.⁶⁴

⁵⁹417 U.S. 506, 41 L. Ed. 2d 270, 94 Sup. Ct. 2449 (1974).

⁶⁰13 U.S.C. § 78j(b).

⁶¹346 U.S. 427 (1953).

⁶²15 U.S.C. §§ 77a, *et seq.*

⁶³417 U.S. 506, 515 (1974). *See* Note at 436.

⁶⁴*Id.* at 519-520.

Zapata and *Scherk* have established the guidelines for giving effect to forum selection clauses and arbitration agreements, i.e. the transaction must be "truly international" and the choice must be just and reasonable. However, the exact limits of these guidelines can only be established by future litigation.⁶⁵

In *McCreary Tire and Rubber Company v. CEAT*⁶⁶ the court held the congressional ratification in 1970 of the Convention on Recognition and Enforcement of Foreign Arbitral Awards was intended to eliminate vestiges of judicial reluctance to enforce arbitration agreements in the international commercial context. This mandated the federal district court to stay its proceedings pending arbitration of the dispute in Brussels, Belgium, as agreed upon in the tire distribution contract.

In *Biotronik, Etc. v. Medford Medical Instrument Co.*⁶⁷ the court was asked to refuse enforcement of a foreign arbitral award on grounds of fraud. The American party previously had notice of the arbitration proceeding in Paris, France, but it had not participated. The court held that failure of the adverse party to present the American party's case did not constitute fraud. Therefore, the court was required to enforce the award under the United Nation's Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

In *Sam Reisfeld and Son Import Co. v. S.A. Eteco*⁶⁸ the court upheld the stay of plaintiff's case pending arbitration in Contrai, Belgium, pursuant to a mandatory arbitration clause. Plaintiff argued that the chosen forum was so unreasonable that it should not be enforced. However, the court held that the unreasonableness test which *Zapata* applied to forum selection clauses was not applicable to arbitration clauses, which are governed exclusively by the Federal Arbitration Act.⁶⁹ The Act requires that "a party seeking to avoid arbitration must allege and prove that the arbitration clause itself was a product of fraud, coercion, or 'such grounds as exists at law or in equity for the revocation of any contract.'"⁷⁰ Thus, to invalidate an arbitration clause may require a showing of fraud in the inducement whereas to invalidate a forum selection clause may require only a showing of unreasonableness. In certain cases this may be a crucial difference. However, it is undesirable to have a different test applied to arbitration agreements, since there is no good reason for upholding an arbitration agreement in a situation where a forum selection clause would be held unreasonable. The standard should be the same for arbitration clauses and forum selection clauses, and the standard should be the reasonableness test.

⁶⁵See Note at 438.

⁶⁶501 F.2d 1032 (3d Cir. 1974).

⁶⁷415 F. Supp. 133 (D. N.J. 1976).

⁶⁸530 F.2d 679 (5th Cir. 1976).

⁶⁹U.S.C. §§ 1, *et seq.*

⁷⁰*Ibid.* at 681.

Finally, there are two cases which have refused to recognize a mandatory arbitration clause. In *Weissbuch v. Merrill Lynch, Pierce, Fenner and Smith*⁷¹ the court held that the arbitration agreement was unenforceable in the face of a rule 10b-5 claim, since there was no international concerns involved. In *Allegaert v. Perot*⁷² the court held that the trustee in Bankruptcy was not bound by the bankrupt's arbitration agreement.

Choice of Forum and Choice of Law

The United States Supreme Court has upheld the contractual selection of foreign forum⁷³ and foreign procedure,⁷⁴ but the question remains whether parties can freely select the applicable substantive law.

The substantive law which a chosen forum chooses to apply is a matter of its domestic choice of law principles. Oftentimes, the parties will select both the forum and the applicable law. However, in the absence of an express choice of law the chosen forum is justified in applying its own substantive law. Presumably this is what the parties intended. This, however, should only be a rebuttable presumption.⁷⁵

For purposes of this discussion it will be presumed, unless otherwise indicated, that the chosen forum would apply its own substantive laws.

This section deals with the problems that can be encountered under governmental interest analysis and constitutional due process when the chosen state applies its own laws.⁷⁶ The fact situations are based on *Zapata* and variations thereof. State *A* is the state where plaintiff is domiciled and his filed suit. State *B* is where the defendant is domiciled. State *C* is the disinterested third state. The relevant factors to be considered in governmental interest analysis are—

1. the domicile, nationality, residence or place of business of plaintiff;
2. the domicile, nationality, residence or place of business of defendant;
3. the locations of the transactions;
4. the chosen forum; and
5. the forum where suit is brought in contravention of the forum selection clause.⁷⁷

With some variations in the fact pattern four different situations can arise:

- I. Plaintiff files suit on State *A* in contravention of the forum clause which selected State *B*, and State *B* has the only relevant interests in having its

⁷¹558 F.2d 831 (7th Cir. 1977).

⁷²548 F.2d 432 (2d Cir. 1977).

⁷³*M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972).

⁷⁴*Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974).

⁷⁵Gilbert, at 43.

⁷⁶This discussion is based on a close reading of Gilbert, at 43-66, see note 1 above, and CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* (1963) [hereinafter cited as CURRIE].

⁷⁷Gilbert, at 45; CURRIE, at 82-83.

laws applied. This is a false conflict and Professor Currie argued that in this situation State *A* *must* apply State *B*'s laws or constitutional due process would be violated. Therefore, in this situation it would be consistent with Professor Currie's governmental interest approach and due process for State *A* to dismiss the suit and give effect to the forum selection clause.

- II. Plaintiff files suit on State *A* in contravention of the forum clause which selected State *B*, and State *A* has the only relevant interests in having its laws applied. This is also a false conflict, but governmental interest analysis and due process require that the interested state's law be applied. Thus, if the court in State *A* would give effect to the forum selection clause it would allow the parties to do with a choice of forum clause what they could not do with an express choice of law clause. Therefore, in this situation the court in State *A* would be justified in maintaining plaintiff's suit and to refuse to give effect to the forum selection clause.
- III. Plaintiff files suit in State *A* in contravention of the forum clause which selected State *B*, and both states have relevant interests in having their laws applied. This is true conflict and Professor Currie strenuously argued that the court where suit is filed, in State *A*, *must* apply its own laws or it would impermissibly be performing the legislative function of weighing the different state interests involved. Thus, in this situation the court in State *A* would be required by governmental interest analysis to deny enforcement of the forum selection clause. However, it would not violate due process by enforcing the forum selection clause, since State *B* does have the constitutionally required relevant interests. Therefore, if the court in State *A* is not bound by governmental interest analysis it may legitimately uphold the forum selection clause. This would be the case if State *A* follows a different conflicts of law theory, such as Professor Baxter's⁷⁸ comparative impairment approach or the RESTATEMENT'S (SECOND) CONFLICT OF LAWS (1971)⁷⁹ most significant relationship approach.
- IV. Plaintiff files suit in State *A* in contravention of the forum clause which selected State *C*, a disinterested third state with no relevant contacts. This was the fact situation in *Zapata*, but the Court never reached the conflict of laws problem. If suit had been filed in State *C*, Professor Currie would require State *C* to dismiss the suit on forum *non conveniens* grounds. This, however, would directly contravene the forum selection clause, which presumptively was inserted because it was convenient to litigate in State *C*. If the suit could not be dismissed Professor Currie would ask State *C* to

⁷⁸See *Bernhard v. Harrah's Club*, 128 Cal. Rptr. 215, 546 P.2d 719 (1976).

⁷⁹RESTATEMENT (SECOND) OF THE CONFLICT OF LAWS §§ 187, 188 (1971).

weigh the various interests involved and apply the law most similar to its own. However, our presumption was that State *C* would apply its own laws in the absence of an express choice of law provision. Thus, if State *C*'s laws are consistent with State *A*'s there is no conflict and State *A* should give effect to the forum selection clause. If State *C*'s laws are in conflict with State *A*'s, but consistent with State *B*'s, there is a true conflict. The resolution of this problem was discussed above, in subsection III. If State *C*'s laws are consistent with neither *A*'s nor *B*'s, State *C* would be a truly disinterested third state. In this situation, governmental interest analysis and due process would seem to prohibit the application of *C*'s laws, since it has no relevant contacts or interests. Therefore, if the suit had been filed in State *A* the court would have been justified in refusing to give effect to the forum selection clause.⁸⁰ This, however, is not a very satisfactory resolution of the problem, since in a "truly international transaction" State *C* is selected to provide a neutral forum, *because* it is a disinterested third state. The RESTATEMENT (SECOND) CONFLICT OF LAWS (1971)⁸¹ would uphold the choice of law and forum of a disinterested third state where the legal systems of the interested states are relatively undeveloped. This exception, though good, is too narrow and would not have allowed England to apply its laws in *Zapata*, since neither United States nor West Germany have relatively undeveloped legal systems. The suggested rule, for truly international transactions with their legitimate needs for a neutral third state forum, is that the choice of forum or choice of law clause should provide the constitutionally required contact and make these clauses permissible. This would be especially valuable where the chosen neutral forum has a special expertise in the particular field of law, as England has in the field of maritime law. However, this rule would only establish that a choice of forum clause which selects a disinterested third state is not unreasonable *per se* due to constitutional infirmity. The choice of forum would still have to satisfy the other elements of the unreasonableness test.

Selected Examples of Foreign Countries Attitude Toward Contractual Choice of Forum Clauses

England: Decisions dating back to 1796 have upheld the parties contractual designation of a forum of their choice,⁸² and it is assumed, in the absence of evidence to the contrary that the parties intended the laws of the selected

⁸⁰See *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930): Due process requires the state whose laws are applied to have some relevant contacts or interests in applying its laws.

⁸¹RESTATEMENT (SECOND) ON THE CONFLICT OF LAWS § 187, comment f (1971).

⁸²*Cavern and DaCosta, The Contractual Forum: Situation in England and the British Commonwealth*, 13 AM. J. COMP. LAW 179, 180 (1964).

forum to govern.⁸³ Also, in *Vita Food Products, Inc. v. Unus Shipping Co. Ltd.*⁸⁴ the Judicial Committee of the English Privy Council upheld the selection of English law even though the transaction had no relevant contacts with England.

Continental Europe: In most European countries the validity of forum selection clauses is recognized as a rule, with exceptions relating to certain matters only.⁸⁵ Such clauses are common in European contracts, and France, Germany, Holland and Belgium recognize their validity, whereas in Italy a choice of forum is held invalid when one of the parties is an Italian national or domiciliary.⁸⁶ The Draft Convention on the Jurisdiction of the Selected Forum in the case of International Sales of Goods prepared by the Hague Conference in 1956 expressly recognized the validity of forum selection clauses.⁸⁷

Latin America: The Latin American countries to a large degree follow the old French and Spanish theory of autonomy of will.⁸⁸ A basic civil law principle is "that which is not prohibited is permitted."⁸⁹ Therefore, the contractual selection of a forum is permitted, but it may not be "contrary to law, morals or public policy."⁹⁰ The Bustamonte Code which has been adopted in many Latin American countries recognizes this principle.⁹¹

A more exhaustive study of foreign countries' attitudes toward contractual choice of forum clauses is beyond the scope of this paper, but for the interested reader there are several good articles dealing with the comparative aspects of choice of forum clauses.⁹²

Conclusion

Zapata and *Scherk* have firmly established the principle that in a "truly international transaction" the parties may designate the forum where they will resolve any future dispute. The courts must give recognition to such forum selection clauses, unless the party seeking to "escape his contract" can carry the heavy burden of showing that the clause was unreasonable. This unreasonableness test has several elements which each or in combination may invalidate the clause. However, the limits of this test have not yet been established.

⁸³*Id.* at 181.

⁸⁴[1939] A.C. 277, 290 (D.C.).

⁸⁵VAN HECKE, CHOICE OF LAW PROVISIONS IN EUROPEAN CONTRACTS, at 44, INTERNATIONAL CONTRACTS: CHOICE OF LAW AND LANGUAGE, Oceana, 1962. [hereinafter cited as VAN HECKE].

⁸⁶VAN HECKE, at 44.

⁸⁷*Id.*

⁸⁸FOLSOM, CHOICE OF LAW PROVISIONS IN LATIN AMERICAN CONTRACTS, at 56, INTERNATIONAL CONTRACTS: CHOICE OF LAW AND LANGUAGE, Oceana, 1962. [Hereinafter cited as FOLSOM].

⁸⁹FOLSOM at 58.

⁹⁰FOLSOM at 56.

⁹¹FOLSOM at 55.

⁹²See Farquharson, *Choice of Forum Clauses—A Brief Survey of Anglo-American Law*, 8 INT'L LAW. 83 (1974), containing a bibliography; Lowe, *Choice of Law Clauses in International Contracts: A Practical Approach*, 12 HARV. INT'L L.J. 1 (1971); Pryles, *Comparative Aspects of Prorogation and Arbitration Agreements*, 25 INT'L AND COMP. L. Q. 543 (1976).