

## Arbitration in International Commercial Agreements: The Noose Draws Tighter

Corporate counsel faced with negotiating complex transactions between companies located in different countries are always met with the problem of providing for an effective dispute-settling mechanism. For years arbitration has been the favored solution. A variety of agencies and rules are available for the administrative supervision of any arbitration between entities located in different parts of the world. However, arbitration itself has certain inherent disadvantages of which many of us are aware.<sup>1</sup> Counsel often thought that they would worry about avoidance of an unpalatable arbitration somewhat later in the game. It has recently been made quite clear that once arbitration has been chosen, escape from the international arbitration clause is a result virtually impossible to accomplish.<sup>2</sup>

By a 5-4 vote, the United States Supreme Court has given its imprimatur to favoring arbitration in the international context where its decision prevented assertion of claims under the federal securities laws. Alberto Culver, an American company incorporated in Delaware and based in Illinois, had sought to avoid arbitration under an international agreement on the ground that the federal securities laws gave it the right to litigate in the federal courts its claims that it had been defrauded in buying a complex of business rights. In expanding its overseas operations, Alberto Culver had brought from Scherk, a German citizen, certain trademarks and the outstanding securities of two companies organized under the laws of Germany and Liechtenstein. The contract, which was negotiated in the United States, England and Germany, closed in Switzerland and contained a "broad" arbitration clause,<sup>3</sup> as well as

---

\*A.B., University of Michigan; LL.B., Yale University. Partner, Layton and Sherman, New York City.

<sup>1</sup>E.g., *Washington Baltimore Newspaper Guild, Local 35 v. The Washington Post Co.*, 442 F.2d 1234, 1238 (D.C. Cir. 1971).

<sup>2</sup>See, for example, the recent decision in *L/S Stavborg v. National Metal Converters, Inc.*, 500 F.2d 424 (2d. Cir. 1974), where the Court found the reasoning of an arbitral panel to be based on a clearly erroneous interpretation of the contract, but nonetheless refused to vacate an award entered thereon.

<sup>3</sup>E.g., as follows: "any controversy or claim [that] shall arise out of this agreement or the breach thereof" will be referred to arbitration before the International Chamber of Commerce in Paris, France; it also provided and that the laws of Illinois should govern the agreement.

express warranties that the trademarks were unencumbered. Upon later discovery that the trademarks were encumbered, Alberto Culver asserted in a complaint in the Federal District Court in Illinois that the purchase had been induced by fraudulent representations in violation of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Scherk moved to stay the action pending arbitration in France. The District Court denied the motion and enjoined Scherk from proceeding to arbitration and was upheld by the Court of Appeals.<sup>4</sup> The Supreme Court reversed and directed that the arbitration provision be enforced.

In *Scherk v. Alberto Culver Company*,<sup>5</sup> the Court pointedly noted that with respect to any contract touching two or more countries:

A contractual provision specifying in advance the form in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable pre-condition to achievement of the orderliness and predictability essential to any international business transaction. Furthermore, such a provision obviates the danger that a dispute under the agreement might be submitted to a forum hostile to the interests of one of the parties or unfamiliar with the problem area involved.

To Justice Stewart of our Supreme Court the overriding consideration was preventing damage to "the fabric of international commerce and trade" and imperilling the "willingness and ability of businessmen to enter into international commercial agreements." Most significant to the majority was the fact that the subject matter of the contract concerned business enterprises located abroad. In so doing, the Court departed from its prior decision in *Wilko v. Swan*,<sup>6</sup> where it had refused to compel arbitration in connection with a domestic dispute in which one of the parties sought to enforce alleged rights arising under the federal securities law which were claimed to override the provisions of an arbitration clause in a brokerage agreement. Justice Stewart held that in the context of an international contract the considerations which motivated the Court in *Wilko* become chimerical because the availability of speedy resort to foreign courts could hinder access to the American court chosen by a defrauded purchaser. In sum, the Supreme Court in the *Alberto Culver* case held that the agreement of parties to arbitrate "any dispute arising out of their international commercial transactions" would be respected and enforced by the federal courts.

The significant conclusion to be drawn from *Alberto Culver* is that once corporate counsel have acceded to a broad arbitration and forum selection clause, the prospect of ever avoiding resolution of any dispute before a panel of

---

<sup>4</sup>484 F.2d 611.

<sup>5</sup>417 U.S. 506 (1974).

<sup>6</sup>346 U.S. 427 (1953).

arbitrators is gone. Claims of fraud in the inducement of the contract itself are exclusively for the arbitrators as are claims of frustration or termination of the contract.<sup>7</sup>

The trend of the Court's thinking in this direction was forecast by its refusal in *M/S Bremen v. Zapata Off-Shore Company*,<sup>8</sup> to set aside a forum-selection clause in an international towage contract between a Houston-based American corporation and a German corporation which provided that all disputes "be treated before the London Court of Justice." The expansion of overseas commercial activities by United States companies in an era of expanding international trade led the Court to conclude that where two parties freely negotiate an international commercial agreement they will not escape specific enforcement of the selection of a foreign court submission, absent an overwhelming showing of unreasonableness, unfairness or injustice. "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."<sup>9</sup> The question presented thereafter, however, is how important the use of the broad forum selection clause becomes in negotiating a substantial international agreement. Obviously, the advantages of arbitration are the predictability of the forum in which the parties may eventually find themselves, and predictability with respect to the law which may be applied, as well as some of the procedures, which can be controlled by selection of a particular administering organ such as the International Chamber of Commerce.

It is worth giving serious consideration to the possibility of separating out certain types of disputes which are susceptible of being arbitrated by their very nature, from other types of disputes which United States businessmen are extraordinarily reluctant to leave to arbitrators. The *Alberto Culver* case is a good example. In the ordinary course of negotiation, one can expect problems to arise with regard to such matters as actual performance of the contract, delivery dates, quality of goods that are delivered, payments, and technical questions that require interpretation under the agreement. However, when one discovers at a later point and time the possibility that a fundamental fraud or misrepresentation may have occurred, the prospect of having such a claim arbitrated is somewhat frightening. By tradition and history, American lawyers are conditioned to presenting such claims in a court of law, where if their proof and claims are legally sufficient, the prospect exists of securing a binding ruling which may avoid the compromise nature of arbitration awards.

---

<sup>7</sup>Island Territory of Curacao v. Solitron Devices, Inc., 356 F.Supp 1 (S.D.N.Y. 1973); *aff'd*. 489 F.2d 1313 (2d Cir. 1973).

<sup>8</sup>407 U.S. 1 (1972).

<sup>9</sup>407 U.S. at 9.

To a large extent, the selection of arbitration itself, forum, law to be applied, and the type of arbitrators to be appointed, depends to a remarkable degree on the nature of the several contracting parties. For present purposes, the general rule that may be kept in mind is that where the contracting parties are sizeable corporations, each with relatively equal bargaining power, and reputations and interests for the future in conducting international trade, the risks of being completely taken advantage of in the arbitral setting are minimized. However, where the contract by its nature is one-sided, *i.e.*, where the contracting parties are not of equal bargaining power, where one of the parties is extremely unsophisticated, or has the potential of subjecting its counterpart to an unfriendly forum, to unfriendly courts and to a strange legal system, arbitration does not necessarily present a solution.

The prime danger of arbitration is that it may subject a corporation to specious or largely fabricated claims on the theory that somehow the panel of arbitrators will award something to the claiming party, whether out of sympathy, or out of desire to "split the baby," or out of a tendency not to leave one side completely unhappy. Such a result can be prevented by skillful ground rules set forth in an arbitration clause. One obvious solution is to provide that in the appointment of arbitrators, at least two out of three arbitrators shall be lawyers of a distinguished character selected from specified panels. Another solution is selection of an administering authority whose procedural rules and reputation are such that a fair amount of predictability and confidence is engendered in the course of supervision of the arbitral process. Particularly, corporations will have had differing experiences with entities such as the International Chamber of Commerce, the World Bank Centre for Settlement of Investment disputes, or the ICE rules.

Insufficient consideration has been given, however, to the possibility of restricting arbitration to the narrower areas in which technical expertise can truly make a contribution. For example, it is quite clear that the benefit of having experts in the particular subject areas of a commercial contract serving as dispute settlers is quite plain. Yet having such persons making determinations of fundamental questions such as, inducement to enter into a contract by fraudulent means, basic misrepresentations or claims of material breach of agreements, is unsatisfactory. American businessmen would clearly prefer to have such claims determined in a legal context. The dilemma could be resolved by using a narrow and carefully defined arbitration clause with respect to settlement of technical questions involving performance, payments, compliance with terms of the agreement from a technical point of view, and by specifying that recognized experts in addition to a lawyer would serve as dispute settlers for those purposes, while carefully reserving to a legal forum any other and more fundamental questions which can expose a company to large damage claims or substantial threats to its commercial relations. Where a narrow and

carefully defined arbitral provision is employed, the parties may be able to expect a speedy and relatively inexpensive dispute settlement which would permit them to negotiate remaining commercial differences and to proceed with any activities left to be performed. However, once arbitration is sought as a fundamental remedy in substantial money claims or for substantial questions as to performance arising out of a relationship which will continue in the future, a serious question arises as to whether the international arbitration process is either speedy or inexpensive. Many have found arbitration in the international context to be expensive, lengthy and unsatisfactory from the standpoint of resolving specific disputes where large amounts are at stake.

Often the solution to a search for a dispute-settlement mechanism is to pick none at all, thus leaving both parties faced with the unpleasant prospect of litigation in an unfriendly forum unfamiliar with the subject matter of the agreement. The Supreme Court has characterized this possibility as awarding the race to the diligent.<sup>10</sup> However, absent forum selection or arbitration, both sides are under substantial pressures to settle their disputes by negotiation rather than by the prospect of litigation either in the other party's backyard where expense, delay and a possibly unfavorable result may be anticipated; or where uncertainty cannot be tolerated. The litigated solution is unacceptable in commercial transactions in certain parts of the world such as the Soviet Bloc countries or Red China.<sup>11</sup> However, in most ordinary commercial contacts, the absence of any dispute-settling procedure may be an appropriate method of discouraging parties from failing to resolve questions by negotiation.

On the assumption that some arbitration provision, whether broad or narrow, is required in order to complete the transaction, counsel should give consideration to modifications of the standard arbitration provision so as to decrease the disadvantages of the arbitration proceedings. In order to assure that any award rendered as the result of international arbitration may speedily be enforced, the clause should express agreement by the parties that "any award made shall be complied with and may be entered as a judgment in any jurisdiction." In the absence of such language, United States courts have held that under the Federal Arbitration Act judgment may not be rendered on an award in Federal district courts pursuant to a contractual provision which did not contain language evidencing the intention of the parties that judgment be rendered thereon in any court in any jurisdiction.<sup>12</sup>

---

<sup>10</sup>94 S. Ct. 2455-56.

<sup>11</sup>The Soviets to date have preferred arbitration in Sweden with the President of the Stockholm Chamber of Commerce appointing the arbitrator. STRAUSS, *THE GROWING CONSENSUS ON INTERNATIONAL COMMERCIAL ARBITRATION*, *supra* at p.710.

<sup>12</sup>*Varley v. Tarrytown Associates, Inc.*, 477 F.2d 208 (2d Cir. 1973). However, recently where the parties have by conduct or in some manner other than specific language (use of Federal court power

The procedural law to govern the conduct of the proceeding, as well as the substantive law, should be specified; otherwise substantial precedent exists for implying that the procedural rules of the country or province where the award is made will apply. If the parties have not specified the locale either, this significant decision and others will be made by the administering agency.<sup>13</sup>

Oftentimes under the procedural rules of the administrative agency supervising the arbitration (such as ICC), the parties enter into "terms of reference" by which they specify particular ground rules. It is not unusual in such a document for the parties once again to agree to "comply in all respects with any award rendered by the arbitrators." However, there is much slippage between the rendering of an award and the time when a check is issued to the prevailing party. For that reason among others, after many years of experience, the principal commercial nations, members of the United Nations, drafted the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.<sup>14</sup>

Congress in 1970 implemented that Convention by passing Chapter II of the United States Arbitration Act, 9 U.S.C. Section 201 ff. The goal of the Convention was to unify the treatment given to commercial arbitration agreements in international contracts and to aid in their speedy enforcement. Nonetheless, on the assumption that an appropriate award has been rendered in favor of a prevailing party, should the losing party, whether a foreign corporation or not, resist or simply refuse to honor the award, proceedings must be instituted in the courts of the losing party's country for enforcement of the award. Enforcement proceedings add an additional and expensive aspect to the litigation process.<sup>15</sup> For example, under the Convention as adopted by the United States, a resisting party has at least four, and possibly five, defenses available to it upon being sued in a Federal District Court. The assumption of the rules of procedure of most administrative arbitration associations is that the parties will comply in good faith with any award rendered by a majority of the arbitrators or by a single arbitrator. Unfortunately, this is not always the case. Consideration should, therefore, be given to providing that both parties to any arbitration must post security in the nature of a bond with the arbitration association in question to ensure that any award rendered may be collected out of such a bond. The advantage of such a provision would be to discourage unnecessary resistance to the enforcement of an award. On the other hand, where a corporation is compelled to enter into an arbitration clause much against its better judgment,

---

to appoint an arbitrator, or a motion to vacate an award) evidenced an intention to have judgment entered by a Federal court, their consent has been implied. *Stavborg v. National Metal Converters*, *supra*. Such problems may be avoided by clearly providing for entry of judgment.

<sup>13</sup>See Cohn, *The Rules of Arbitration of The International Chamber of Commerce*, Vol. 14 INTL. AND COMP. L.Q. 150-52 (Jan. 1965).

<sup>14</sup>9 U.S.C. Ch. 2, T.I.A.S. 6997.

<sup>15</sup>See Cohn, *supra* n. 13 at pp. 165-68.

the posting of such security would be substantially to its disadvantage. As indicated above, if it refuses to comply with an award which has been entered against it, and there are insufficient assets to be levied against in the other party's country, a proceeding must be brought in its own home territory to enforce the award. Under Article V, several defenses are available against enforcement of an international arbitration award. They very type of challenge raised by Alberto Culver in the *Scherk* case would be available to Alberto Culver in challenging enforcement of the award.<sup>16</sup> It might also be argued that the procedures employed by the arbitrators themselves were not in accord with the procedures set forth in the agreement or that recognition or enforcement of the award is contrary to the public policy of the enforcing country. Most recently an American corporation, Parsons & Whittemore Overseas, Inc., lost an arbitration proceeding to an Egyptian corporation over an agreement to construct, start up, manage and supervise a paperboard mill in Alexandria, Egypt. Parsons sought a declaratory judgment to prevent enforcement of the award and the Egyptian company counterclaimed for enforcement of the award under the Convention. The American company raised four defenses available to it under Article V (1) and (2) of the Convention, as well as the claim that the award was "in manifest disregard of law." All of the defenses were rejected by the District Court whose decision was recently affirmed by the U. S. Court of Appeals for the Second Circuit.<sup>17</sup>

The Court noted that the American corporation had the burden of proof in resisting enforcement of the award<sup>18</sup> and, after analysis of the legislative history of the Convention and the United States enabling legislation, concluded that defenses against enforcement should all be construed narrowly. There, severance of United States-Egyptian diplomatic relations and withdrawal of AID financing of the project were rejected as a public policy defense on the ground that equating "national" policy with basic notions of morality and justice constituted a parochial device that would undermine the Convention's utility. Similarly, the Court rejected the claims that (1) United States foreign policy issues made the subject matter non-arbitrable, (2) that the United States company was "unable to present" its case before the arbitrators since the speaking schedule of one of its witnesses did not enable him to attend the hearings, (3) that the arbitrators exceeded their authority, or (4) that the award was in manifest disregard of the law.

<sup>16</sup>See note 14, 94 Sup. Ct. 2449 at p. 2457.

<sup>17</sup>*Parsons & Whittemore Overseas, Inc. v. Societe Generale De L'Industrie Du Papier (RAKTA)*, Nos. 174, 637, \_\_\_\_\_ F.2d \_\_\_\_\_ (Dec. 23, 1974), 43 LW 2298; text in 9 INT'L LAW. (1975) pp. 545 ff.

<sup>18</sup>No doubt exists on this score. See Quigley, *Accession by the United States to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 70 YALE L.J. 1049 (1961); G.W. HAIGHT, SUMMARY ANALYSIS OF RECORD OF THE UNITED NATIONS CONFERENCE.

The lesson of *Parsons & Whittemore* is plain that as the United States had embarked on a policy favoring the supra-national emphasis of the Convention, that policy would be enforced by the courts; and accordingly defenses against confirmation of a foreign arbitral award will be strictly construed.

The Court noted that: "There is no special national interest in judicial, rather than arbitral, resolution of," breach of contract claims in the international breach of contract claims in the international context.

The Supreme Court observed that the United States cannot legislate that all disputes involving international contracts must be determined by the standards of justice which exist under United States law in preference to the laws of other countries on the assumption that American standards of fairness are superior to those prevailing elsewhere. The purpose of the Convention was to provide speedy and effective enforcement of a controversy already decided by arbitrators. It was further the intention of the Convention that courts of signatory countries where enforcement is sought should not lightly decline enforcement on the basis of parochial views as to the terms of the agreement or the decision made by the arbitrators.<sup>19</sup> Nonetheless, the Convention provides that recognition of an award may be refused when the arbitration agreement "is not valid under the law to which the parties have subjected it."<sup>20</sup>

Counsel should be aware that in specifying the law which will govern interpretation of the contract itself, consideration should be given to such matters as ultimate enforcement, public policy, and the subject matter of the contract itself.<sup>21</sup> The dissenting opinion in *Alberto Culver* would have found the agreement to arbitrate a claim of securities fraud "null and void, inoperative or incapable of being performed"<sup>22</sup> on the theory that in Section 29(a) of the 1934 Securities and Exchange Act Congress had made agreements to arbitrate liabilities under said Act "void" and "inoperative." However, the decision of the majority makes clear that upon signing an international agreement containing a broad arbitration provision, a litigant gives up its federal securities rights; and arbitrators would be deciding whether securities fraud or misrepresentations in the making of the agreement were insufficient to block enforcement of the agreement. Additionally, the dissent noted that when relegated to the arbitration process itself, a party effectively loses its right to the extensive pre-trial discovery provided by the Federal Rules of Civil Procedure. Additionally, most arbitral awards can be made without explication of reasons

---

<sup>19</sup>See HAIGHT, *op. cit.*, note 18, *supra*, pp.24-28.

<sup>20</sup>Article V(1)(a).

<sup>21</sup>It must also be borne in mind that in the absence of specifying the locale for arbitration, the law chosen may influence the decision by an administering agency or court as to locale. See *Aerojet-General Corporation v. American Arbitration Association* F.2d (9th Cir. 1973).

<sup>22</sup>94 S. Ct. at p. 2461.



and may also be made without development of a record. It may therefore be extremely difficult to resist enforcement of the award in a Federal District Court, not having had opportunity for pre-trial discovery in the arbitral process itself and possibly not having a complete record of the proceedings which took place or a reasoned opinion by the arbitrators.<sup>23</sup>

An interesting question is raised upon the application for enforcement of an award when the resisting party attempts to employ the full panoply of federal pre-trial discovery in order to make out its defense that the award was in some manner improperly arrived at, apart from simply disagreeing with the judgment of the arbitrators. In *Solitron Devices v. Territory of Curacao*,<sup>24</sup> the first decision reported under the Convention, the proceeding was conducted entirely on the basis of affidavits, as would appear to be required by construction of Title 9, United States Code Section 6, which makes it clear that any applications are to be treated as motions would be treated in the federal courts. **Quaere**, whether anything but the most limited type of discovery is available in connection with resisting a motion for confirmation, absent a factual showing which would warrant broad Federal discovery procedures.

From the above, several basic considerations become evident:

1. Strong United States and international policy exists favoring arbitration as a dispute-settling device on the theory of encouraging international business transactions by American businessmen.

2. Upon signing a broad arbitration clause the American corporate contractor waives most of the rights otherwise available to it which are created by federal statute. The prospect noted by a footnote in the majority opinion in *Alberto Culver* seems a very unlikely and unrewarding manner of vindicating federal rights.

3. It is questionable that when actually engaged in arbitration anything approaching the procedural rights ordinarily available to a United States corporation in Federal litigation can be found through the administration of an international arbitration.

4. Serious consideration should be given to using narrow rather than broad arbitration provisions. In any terms of reference or compromise signed prior to commencement of an arbitration, thought should be given to providing for posting of security by the party seeking to arbitrate as well as by the party resisting arbitration, and to providing for the imposition of penalties upon a party delaying the arbitral process.

---

<sup>23</sup>See *I/S Stavborg v. National Metal Converters*, *supra* at 429, where it is noted that the AAA discourages the practice of written opinions in order to further insulate the arbitral process from judicial review.

<sup>24</sup>356 F. Supp. 1 (S.D.N.Y. 1973).

5. Since many negotiations will not permit the drafting of such complex or sophisticated arbitration provisions, consideration ought to be given to simply doing away with arbitration and providing that upon the claim by one party of a breach of the agreement, the opposite party consents to suit in the Federal District Court in which it does business or in the local foreign court in which it conducts its business. Thus, the party seeking to litigate is exposed to the expense of initiating suit in a foreign country and in the backyard of its opposite number. While not entirely satisfactory this device should serve to discourage the making of baseless claims or unnecessary resort to the litigating process.

6. Consideration should also be given to providing for continuation of performance under an agreement, where essential or appropriate, while arbitration or court resolutions are sought.

7. In choosing the law which will govern interpretation of an international agreement itself, attention ought to be given to the law which will govern the procedural aspects of arbitration. In the face of silence on that subject, it has often been held that the procedural law of the physical place where arbitration takes place will govern. Parties are often sorely disappointed when they find that substantial aspects of their claims are adversely affected by such local procedural law.<sup>25</sup> The preferred method would be to specify procedural law as well as substantive law governing the contract provisions themselves.

8. Additionally, the arbitration clause should make clear whether party-appointed arbitrators are expected to be impartial and independent or whether they are to be in the nature of the advocate of one of the parties. In the first case, the arbitrator must disclose any financial or personal interest or even prior connection with the party that appointed him and any other party, and during the course of the proceedings his conduct must be above reproach and insulated from his nominator. Any other conduct could serve as grounds for setting aside the award. In the event of the party-appointed arbitrator being considered as the advocate of a party, it is assumed that he has some contacts or connection with the party appointing him and he may be thought of as the explicator of the position taken by his nominator.

Finally, once the arbitration clause is inserted into an agreement, it is clear from the trend of decisions that its impact will not lightly be avoided; hence when the choice is made it should be an educated one.

---

<sup>25</sup>J. Cohn, *supra*, n. 13 pp. 150-54.