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STUDENT COMMENT

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INTRODUCTION

International commercial arbitration is slowly emerging as a viable alternative to traditional litigation as a means of resolving disputes between parties to a transnational contract. Many businessmen prefer to submit their differences to arbitration because they believe that national court systems do not provide commercially desirable forums in which to settle international business disputes. It should be stressed, however, that the arbitration process is still fraught with many obstacles and should not be viewed as a panacea to be included in every international contract. For example, arbitration is not necessarily less expensive than the litigation process, nor is it always more expeditious.[1] There are still instances when arbitration constitutes nothing more than the first step of a conflict resolution which inevitably finds its way to the courtroom.[2]

Despite the potential disadvantages mentioned above, arbitration can be extremely valuable when the arbitration clause in the contract has been carefully drafted to reflect the specific needs of the respective parties. Recent court decisions indicate that the arbitration process is being applied more consistently, and arbitration clauses are being stringently enforced with few exceptions. This is

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1. The cost of arbitration proceedings under the International Chamber of Commerce (ICC) is based on a graduated percentage of the amount of the dispute. A case involving a claim of $1,200,000 which is decided before three arbitrators would cost between $39,125 and $110,350, including registration fees, arbitration fees, and administrative charges. This amount does not include, however, additional attorney fees, expert witness fees, travel expenses, etc. *See* ICC Arbitration: The International Solution to International Business Disputes, ICC Publication 301, ICC Services S.A.R.L. 1977.

2. This is especially true if one of the defenses enumerated in Article V of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards is proven. See note 3 *infra*.

primarily the result of the United States' ratification and subsequent implementation of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (Convention),[3] as evidenced by the 1970 amendments[4] to the Federal Arbitration Act of 1925.[5] United States courts are no longer quite so fearful of having their powers usurped by arbitration proceedings. Furthermore, the International Chamber of Commerce has facilitated the arbitration process by formulating uniform rules of procedure which help to provide predictability as well as to diminish the possibility of an inequitable result.[6] The purpose of this comment is twofold: (1) to trace

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3. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, *opened for signature* June 10, 1958, T.I.A.S. No. 6997, 330 U.N.T.S. 38 [hereinafter cited as Convention]. For an excellent analysis of the Convention see Quigley, *Convention on Foreign Arbitral Awards* 58 A.B.A.J. 821 (1972). For a recent review of the Convention, see Sanders, *A Twenty Year's Review of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 13 INT'L LAW. 269 (1979).

The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *done at* Washington, Mar. 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159, represents another multinational attempt to settle disputes through arbitration. This convention, which does not apply to private parties, concerns disputes between a foreign investor and a host state. For an analysis of this treaty, see Coll, *United States Enforcement of Arbitral Awards Against Sovereign States: Implications of the I.C.S.I.D. Convention*, 17 HARV. INT'L L. J. 401 (1976).

The European Convention on International Commercial Arbitration, *done* Apr. 21, 1961, 484 U.N.T.S. 349, and the Inter-American Convention on International Commercial Arbitration, OAS/Ser. A/20 (SEPF), 14 INT'L LEGAL MATERIALS 336 (1975) represent regional efforts to achieve uniformity in international commercial arbitration procedures. For an analysis of the Inter-American Convention, see Association of the Bar of the City of New York, Committee on Arbitration, *The Inter-American Convention on International Commercial Arbitration*, 9 LAW. AM. 43 (1977).

4. 9 U.S.C. §§ 201-208 (1976).

5. 9 U.S.C. §§ 1-14 (1976).

6. The ICC created the Court of Arbitration in 1922. The Court is comprised of five Vice-Chairmen, a Secretary General, technical advisers chosen by the ICC Council, and members appointed by ICC National Committees and Councils. The Court does not settle the dispute itself; rather it supervises the application of the ICC Rules of Conciliation and Arbitration (Rules) by the arbitrator(s) named in each individual case. Other functions of the Court include: (1) taking any necessary measures with regard to appointing, replacing, or challenging the arbitrators; (2) determining the place of arbitration when the parties have not already done so; (3) determining if a binding arbitration clause exists between the parties, in the event of a challenge; (4) ensuring that the arbitrators' terms of reference are drafted without delay; (5) setting a time limitation at which the arbitration shall proceed in the event that one of the parties refuses to sign the terms of reference; (6) extending time limits for making the award, if necessary; (7) scrutinizing the draft award to determine if modifications are required, and/or drawing the arbitrators' attention to points concerning the merits of the case without in any way affecting their liberty of decision; and (8) determining the amount of deposit to be made at the commencement of the proceeding and the

the development of the factors which ultimately resulted in the seriousness with which the judicial system now interprets international commercial arbitration clauses; and (2) to outline the remaining (albeit narrow) defenses to foreign arbitral awards. In particular, the construction of the nonarbitral subject matter defense as interpreted by United States courts will be examined in a national and international context.

The Geneva Protocol on Arbitration Clauses and the Geneva Convention of the Execution of Foreign Arbitral Awards

The 1923 Geneva Protocol on Arbitration Clauses[7] and the 1927 Geneva Convention on the Execution of Foreign Arbitral Awards[8] represented the first major multilateral efforts to uniformly recognize arbitral awards as binding. The Protocol recognized as valid and irrevocable all existing and future agreements to arbitrate between nationals of Contracting States.[9] Under the Protocol, the arbitration agreement could concern any matter capable of settlement by arbitration. However, the Contracting States could reserve the right to limit the arbitrability of a dispute only to those agreements which were commercial in nature.[10] Where a suit was brought despite an arbitration agreement, courts were required to stay proceedings pending arbitration.[11] Awards would only be enforced in accordance with the law of the forum state.[12]

The Geneva Convention was supplementary to the Protocol, and applied only to arbitral awards made pursuant to the Protocol. Article 1 of the Geneva Convention provides that submission to the arbitration be "recognized as binding and shall be enforced in accordance with the rules of the procedure of the territory of one of the High Contracting Parties to which the present Convention applies

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costs of the arbitration, in accordance with the schedule annexed to the Rules. *Supra* note 1, at 13.

The ICC boasts a high rate of success—over 90% of the awards made by the ICC are settled promptly and without question. This is partially attributed to the ICC Rules which are regularly revised to adapt to changes and developments in international commercial relationships. *Id.* at 11.

7. Geneva Protocol on Arbitration Clauses, *adopted* Sept. 24, 1923, 27 L.N.T.S. 158 [hereinafter Geneva Protocol].

8. Geneva Convention on the Execution of Foreign Arbitral Awards, *adopted* Sept. 26, 1927, 92 L.N.T.S. 301 [hereinafter Geneva Convention]. For a discussion of the Geneva Protocol and the Geneva Convention, see Contini, *International Commercial Arbitration*, 8 AM. J. COMP. L. 283, 287-90 (1959).

9. Geneva Protocol, art. 1, note 7 *supra*.

10. *Id.*

11. *Id.* art. 4.

12. *Id.* art. 3.

and between persons who are subject to the jurisdiction of one of the High Contracting Parties."[13] Furthermore, Article 1 lists five defenses which may be raised against enforcement and recognition of arbitral awards, one of the most significant of which is as follows:

> (b) that the subject matter of the award is capable of settlement by arbitration under the law of the country in which the award is sought to be relied upon.[14]

Article 2 lists three more exceptions, including annulment by the country in which the award was made, notice requirements, and matters which do not fall within the terms of the submission to arbitration.[15] The remaining articles deal with enforcement and defense procedures.[16] The United States is not a party to either the Protocol or the Geneva Convention, primarily because accession would have conflicted with the arbitration statutes of the several states at the time.

The New York Convention

The 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards[17] represented a culmination of increasing international support for the use of commercial arbitration. Adopted and signed by twenty-three of forty-five countries participating in the U.N. Convention on Commercial Arbitration, the New York Convention signified an international desire to unify the law so as to give full effect to international arbitration agreements outside of the countries where they were formulated. Article V of the New York Convention is essentially an evolution of Articles 1 and 2 of the Geneva Convention, in that it lists different defenses to foreign arbitral awards. The New York Convention, however, provides that only two of these defenses may be raised *ex officio* by a court of the state requested to enforce an award:

> (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
> (b) The recognition or enforcement of the award would be contrary to the public policy of that country.[18]

Although the United States participated in the conference, it did not sign the New York Convention for the following reasons: (1) if the United States ratified the Convention in a manner which would

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13. Geneva Convention, art. 1, note 8 *supra.*
14. *Id.* art. 1(b).
15. *Id.* art. 2(a)-(c).
16. *Id.* arts. 3-11.
17. *See* note 3 *supra.*
18. *Id.* art. V(2)(a)-(b).

avoid conflict with state laws, there would be no meaningful advantages to be gained; (2) if it ratified in a manner that assured such advantages, it would override a majority of state arbitration laws; (3) the United States lacked an adequate legal basis to accept an international convention dealing with this subject matter; and (4) the New York Convention endorsed principles of arbitration law that would be undesirable for the United States to embrace.[19]

In 1968, prompted by increased private support for an international agreement that would support commercial arbitration, President Johnson submitted the Convention to the Senate, which in turn gave its advice and consent to ratification. Accession was delayed until the necessary legislation could be implemented. After legislation was enacted that amended the Federal Arbitration Act of 1925 and clarified existing law and procedures pursuant to the objectives of the Convention, the United States fully ratified the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards on February 1, 1971.

The Federal Arbitration Act of 1925

Historically, the United States courts have reacted with hostility to arbitration agreements, fearing that their jurisdiction was being circumvented. Finally in 1925, the Federal Arbitration Act (1925 Act)[20] was enacted which declared arbitral agreements to be "valid, irrevocable and enforceable."[21] Unfortunately, it was several years before arbitration agreements received consistent treatment in the courts. In 1959, the Second Circuit held in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*[22] that the 1925 Act created federal rather than state law, and in *Prima Paint Corp. v. Conklin*[23] the Supreme Court finally upheld this construction of the 1925 Act.

The 1925 Act provides for enforcement of arbitration agreements in the federal courts, and permits the federal court in the district in which the award was rendered to confirm the award.[24] It also provides for the staying of litigation instituted by one party in defense of an arbitration agreement between the parties.[25] However, under the 1925 Act a party must satisfy all the usual requirements to gain

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19. *See* Aksen, *American Arbitration Accession Arrives in the Age of Aquarius: United States Implements United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 3 SW. U. L. REV. 1, 4 (1971).

20. 9 U.S.C. §§ 1-14 (1976).

21. *Id.* § 2.

22. 271 F.2d 402 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960).

23. 388 U.S. 395 (1967).

24. 9 U.S.C. § 9 (1976).

25. *Id.* § 3.

access to the federal courts.[26] Furthermore, arbitration clauses in international contracts which do not affect the foreign "commerce" of the United States are not within the scope of the 1925 Act, regardless of whether an American citizen is a party to the contract.[27]

Although the courts were generally more prone to uphold the validity of arbitration agreements after the passage of the Federal Arbitration Act of 1925, certain kinds of issues were still considered to be nonarbitrable by their very nature. A brief discussion of particular disputes between domestic parties which are deemed to be nonarbitrable by U.S. courts will provide a useful backdrop for the examination of the aspects of international arbitration.

The plaintiff in *Wilko v. Swan*[28] was a purchaser of securities who brought suit against a brokerage firm to recover damages for misrepresentation under section 12(2) of the Securities Act of 1933 (1933 Act).[29] The defendant moved for a stay of proceedings pending arbitration in accordance with an agreement between the parties. The district court denied the stay,[30] and held that the arbitration agreement deprived the plaintiff of the advantageous court remedy provided by the 1933 Act. A divided court of appeals reversed,[31] holding that the Securities Act of 1933 did not prohibit the agreement from referring future controversies to arbitration. The United States Supreme Court granted certiorari "to review this important and novel federal question affecting both the Securities Act and the United States Arbitration Act."[32] The Supreme Court held that the agreement to arbitrate was void under section 14 of the 1933 Act and reversed. Section 14 states: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."[33] The Court found the arbitration agreement to be a "stipulation" and the right to select a judicial forum a "provision" which could not be waived under section 14.

In reaching its decision, the Court recognized the conflict between the Securities Act of 1933, which was enacted by Congress to protect the rights of investors and which forbids a waiver of any of

26. *Id.* § 4.
27. *Id.* § 2.
28. 346 U.S. 427 (1953).
29. 48 Stat. 74, 15 U.S.C. § 77a.
30. *See* Wilko v. Swan, 107 F. Supp. 75 (S.D.N.Y. 1952).
31. *See* Wilko v. Swan, 201 F.2d 439 (2d Cir. 1953).
32. 346 U.S. at 430.
33. 48 Stat. 84 (1933) (codified at 15 U.S.C. § 77n (1976)).

these rights, and the United States Arbitration Act which "establishes by statute the desirability of arbitration as an alternative to the complications of litigation."[34] In ultimately concluding that "the intention of Congress concerning the sale of securities is better carried out by holding invalid . . . an agreement for arbitration of issues arising under the [1933] Act,"[35] the Court stated that "the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness,"[36] and that "Congress must have intended § 14 . . . to apply to a waiver of judicial trial and review."[37]

Wilko is considered to be a leading decision concerning the issue of whether federal law precludes certain matters from being submitted to arbitration. Relying on *Wilko*, *American Safety Equip. Corp. v. J. P. Maguire & Co.*[38] held that antitrust claims may not be settled by arbitration. The case concerned the grant by Hickok Manufacturing Company (Hickok) of an exclusive license to American Safety Equipment Corporation (ASE) to use the Hickok trademark in connection with safety protective devices and accessories. Paragraph 3 of the license agreement provided for royalties based on ASE's total annual sales of safety protective devices whether or not the Hickok trademarks were used, and on accessories if sold under trademark. Paragraph 27 permitted ASE to grant sublicenses for territories outside the United States subject to approval by Hickok, if certain conditions were met, the most important of which was that a sublicensee could not be "a competitor of Hickok or of any of its licensees with respect to any products sold or dealt with by said proposed licensee."[39] The license also provided for disputes and claims arising out of the agreement to be settled by arbitration.

In 1966, three years after the license had been granted, ASE sought a declaratory judgment in the district court that the license agreement was void *ab initio* and that no obligations had or would accrue under it. The complaint alleged that certain paragraphs of the agreement unlawfully extended Hickok's trademark monopoly and unreasonably restricted ASE's business and, therefore, violated the Sherman Act.[40] Maguire, claiming to be an assignee of Hickok's royalty rights, invoked the arbitration clause claiming royalties due

34. 346 U.S. at 431.
35. *Id.* at 438.
36. *Id.* at 437.
37. *Id.*
38. 391 F.2d 821 (2d Cir. 1968).
39. *Id.* at 822.
40. *Id.* at 823.

under the license agreement. ASE filed another declaratory action against Maguire, repeating the relief requested against Hickok, and seeking an injunction against the arbitration proceeding commenced by Maguire. ASE asserted that the district court had exclusive jurisdiction to determine the existence of antitrust violations. In addition, it claimed that the purported assignment was invalid and, therefore, Maguire had no right to demand arbitration under the agreement. The district court not only held that the validity of the assignment should be resolved in arbitration, but also found the arbitration clause to be broad enough to encompass claims of antitrust violations.[41]

On appeal, the court of appeals determined that the district court had erred in staying ASE's actions and ordering arbitration of ASE's antitrust allegations. In its opinion the court cited *Wilko v. Swan*:[42]

> We think that the remedy a statute provides for violation of the statutory rights it creates may be sought not only in any "court of competent jurisdiction" but also in any other competent tribunal, such as arbitration, *unless the right itself is of a character inappropriate for enforcement by arbitration.* (Emphasis supplied.)[43]

The court recognized a "conflict between federal statutory protection of a large segment of the public, frequently in an inferior bargaining position, and encouragement of arbitration."[44] It went on to compare a plaintiff asserting rights under the Sherman Act to a "private attorney-general who protects the public's interest."[45] Noting that antitrust violations can affect staggering numbers of people, the court believed that Congress intended such claims only to be resolved in the courts. Even if all antitrust litigations do not reach such swollen proportions, "a rule to govern the arbitrability of antitrust claims, . . . must consider the rule's potential effect."[46]

Furthermore, the court found "the issues in antitrust cases are prone to be complicated, and the evidence extensive and diverse, far better suited to judicial than to arbitration procedures."[47] In addition, because commercial arbitrators are often chosen for their busi-

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41. *See* American Safety Equip. Corp. v. Hickok Mfg. Co., 271 F. Supp. 961 (S.D.N.Y. 1967).
42. 201 F.2d at 444.
43. 391 F.2d at 825.
44. *Id.* at 826.
45. *Id.*
46. *Id.* at 827.
47. *Id.*

ness expertise, and it is the business community that generally is regulated by the antitrust laws, it would not seem appropriate for arbitrators to determine these kinds of issues.[48]

Although the court determined potential antitrust violations to be outside the realm of arbitration, it expressed general support for the enforcement of arbitration clauses in most instances. The opinion makes reference to a few cases where the court upheld arbitration clauses.[49] Even in this decision it found the antitrust claims to be severable, and thus, the other disputes would be appropriate for arbitration.

The defense of nonarbitrable subject matter also proved successful in a patent dispute, *Beckman Instruments, Inc. v. Technical Dev. Corp.*[50] Beckman refused to pay royalties on an apparatus covered by a patent it had sublicensed from Technical. Pursuant to the terms of the agreement, Technical demanded that the dispute be submitted to arbitration. Beckman then filed a complaint in the district court challenging the validity of the patent. Relying solely upon the doctrine of licensee estoppel,[51] the district court entered judgment for Technical. The district court also vacated its prior order staying all judicial proceedings pending arbitration, and entered an order restraining arbitration during the pendency of the appeal.

Two months after the district court reached its decision, the court of appeals found that the doctrine of licensee estoppel had been overruled by the U.S. Supreme Court in *Lear, Inc. v. Adkins*.[52] The court of appeals then determined that the parties did not expressly provide for arbitration of patent validity questions, and in any event, "such questions are inappropriate for arbitration proceedings and should be decided by a court of law, given the great public interest in challenging invalid patents."[53] The court of appeals cited the language of the district court in affirming their decision as to the

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48. *Id.*

49. *Id.* at n.11. The court makes reference to Atlantic City Elec. Co. v. General Elec. Co., 226 F. Supp. 59 (S.D.N.Y. 1964); and Ohio Valley Elec. Corp. v. General Elec. Co., 244 F. Supp. 914, 949-51 (S.D.N.Y. 1965).

50. 433 F.2d 55 (7th Cir. 1970).

51. Under the doctrine of licensee estoppel, a licensee was generally estopped from challenging the validity of the patent on any ground, especially where the licensee had acknowledged the validity of the patent and agreed not to contest it. "The general rule is that the licensee under a patent license agreement may not challenge the validity of the licensed patent in a suit for royalties under the contract." Automatic Radio Mfg. Co., Inc. v. Hazeltine Research, Inc., 339 U.S. 827, 836 (1950), *rehearing denied*, 340 U.S. 846 (1950).

52. 395 U.S. 653 (1969).

53. 433 F.2d at 63.

arbitrability of patent disputes:

> The complex principles of patent law which a court must consider and apply when deciding issues of validity and infringement, affect important questions of public policy and public rights. In considering the validity of patent claims, a court makes decisions crucial not only to the parties involved, but of vital importance to the public generally.[54]

Thus, the court held that issues concerning the validity of a U.S. patent were incapable of being determined by arbitration proceedings.

Federal Arbitration Act of 1970

After the passage of the Federal Arbitration Act of 1925, U.S. courts increasingly acknowledged the validity of arbitration agreements. However, certain categories of disputes were still considered to be nonarbitrable under U.S. law. As explained above, the most prominent categories which were deemed to be nonarbitrable were those disputes which concerned patent validity, antitrust claims, and disputes arising under the securities laws.

In 1970 the Federal Arbitration Act of 1925 was amended in order to effect the United States' enforcement of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The implementing legislation to the Convention[55] is really an additional chapter (1970 Act) to the 1925 Act rather than an amendment in the true sense of the word. The 1970 Act is comprised of eight short sections (sections 201-208). Section 202 states that an arbitration agreement or arbitral award that arises out of legal relationships which are considered commercial (whether or not contractual) falls within the Convention. If United States citizens are the only parties to such an agreement, the Convention will not apply "unless that relationship involves property located abroad, or has some other reasonable relation with one or more foreign states."[56]

Section 203 grants original jurisdiction to the federal district courts for actions which fall under the Convention, regardless of the amount in controversy. Other important sections of the 1970 Act include section 205 which allows the defendant in an enforcement proceeding to remove the action from a state to a federal court. Section

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54. *Id.*

55. 9 U.S.C. §§ 201-208 (1976). For an analysis of the 1970 Act and general background of federal arbitration legislation, see Swisher, *International Commercial Arbitration Under the United Nations Convention and the Amended Federal Arbitration Statute,* 47 WASH. L. REV. 441 (1972).

56. 9 U.S.C. § 202.

206 allows the court to "direct that arbitration be held in accordance with the agreement at any place therein provided for, whether that place is within or without the United States."[57] In addition, the court may appoint the arbitrators pursuant to the provisions of the agreement.

Section 207 allows a party to have an arbitral award confirmed in a court of competent jurisdiction within three years unless an Article V Convention defense is proved. The last section states that the 1925 Act "applies to actions and proceedings brought under this chapter to the extent that chapter is not in conflict with this chapter or the Convention as ratified by the United States."[58]

Thus, the implementation of the Convention by the United States has upgraded the enforcement of foreign arbitral awards. Not only have United States courts upheld international arbitral awards more readily, but they have construed defenses against arbitration very narrowly. Such defenses are pleaded on the basis of (1) procedural due process; (2) nonarbitrable subject matter; (3) manifest disregard of the law by the arbitrators; (4) *forum non conveniens*; (5) a conflict with United States national policy or domestic law; or (6) issues which are contrary to public policy.[59]

The only two defenses which the court may evoke *ex officio* are the nonarbitrable subject matter defense and the contrary to public policy defense. Some authors have commented on the intertwining nature of these two defenses.[60] In any event, the nonarbitrable subject matter defense is the most narrowly construed, and is worthy of discussion in depth. To illustrate how the courts have interpreted this defense when it has arisen from an international, rather than a domestic contract, it will be helpful to explore a few of the cases in which the defense has been pleaded.

In 1974, the United States Supreme Court issued one of its most important decisions in support of international commercial arbitration, *Scherk v. Alberto-Culver Co.*[61] Alberto-Culver Co., an American corporation, purchased three businesses organized under the laws of Germany and Liechtenstein from Fritz Scherk, a German citizen, together with all trademark rights of the businesses. The sales contract was negotiated in the United States, England, and Ger-

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57. *Id.* § 206.

58. *Id.* § 208.

59. Junker, *The Public Policy Defense to Recognition and Enforcement of Foreign Arbitral Awards*, 7 CAL. W. INT'L L. J. 231 (1979).

60. *See, e.g.*, Sanders, *supra* note 3, at 270.

61. 417 U.S. 506 (1974), *rehearing denied*, 419 U.S. 885 (1974).

many, signed in Austria, and closed in Switzerland. The contract contained express warranties by Scherk that the trademarks were unencumbered, and a clause which stated that all disputes arising out of the contract would be referred to arbitration before the International Chamber of Commerce in Paris.

One year after the transaction was closed, Alberto-Culver allegedly discovered that the trademark rights were subject to substantial encumbrances. After Scherk refused Alberto-Culver's offer to rescind the contract, Alberto-Culver brought suit in federal district court contending that Scherk's fraudulent representations of the status of the trademark rights constituted violations of section 10(b) of the Securities Exchange Act of 1934,[62] and Rule 10b-5[63] promulgated thereunder.

Scherk filed a motion to dismiss the action pending arbitration before the International Chamber of Commerce in Paris pursuant to the contract, and Alberto-Culver sought a preliminary order enjoining Scherk from proceeding with arbitration. The district court, relying entirely on *Wilko v. Swan*,[64] granted a preliminary order enjoining Scherk from proceeding with arbitration.[65] The Seventh Circuit Court of Appeals affirmed,[66] also relying upon the *Wilko* decision, and the Supreme Court granted certiorari.

The Supreme Court reversed, distinguishing *Wilko* on the grounds that "Alberto-Culver's contract to purchase the business entities belonging to Scherk was a truly international agreement"[67] and that "such a contract involves considerations and policies significantly different from those found controlling in *Wilko*."[68] The Court acknowledged that in *Wilko* "no credible claim could have been entertained that any international conflict-of-laws problems would arise"[69] because the parties, negotiations, and subject matter of the contract were all situated in the United States. In contrast to *Wilko*, in *Scherk* serious uncertainty would exist concerning the law to be applied to any dispute arising out of the contract in the absence of an arbitration agreement. The Court recognized that "[s]uch uncertainty will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws

62. 48 Stat. 891 (1934), (codified at 15 U.S.C. § 78j(b) (1976)).
63. 17 C.F.R. § 240.10b-5 (1978).
64. 346 U.S. 427 (1953).
65. 417 U.S. 506.
66. *See* Alberto-Culver Co. v. Scherk, 484 F.2d 611 (7th Cir. 1973).
67. 417 U.S. at 515.
68. *Id.*
69. *Id.* at 516.

and conflict-of-laws rules."[70] Choice-of-law and choice-of-forum provisions are almost "indispensable precondition(s) to achievement of the orderliness and predictability essential to any international business transaction."[71] Therefore, a refusal by national courts to enforce an international arbitration agreement "would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages."[72]

Although both *Wilko* and *Scherk* involved disputes concerning violations of the securities laws, the Court justified its differential treatment of the two cases by stating:

> The exception of the clear provisions of the Arbitration Act carved out by *Wilko* is simply inapposite to a case such as the one before us. In *Wilko* the Court reasoned that "[w]hen the security buyer, prior to any violation of the Securities Act, waives his right to sue in courts, he gives up more than would a participant in other business transactions. The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him . . . ." 346 U.S. at 435, 74 S.Ct. at 187. In the context of an international contract, however, these advantages become chimerical since, as indicated above, an opposing party may by speedy resort to a foreign court block or hinder access to the American court of the purchaser's choice.[73]

Thus, the Supreme Court ultimately held that the arbitration agreement was to be enforced by the federal courts in accordance with the provisions of the Arbitration Act. In a footnote to its opinion the Court also recognized that the decision was supported by "international developments and domestic legislation in the area of commercial arbitration subsequent to the *Wilko* decision,"[74] specifically referring to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the federal legislation which implemented the Convention.

In reversing a preliminary order enjoining Scherk from proceeding with arbitration, the Supreme Court sternly limited the *Wilko* decision as applied to international agreements. Although the Court did not rely on the Convention as primary authority for its holding, by recognizing that the United States' accession to the Convention was indicative of congressional policy, it set an important precedent

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70. *Id.*
71. *Id.*
72. *Id.* at 516-17.
73. *Id.* at 517-18.
74. *Id.* at 520, n.15.

for future interpretations. It is important to note that Justice Douglas, in a strong dissenting opinion, still felt that the Securities Exchange Act of 1934 rendered the case nonarbitrable. He emphasized that the victims were not the Alberto-Culver Corporation, but rather the thousands of investors who were security holders—the very "wards" which the 1934 Act seeks to protect.[75] While acknowledging that the majority rested its decision on the fact that this was an international agreement, he pointed out that the Convention "provides that a forum court in which a suit is brought need not enforce an agreement to arbitrate which is 'void' and 'inoperative' as contrary to public policy."[76] He maintained that "section 29 of the 1934 Act, which renders arbitration clauses void and inoperative, recognizes no exception for fraudulent dealings which incidentally have some international factors."[77]

Shortly after the *Scherk* decision was handed down by the Supreme Court, a U.S. district court in Texas was confronted with a similar case on a domestic level. The plaintiff in *Newman v. Shearson, Hammill & Co., Inc.*[78] brought suit against the defendant, a broker-dealer, alleging numerous violations of the registration and antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. The defendant filed a motion to stay the action and to order arbitration pursuant to the United States Arbitration Act. As in *Wilko*, the court was forced to reconcile "strong public policy in favor of arbitration" with the 1933 and 1934 Acts which prohibit agreements to arbitrate controversies concerning alleged violations of the federal securities laws.[79]

In ultimately denying the defendant's motion to order arbitration, the court held that "the reasoning and logic of the *Wilko* holding are compelling and have been consistently followed in subsequent cases involving the 1933 Act, as well as in cases involving the Exchange Act."[80] A significant aspect of the court's opinion is that it specifically ruled as "incorrect" the defendant's contention that *Wilko* was overruled by *Scherk*. Rather, the court stated that *Scherk* "simply carved out a narrow exception to the *Wilko* holding, and is applicable only to international transactions."[81] Thus, the court seemed to indicate that there are strong public policy considerations

75. *Id.* at 527.
76. *Id.* at 530.
77. *Id.* at 534.
78. 383 F. Supp. 265 (W.D. Tex. 1974).
79. *Id.* at 267.
80. *Id.* at 268.
81. *Id.*

that encourage arbitration of international disputes which, on a domestic level, might be deemed nonarbitrable under U.S. law.

In late 1974, a United States court finally enforced a foreign arbitral award based on the amended legislation to the Federal Arbitration Act which implemented the United States' accession to the Convention. The case was *Parsons & Wittemore Overseas Co. (Overseas) v. Société Générale de l'Industrie du Papier (RAKTA)*[82] and it involved several Convention Article V defenses invoked by a United States corporation, Overseas, against confirmation of a foreign arbitral award in favor of the Egyptian corporation, RAKTA.

Overseas had contracted with RAKTA in 1962 to construct, manage, and supervise a mill in Egypt. Included in the contract's terms was an arbitration clause to settle any differences which might arise and a *force majeure* clause which excused delay in performance due to factors beyond Overseas' control. In 1967, the Arab-Israeli Six-Day War erupted causing the majority of the Overseas crew to leave Egypt. On June 6, the Egyptian Government ordered all Americans expelled from Egypt except those who would apply and qualify for special visas. Overseas, relying on the *force majeure* clause, abandoned the project. RAKTA invoked the arbitration clause, seeking damages for breach of contract, and was successful. The United States District Court for the Southern District of New York confirmed the foreign arbitral award[83] and Overseas appealed. Overseas raised the following defenses against arbitration: (1) that it was contrary to public policy; (2) that the subject matter was nonarbitrable; (3) that there would be denial of due process; and (4) that it would involve resolution of issues not within the scope of the matters submitted to arbitration. Construing all of the defenses narrowly, the second circuit rejected each defense and affirmed the district court's confirmation of the award. Specifically, the court construed Overseas' public policy defense strictly, declaring that "enforcement of foreign arbitral awards may be denied on this basis only where enforcement would violate the forum state's most basic notions of morality and justice."[84] It recognized the loophole that could be created and noted that the provision under the Convention "was not meant to enshrine the vagaries of international politics under the rubric of 'public policy.' "[85]

With regard to the Article V (2)(a) defense of nonarbitrable sub-

82. 508 F.2d 969 (2d Cir. 1974).
83. *Id.* at 971.
84. *Id.* at 974.
85. *Id.*

ject matter, the court stated that the United States might accept such a defense when enforcement of an award involving arbitration of an antitrust claim was involved,[86] as in *American Safety Equip. Corp. v. J.P. Maguire & Co.*[87] However, the court limited the defense even further by declaring, "[o]n the other hand, it may well be that the special considerations and policies underlying a 'truly international agreement' " as in *Scherk* "call for a narrower view of nonarbitrability in the international than domestic context," as in *Wilko*.[88] However, the court did not even have to deal with such fine distinctions; a dispute is not made nonarbitrable merely because an issue of national interest may incidentally figure into the breach of contract claim. "Rather, certain *categories* of claims may be nonarbitrable because of the special national interest vested in their resolution."[89] The court also believed that Overseas "grossly exaggerated the magnitude of the national interest involved in the resolution of its particular claim. Simply because acts of the United States are somehow implicated in a case one cannot conclude that the United States is vitally interested in its outcome."[90] Finally, by analogy, the court concluded that since the Supreme Court decided in favor of arbitration in the more prominent *Scherk* case, the foreign award against Overseas dealt with a subject arbitrable under United States law.

In 1976 the United States Court of Appeals, District of Columbia decided the case of *Hanes Corp. v. Millard*,[91] in which the court had to determine the enforceability of an arbitration clause in an international licensing agreement. The agreement contained a clause which provided that any dispute arising from the contract would be settled before the International Chamber of Commerce according to its rules of conciliation and arbitration.

The facts of the case are quite complicated, but in condensed form, the case involved three French citizens who assigned their

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86. *Id.* Five years later the District Court for the Southern District of New York held that it would be inappropriate to permit an international tribunal to arbitrate a Sherman Act claim in view of the strong public interest in private enforcement of the U.S. antitrust laws. The court, however, did stay the action pending arbitration of the other alleged claims which could be determined before an international tribunal. *See* Société Nationale pour la Recherche, la Production, le Transport, la Transformation et la Commercialisation des Hydrocarbures v. General Tire & Rubber Co. 430 F. Supp. 1332 (S.D.N.Y. 1977).

87. 391 F.2d 821 (2d Cir. 1968).

88. 508 F.2d at 974.

89. *Id.* at 975.

90. *Id.*

91. 531 F.2d 585 (D.C. Cir. 1976).

rights in a U.S. patent to Hanes, a United States corporation. The patent rights expired in 1969, and in 1973 the Frenchmen filed a request for conciliation with the International Chamber of Commerce in Paris, pursuant to the agreement, alleging a claim for unpaid royalties during the life of the patent. Rather than pursuing conciliation and arbitration, Hanes brought suit seeking a declaration that the patent did not extend to the products in question, or alternatively, was invalid. The defendants filed a motion to dismiss or stay the action pending arbitration. After denying the motion, the district judge raised the issue of the statute of limitations and instructed the parties to file supplemental briefs. Hanes then filed a supplemental brief and an amended complaint in which a newly-added Count II requested the court to declare any royalty claims to be barred by the statute of limitations. The district court entered summary judgment for Hanes on Count II, stating that although an action for patent infringement could still be maintained, an action for breach of contract was barred by the statute of limitations. The district court also held Hanes' claims in Count I regarding the scope and validity of the patent were "either moot or premature"; moot, insofar as they related to threatened contract claims which were barred by the statute of limitations, and premature, insofar as they might relate to an action for patent infringement which had not been threatened.[92]

Upon appeal, the circuit court noted that "one of the most . . . appropriate uses of the declaratory judgment procedure is to enable one who has been charged with patent infringement to secure a binding determination of whether proposed conduct will infringe a patent . . . without waiting until he becomes the defendant in an actual infringement suit."[93] The court also declared that "[t]he purpose of granting declaratory relief to one potentially liable for infringement is to allow him to know in advance whether he may legally pursue a particular course of conduct."[94] However, because the patent had already expired in this case, "[n]o future activity on the part of Hanes [would] . . . affect the liability it may have incurred during the patent's life."[95] Hanes was "simply in the position of one expecting to be sued for past alleged transactions."[96] Nonetheless, the court determined that with regard to Count I there would have been a "useful purpose" served had the district court granted declar-

92. *Id.* at 592.
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*

atory relief as Hanes originally requested.[97] The court emphasized that, while there is no obstacle to having state as well as federal courts adjudicate issues of patent validity, in this case the alternative to federal adjudication would have been to leave the issues of patent scope and validity to an arbitration panel. The court noted that complex issues of patent validity concern questions that may be unfamiliar to arbitrators, especially if the members of the arbitration panel are not lawyers or are citizens of a foreign country. The court also recognized that "the expertise of arbitrators has always lain in resolving . . . contractual disputes rather than in interpreting the import of complicated federal legislation."[98] Furthermore, if the arbitration panel were to determine that the issues of patent law were nonarbitrable, as in *Beckman*, "it is possible that the next tribunal to face these issues—most likely one called upon to review or enforce an arbitration award—would be a court in a foreign country, again not a desirable forum for determining the scope and validity of [a] United States [p]atent . . . ."[99] Therefore, the court held that the district judge "would not have acted improperly had he entertained and proceeded to resolution of the declaratory relief that was originally sought."[100]

The circuit court, however, did reach a different conclusion with regard to the arbitrability of Count II of the complaint. The court realized that the advantages of arbitration are especially important when the dispute is international in character. Relying on *Scherk*, the court stated that the international character of an arbitration agreement constituted a special reason for judicial deference to the arbitral process, especially in order to limit the uncertainties inherently attendant upon international trade and commerce. Therefore, the court held that the district court's assumption of declaratory judgment over Count II which displaced the international arbitration proceeding was improper. The court stated that:

> The Frenchmen are not likely to be familiar with the statutes of limitations and choice of law rules of a particular American jurisdiction where suit is brought. Although arbitration has been criticized for its unpredictability, in the international setting it may promote certainty by moderating the disparities among unfamiliar and contrasting choice of law rules and statutes of limitations that would govern questions of timeliness in a judicial proceeding. And as we noted above, the agreement to arbitrate

97. *Id.* at 593.
98. *Id.*
99. *Id.* at 594.
100. *Id.*

> may represent, if not a designation by the parties of a particular statute of limitations to govern all claims, at least a commission of the authority to select and apply the statute to an arbitrator expected to be sensitive and sympathetic to the peculiar needs of international commerce.[101]

Thus, although the court held that questions which concerned the scope and validity of a U.S. patent would be nonarbitrable, the court did recognize the importance of arbitration, especially in the internatonal context, and held that Count II of the complaint, regarding the statute of limitations would be an appropriate subject for arbitration.

In 1977, the U.S. Court of Appeals, Seventh Circuit decided the case of *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*[102] The court was faced with "the matter of deciding what effect an arbitration clause in an agreement has upon a claim for relief under S.E.C. Rule 10b-5."[103]

After opening a trading account and participating in Merrill Lynch's Money Management Option Program, the plaintiffs had lost a substantial amount of their investment. Believing that the defendant had misled them with certain untrue and deceptive representations, the plaintiffs filed suit in the district court alleging: (1) an action under Rule 10b-5 of the S.E.C. regulations; (2) fraud and deceit; and (3) breach of contract. Relying on the arbitration clause in the agreement, the defendant moved for a stay of proceedings. The district court held that the 10b-5 action was not subject to arbitration, but that the fraud and contract claims were properly arbitrable.

Upon appeal, the court of appeals discussed both the *Wilko* and *Scherk* cases. The court recognized that *Scherk* had held an international agreement containing an arbitration clause to be enforceable against a claim arising under Rule 10b-5. However, the court emphasized that *Scherk* noted the "crucial differences" between an international agreement and the agreement involved in *Wilko*, and upon weighing the policies embodied in the federal securities laws, the court in *Scherk* concluded that the arbitration clause should be given deference. Specifically citing *Scherk*, the court stated:

> A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually de-

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101. *Id.* at 599.
102. 558 F.2d 831 (7th Cir. 1977).
103. *Id.* at 832.

> structive jockeying by the parties to secure tactical litigation advantages. In the present case, for example, it is not inconceivable that if Scherk had anticipated that Alberto-Culver would be able in this country to enjoin resort to arbitration he might have sought an order in France or some other country enjoining Alberto-Culver from proceeding with its litigation in the United States. Whatever recognition the courts of this country might ultimately have granted to the order of the foreign court, the dicey atmosphere of such a legal no-man's-land would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements.[104]

The court noted, however, that *Scherk* did not address the issue of whether an arbitration clause would be enforced against a 10b-5 action where there were no international dimensions involved. Quoting from *Scherk*, the court stated that "[c]oncededly, situations may arise where the contacts with foreign countries are so insignificant or attenuated that the holding in *Wilko* would meaningfully apply. Judicial response to such situations can and should await future litigation in concrete cases."[105]

Nonetheless, the defendant contended that *Wilko* should not be applied because the "right of action under Rule 10b-5 has been judicially created and that, therefore, there would be no violation of the anti-waiver provision, Section 29(a), of the 1934 Act."[106]

In affirming the district court's holding that the 10b-5 action was nonarbitrable, the court stated that "[t]he differences between the 1933 and 1934 Acts notwithstanding, we nevertheless continue to adhere to our belief that policy considerations mandate the application of *Wilko* to Rule 10b-5 situations absent the presence of international concerns."[107]

In 1978 the tenth circuit decided *Merrill Lynch, Pierce, Fenner & Smith v. Moore*,[108] a case which involved a situation almost identical to that which the seventh circuit had faced in *Weissbuch*. The plaintiffs alleged that the defendants had violated section 17(a) of the Securities Act of 1933, section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5. The district court ordered the parties to proceed to arbitration pursuant to their agreement, and the plaintiffs appealed.

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104. *Id.* at 834.
105. *Id.*
106. *Id.* at 835.
107. *Id.*
108. 590 F.2d 823 (10th Cir. 1978).

After determining that *Wilko* prohibited the claims arising out of the 1933 Act from being arbitrated, the tenth circuit was then faced with determining whether *Wilko* also applied to section 10(b) of the 1934 Act and Rule 10b-5. The court recognized that Congress carried the policy contained in section 14 of the 1933 Act, which renders stipulations for arbitration void, into the 1934 Act. Section 29(a) of the 1934 Act states: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange thereby shall be void."[109] Merrill Lynch then asserted that *Wilko* had been limited by the Supreme Court in *Scherk*. The court held that:

> In the case at bar, like the *Wilko* case which is distinguished in *Scherk*, there is no question but that the laws of the United States generally, and the federal securities laws in particular, would govern disputes arising out of stock purchase agreements. The parties, the negotiations and the subject matter were all within this country and no international conflicts of laws problem exists. *Scherk* does not, therefore, apply to the instant case.[110]

Referring to *Wilko v. Swan*,[111] *Newman v. Shearson, Hammill & Co., Inc.*,[112] and *Sibley v. Tandy*,[113] the court observed that "there has been an almost universal tendency in these decisions to distinguish *Scherk*."[114] Thus, the court ultimately reversed the decision of the district court and held that all claims arising out of violations of the 1933 and 1934 Acts were nonarbitrable.

CONCLUSION

In sum, it is evident that international commercial arbitration is being seriously recognized by United States courts as a means of settling disputes between parties to transnational contracts. Especially after the United States acceded to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and implemented the accompanying legislation which amended the Federal Arbitration Act of 1925, United States courts have shown increasing support for international commercial arbitration. Defenses to foreign arbitral awards are being construed narrowly with the possible exceptions of patent and antitrust disputes. However, if

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109. 48 Stat. 903 (1934), (codified at 15 U.S.C. § 78cc(a) (1976)).
110. 590 F.2d at 828.
111. 346 U.S. 427 (1953).
112. 383 F. Supp. 265 (W.D. Tex. 1974).
113. 543 F.2d 540, 543 (5th Cir. 1976), *cert. denied*, 434 U.S. 824 (1977).
114. 590 F.2d at 828.

the agreement is found to be "truly international" as in *Scherk*, it is possible that courts will allow support of international commercial arbitration to overshadow domestic policy. Thus, an arbitration clause should only be included in an international commercial contract after much forethought and consideration of its ramifications, as existing case law indicates that the clause will most likely be enforced.