

Arbitration in International Trade from the U.S. Viewpoint

—Arbitration as a Means of Resolving International Trade
Disputes: Observations of an Overseas American Lawyer—

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DR. KIM and distinguished friends, it is a special honor and privilege for me to appear today and offer to share with you some observations and suggestions in regard to a most important subject.

However, I trust you will allow me to digress for a moment and at the same time approach the subject from a practical point of view. I first saw Seoul in 1952-war-time. The destruction and devastation was virtually total and complete. Desolation was everywhere. No country in world history had ever suffered so much. Today, less than three decades later, this country has achieved a miracle. The Korean people's spirit and determination with great leadership has achieved the impossible. This dynamic nation is expanding its economic and international trade throughout the world. Not only are thousands of different Korean made products sold abroad to every corner of the world, but your cargo and passenger jet planes and cargo ocean ships, your deep sea fishing fleets, your construction and development companies, your banks and financial institutions, your businessmen are in every major trading area of the world.

With all of this tremendous business activity in every corner of the globe going on, and business being conducted in dozens of countries with dozens of languages, customs, laws, and different court systems, what happens if a dispute arises? Lets ask ourselves as lawyers, law professors, judges, —what can we do to assist our international businessmen and our government leaders

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and officials to keep up with this space-age world of commerce? Horse and buggy methods are not adequate in the jet-age. Business should not be slowed down to a snails pace or stopped completely when an international trade dispute arises. Misunderstandings, errors in specifications, mistakes in production, missed time schedules, are unfortunate enough—and that situation, when it arises, should not be aggravated by lawyers, or law systems that cause further disruption, delay and unexpected expense, and simply add to the costs of doing business. The United States Supreme Court has stated an arbitration agreement is an “almost indispensable precondition to the achievement of the orderliness and productivity essential to any international business transaction.” As members of the legal profession we have a great duty and responsibility in this highly important area of international commerce—it is an even greater *opportunity* for us if we will set our minds and employ our talents to perfecting and propagating a system of resolution of international trade disputes that is modern and efficient, as well as fair and just.

In my remarks I am going to assume that we are not discussing the informal means of dispute resolution that are and should be utilized first of all by businessmen or persons involved in some misunderstanding or difference of interpretation, in the course of their business relations. We are addressing the problem of resolving a dispute that has not been settled by good faith discussion and negotiation between the parties. Basically we are going to embark on a discussion of a formal system of dispute resolution outside the normal court procedure—but a system that is enforceable through the courts if one or the other parties tries to back out. This system is known as transnational commercial arbitration.

In recent years, there has been a dramatic increase in the number of transnational arbitration cases filed in arbitration centers around the world. In the past arbitrations were simple, informal proceedings, handled by commercial associations or commercial lawyers located in cities such as Paris or London. They often had little litigation experience.

Today, international arbitration centers located in Paris, New York, Washington, and other cities around the world handle highly sophisticated commercial disputes, involving millions or even hundreds of millions of dollars, in which parties are represented by litigation attorneys from major U.S. or foreign law firms.

Because of this rapid expansion and growth in the use of arbitration systems, it experienced a number of serious growth pains. While many lawyers and businessmen advocated the use of arbitration as the better method of resolving international trade disputes, they sometimes failed to warn potential users that the system was still in its infant stage. Moreover, some litigants were disappointed and felt the system did not provide a fair basis on which a party received a fair hearing on the merits of a dispute. Consequently, there were many movements by individual lawyers and interested groups to move for needed reforms and improvements at the national and international level to make the international arbitration system a more efficient and workable device.

From this point on in my discussion we are going to relate to the following three general areas or topics:

1. The status or recognition given by United States courts to agreements to arbitrate international trade disputes, even when the arbitration is to occur in the foreign party's country or even a third country, and
2. What are some of the advantages, disadvantages and pitfalls to avoid in arbitration, and
3. What are some of the important considerations in drafting arbitration clauses in agreements and in drafting an arbitration agreement itself, sometimes called the "Terms of Reference", or "Submission Agreement".

In the United States, most commercial arbitrations are governed by the United States Arbitration Act, (Title 9 U.S.C.) which applies to all transactions in interstate or foreign commerce or admiralty. It preempts all local U.S. state laws on the subject.

The U.S. Arbitration Act sets forth a national policy of the United States

in favor of arbitration. This is extremely significant as we will discuss further when we analysis the U.S. Supreme Court's ruling in the 1972 Zapata case. The only issue that may be decided by a court under the law set forth in the Arbitration Act is simply whether a valid agreement exists to arbitrate: if it does exist, all other issues, even a claim that the contract containing the arbitration clause—but not the arbitration clause itself—was induced by fraud, are for the arbitrators to determine. Furthermore, while most U.S. states recognize arbitration ousts courts of their jurisdiction, in those few states that do not have such state policy, that state policy and state law will be ignored and an arbitration agreement that involves commerce or admiralty will be enforceable even in that state whose laws disapprove of arbitration. For example there is a State of Texas law that required attorneys signatures on arbitration agreements for them to be valid and enforceable in the State of Texas. The Federal Court struck down that state statute in strong wording that stated: "In sum, special state laws or decisions governing the validity of arbitration agreements do not apply when those agreements are contracts, or parts of contracts, 'evidencing a transaction involving (interstate or foreign) commerce'".

In 1972, The United States Supreme Court in *M/S Bremen v. Zapata Off-Shore Company*, in a landmark case, departed from precedent and upheld for the first time a Choice of Forum clause, which divested the U.S. courts of jurisdiction over an international contract dispute. The facts are interesting: A German company won a contract from an American Corporation, Zapata Off-Shore Company for the towing of an oil drilling rig from Louisiana (in the United States) to Italy. During the towing of the rig, a storm at sea came up and the rig was badly damaged in the Gulf of Mexico. The rig was taken to Tampa, Florida. While there, Zapata, owner of the rig, sued the German company in the U.S. Federal Court, alleging negligence by the German company and asking for \$3,500,000.00 in damages to the rig. The German company moved to dismiss the suit relying upon a forum selection clause in the contract between the parties which stipulated that all disputes shall be litigated in the

London Court of Justice. The U.S. federal court and the Fifth Circuit Court relied upon the Carbon Black case that stated: "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 a stunning reversal, the U.S. Supreme Court stated, and I quote, because these words have great import in the recognition of international law and trade:

"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." The citation is 407 U.S. 1. Therefore the Supreme Court concluded "that the forum selection clause should control absent a strong showing that it should be set aside". Thus it has been concluded by legal scholars and practitioners in the United States 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.

Now, you point out quite rightly that case and the contract involved there had no arbitration clause, that it was simply a matter of allowing one court to handle the case rather than another court. The glad tidings of the Zapata case—and I say they are glad tidings even though it is a decision by the U.S. Supreme Court that divests and removes a U.S. court from jurisdiction over the

case—because it is relegating national law to international law—it is recognizing international trade and international trade disputes and not just national trade and national disputes. Indeed it was necessary for the U.S. Supreme Court to render such a decision as the *Zapata* decision recognizing that not only may the foreign party designate his own country's court, but one step beyond that to legally sanctioning the contractual choice of forum by a German company in a trade dispute with an American company of the court of a third nation—England.

It has been stated that the common law hostility to arbitration agreements has been even greater than its aversion to forum selection clauses. However as mentioned just a moment ago, the passage by the U.S. Congress of the Arbitration Act of 1925 became a turning for commercial arbitration in the United States. In the light of this specific congressional approval of arbitration the U.S. courts have increasingly upheld the validity of arbitration agreements. In a 1974 case, *Scherk v. Alberto Culver Co.*, the United States Supreme Court, in a 5-4 decision, upheld an arbitration clause in an international commercial contract despite the strong arguments against such recognition based on violations of section 10 (b) of the U.S. Securities Exchange Act of 1934. The Alberto Culver Company, an American corporation, entered into a purchase agreement with Scherk, a German national, for the purchase of several European businesses and associated trademarks which Scherk expressly warranted to have clear 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. Alberto Culver Co. sued Scherk in U.S. federal court alleging he falsified section 10 (b) reporting requirements under the Securities Act, and relied upon *Wilko v. Swan*, where the Court under similar domestic facts (and the key word here is domestic) had held an arbitration agreement void under the Securities Act. The Supreme Court cited *Zapata* held that here there was a “truly international agreement” and said:

“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.” “We 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.”

Therefore we can understand that in the United States under its laws the Supreme Court in the *Zapata* and *Scherk* cases have established the guidelines for giving effect, i.e., recognizing and enforcing agreements that contain forum selection clauses and arbitration agreements, provided that the transaction in the agreement is “truly international”, and the choice is just and reasonable.

The 1970 congressional ratification of the Convention on Recognition and Enforcement of Foreign Arbitral Awards was cited by the U.S. 3rd Circuit Court as further congressional mandate to eliminate vestiges of judicial reluctance to enforce arbitration agreements in the international commerce context. In *McCreary Tire and Rubber Company v. CEAT*, 501 F. 2d 1032, a 1974 case, the Circuit Court mandated the district court to stay its proceedings pending arbitration of the dispute in Brussels, Belgium, as agreed upon in the distribution contract.

Again, in *Biotronik, v. Medford Medical Instrument Co.*, the U.S. court was asked to refuse enforcement of an arbitration award awarded in Paris. The American party had received notice of the arbitration but had not participated. The court brushed aside the American contention that it was fraud for the other party not to present the American’s case at the arbitration. The court held it

was bound to enforce the award under the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Now lets look at another very interesting case involving a U.S. and a Japanese company which presented facts and law that severely tested the true internationality of U.S. courts.

In the case of *IN Re Fotochrome, Inc.*, a New York corporation fell into dispute with Copal Co., Ltd., a Japanese kabushiki kaisha, over the terms of a contract to manufacture special cameras in Japan. The contract contained an arbitration clause which designated Tokyo, Japan as the forum. Arbitration commenced, but before it was completed Fotochrome filed a Chapter XI(Eleven) arrangement in bankruptcy court in New York. The New York bankruptcy judge, concerned about protecting creditors of Fotochrome in the United States who have statutory rights under the Bankruptcy Act, issued an order which stayed all proceedings by creditors, including the pending arbitration. However, the Japanese arbitration association, over which the bankruptcy judge lacked jurisdiction of course, proceeded to award Copal US \$ 624,457.80. Copal then proceeded into U.S. district court in the United States and sought to have the award enforced. In support of its position Copal invoked two treaties (Treaty with Japan on Friendship, Commerce and Navigation; and the UN Convention on the Recognition and Enforcement of Arbitral Awards) which provide for enforcement unless it is contrary to local public policy. The conflict boiled down to a choice between recognizing the foreign award at the expense of local U.S. creditors of Fotochrome, in contravention of the policies behind the Bankruptcy Act, or refusing enforcement of the arbitration award by the Japanese arbitration association and creating uncertainty in international commerce, and the strong presumption in favor of forum selection clauses and arbitration agreements expressed in the two treaties and the U.S. Supreme Court decisions in *Zapata* and *Scherk*.

The Court did not find the choice an easy one. But it 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.”

Thus, an international commercial contract negotiated at arms-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.

Before leaving this subject of a national court enforcing a forum selection or arbitration clause that ousts the jurisdiction of its own court, a brief survey of the Japanese attitude would be helpful to our discussion. The courts of Japan generally recognize an arbitral clause referring arbitration to a foreign country. In addition Japan, being one of the first nations to ratify the 1958 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards, actually enforced a foreign arbitral award even prior to ratifying such convention. In an interesting case involving a dispute between American President Lines and Soubra K.K., a Japanese corporation, although foreign owned, an arbitration was held in New York City. An award was given to APL which was quite strongly objected to by Soubra. APL did not receive satisfaction, payment, of its award from Soubra, and therefore pursued Soubra to its Tokyo main office. APL filed in Tokyo District Court an action to enforce and collect the arbitral award granted by the New York arbitrators. The Tokyo District Court upheld the right of APL to obtain an execution order against Soubra's assets in Japan and the execution on the assets was enforced by the Japanese court. This case has been cited as a landmark case by legal writers, however I have first hand knowledge of the case having represented American President Lines in the Japanese Court which enforced the New York arbitration award in Japan.

A further subject along this line deserves comment. In attempting to enforce foreign arbitral awards in Japan against Japanese defendants, they may attempt to avoid their responsibility by citing that the transaction giving rise to the obligation was in violation of the Foreign Exchange Control and Foreign Trade

Control Law of Japan as an offense against Japanese public policy. However, Japanese courts have consistently turned down such a defense and have enforced the foreign arbitral award. The Japanese courts reasoning has been that although the Foreign Exchange restrictions may subject a party to administrative law sanctions, they do not constitute a strong public policy of Japan in the domain of private law, since they are merely intended to temporarily regulate foreign transactions which, by nature, should be left free (Tomita v. Inoue, 19 Saiko-saibansho Minji-Hanreishu 2306).

Having reviewed the state of the law as it now views the legitimate role of arbitration in settling international or transnational commercial disputes, lets take a look at the present set-up internationally for the handling of arbitration procedure. How does it work, who supervises it, indeed who enforces it—do we really find advantages to using arbitration, and just what are some of the disadvantages or drawbacks to utilizing arbitration in international contracts.

Lets consider a hypothetical but perhaps familiar set of facts. A leading Korean maker of electronic components agrees to supply products to a maker of stereo equipment in a neighboring asian country. The agreement contains no arbitration clause. The Korean maker after delivering his products to the Stereo maker in X country, the Stereo maker informs the Korean supplier that some of the components are defective and that it is blocking the balance of the payment. The Korean maker suspects the parts are quite good and files suit in Seoul against the branch office of the Stereo maker from X country to collect the balance of payment. Almost at the same time the Stereo maker files suit in X country against the branch office of the Korean maker alleging breach of contract, etc. Both cases in each country proceed to judgment, but with opposite results in each country. Neither judgment is enforceable in the other country. Business relations between the two companies are broken off. Each company finds its reputation has been hurt in the opposite country not just by filing suit but because of the dispute and hard feelings.

In our hypothetical case you find the very ingredients that damage and impede

international trade: the non-existence of a speedy, private and fair means of resolving a dispute without publicity and without rupture of a business relationship due to a solvable problem.

The fact that lawyers and their business clients have been frustrated in their attempts to resolve international commercial disputes in the judicial, court level is perhaps the single most important reason why international arbitration has enjoyed its recent surge of popularity. When the system works ideally, the parties can agree in advance to arbitrate all disputes arising from their contract in a neutral forum, under agreed upon laws and rules, and even select their own judges (arbitrators). Arbitration proceedings can be initiated quickly and more privately than court proceedings. Since the proceedings are initiated in the spirit of the parties prior agreement, such proceedings are often more amicable in nature than court proceedings; thus there may still be the opportunity to bring the parties together in friendly compromise, also preserving a business relationship and the company's integrity or reputation.

In addition, international arbitration has become an especially useful device in regulating the rapidly growing number of long-term business arrangements. The primary advantage is that the parties to the contract can initiate arbitration proceedings to resolve disputes while the contract is being performed, without terminating the contract. Thus, in these long range contracts, a dispute on one phase of the project may be arbitrated without causing a destructive split which neither party would desire nor could afford. Distinguished commentator Holtzmann stated in a recent article: "In all of these transactions once the business collaboration begins the parties quickly become 'married'. 'Divorce' would be costly and destructive. To avoid major financial losses parties must be able to continue their business together in a friendly way, even after disputes arise."

For many years, arbitration was not an efficient mechanism for resolving international business disputes. Unlike a national court system, there was no institutionalized leadership to watchdog an arbitration proceeding or to provide the parties with a set formula of procedures, or indeed even an explanation

of how to draft an arbitration clause or a submission agreement. Nations around the world embarked on a period of thoughtful reform and legislation in efforts to improve the system.

Arbitration centers in many parts of the world now provide institutional leadership and procedural guidance for international arbitrations. Notable examples are the International Chamber of Commerce Court of Arbitration (ICC) located in Paris. The International Court of Arbitration for Marine and Inland Navigation, with its secretariat in Gdynia, Poland, the International Center for the Settlement of Investment Disputes (ICSID) with its offices in Washington D.C. Also many national centers now handle international arbitrations, such as the American Arbitration Association with its headquarters in Washington, D.C., and the Japan Arbitration Association, in Tokyo, of which I used to be one of the arbitrators. This reform has resulted in a better understanding of international businessmen's needs, updated arbitration rules, and better administrative services.

The ICC in Paris is an international organization with a membership of 47 separate countries. The "Court of Arbitration" is a misnomer. The Court does not adjudicate cases, but only administers them. When a arbitration is handled by the ICC, it reviews the case and appoints the arbitrators and designates the place of arbitration. The ICC sets the amount of deposit which the parties must make to cover fees and expenses of the arbitrators and ICC administrative expenses. The arbitration proceedings are guided by the ICC rules. The basic function of the Court is to see that the rules are complied with.

Under the ICC Rules the parties can agree in advance to the law that will be applied by the arbitrators to decide the procedural and substantive issues.

The advantages of using such an institution as the ICC are several. First, the institution provides a center which can be confidently designated as the administrator for the proceedings. The parties know in advance that the administrative guidance of such an institution will allow their dispute to be processed in an efficient and impartial manner. Sometimes the institution will

assist in drafting the arbitration clause to ensure that it will be enforceable and held in accordance with its rules. The institutional guidance helps insure fairness of procedure and equality of opportunity to present its side to the arbitrators. ICC officials report there is 92 percent voluntary compliance to all arbitration awards made under its jurisdiction without necessity for subsequent enforcement proceedings in court.

Perhaps the most appealing feature of international arbitration is its privacy—confidentiality or even secrecy. Yet if correctly structured the agreement to arbitrate can provide the reliability of a court system, while preserving the advantages of efficiency and fairness along with privacy.

There are two basic types of arbitration agreements. One is agreed upon before a dispute arises—by inclusion in a contract between the parties as one of the contract clauses. The other type is created after a contract is already in existence, or a relationship exists, and a dispute arises, at which point the parties agree between themselves to arbitrate. This is commonly called a Submission Agreement. Both types of agreements to arbitrate require much care and expertise in drafting, if the agreement to arbitrate will be binding.

While it is said that arbitration is due to the agreement of the parties involved, actually it is usually legal counsel who must compose the arbitration clause or agreement. In order for the arbitration system to work best the following considerations must be resolved at the time an arbitration clause or agreement is negotiated:

1. The selection of an appropriate institution to administer any arbitration proceedings. Most institutions will send a brochure on request, and if requested they will furnish a “boiler plate” arbitration clause. However most such off-the-shelf clauses are incomplete, and should be redrafted along the guidelines presented here.

2. The designation of rules that shall apply to the proceedings, i.e., agreeing to the procedural set of rules that both parties will be bound by. The new UNCITRAL rules may be administered by any institution even though the

institution may have its own rules which are very similar. You should obtain a copy of these UNCITRAL rules and study them and become familiar with them.

3. Select a convenient, neutral location (forum) for the arbitration hearing. The location of the arbitration institution does not necessarily mean the arbitration hearing must take place there. For example, the ICC Court of Arbitration in Paris can, and does, administer proceedings in many cities around the world.

4. The choice of procedural and substantive law that is to be applied by the arbitrators. The selected law should be of a state or a country which has traditionally favored arbitration, since the laws of these jurisdictions will generally facilitate the arbitration of any dispute.

5. The parties should designate the language to be used at the hearing, or that all documents and evidence at the hearing shall be in one or more languages of the parties and the country where arbitration takes place.

6. If a long-term contract is involved, make sure the parties can initiate arbitration proceedings easily without interrupting the smooth execution of the contract when possible.

7. Finally, in regard to the arbitrators, be sure to indicate whether one or three are to conduct the arbitration. Also whether they must be extremely proficient in one or more languages and which languages. Also whether the arbitrators should have specialized technical knowledge in what field.

The foregoing suggestions should enable you as an attorney or advisor to provide the businessman with a more workable device to enforce and resolve related business disputes. In addition, such an agreement may provide him with a better means of avoiding arbitration altogether since the threat of a well-designed enforcement procedure often encourages the other party to respect his contractual obligations more conscientiously.

The other type of arbitration agreement is one that is agreed to after a dispute has arisen and there is no already existing, enforceable arbitration

clause. A submission agreement should contain the following:

(1) A brief statement of the facts which give rise to the parties' dispute; (2) a brief statement of each party's claim, (3) a list of issues to be decided by the arbitrators, (4) the designation of arbitrators, and a procedure for the selection of a third neutral arbitrator, (5) provisions for the replacement of arbitrators, if necessary, due to death or incapacitation, (6) designation of the site for arbitration hearings, (7) designate the applicable law for both the proceedings and the substantive law to be followed by the arbitrators, (8) designate the language(s) to be used at the hearings, (9) designate the forums where the award may be enforced.

When designating and designing arbitration procedures seek to ensure that the arbitration proceedings will be conducted fairly and with a minimum of expense.

Let us recall again the exhortation of the United States Supreme Court, not only to American lawyers but to all lawyers everywhere concerned with keeping pace with the jet-age of international trade that *arbitration* quote *is an almost indispensable pre-condition to the achievement of the orderliness and productivity essential to any international business transaction* unquote.

Finally, gentlemen, you have been so good and kind to listen to me for such a long time and I am most grateful to you. And, if you disagree with anything I've said, let's discuss it, and, if all else fails, let's arbitrate! Thank you very much.