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Contracts: Arbitration Clauses in International Agreements Held Enforceable

In an attempt to expand its overseas operations, respondent Alberto-Culver Company¹ purchased from petitioner Scherk three enterprises operated by him under the laws of Germany and Liechtenstein. The sale contract² provided that one of the three enterprises was to become a public corporation and that Alberto-Culver was to acquire 100 percent of its stock.³ All trademark rights of the three enterprises were included in the sale agreement, and Scherk expressly warranted that the trademarks were unencumbered.⁴ A clause of the agreement provided that all controversies would be submitted to arbitration in accordance with the rules of the International Chamber of Commerce in Paris, France, and that Illinois law would govern the agreement.⁵ Nearly one year after the closing of the sale, Alberto-Culver allegedly discovered that the trademark rights purchased from Scherk were subject to substantial encumbrances which threatened to give others superior rights to the trademarks. Having unsuccessfully offered to return the property and rescind the

1. Alberto-Culver Company, a Delaware corporation with its principal office in Illinois, manufactures and distributes toiletries and hair products in national and international markets.

2. The sale contract was negotiated in Germany, England, and the United States, signed in Austria, and closed in Switzerland. *Scherk v. Alberto-Culver Co.*, 94 S. Ct. 2449, 2450 (1974).

3. *Alberto-Culver Co. v. Scherk*, 484 F.2d 611, 613 (7th Cir. 1973).

4. 94 S. Ct. at 2452.

5. The contract provided that:

The parties agree that if any controversy or claim shall arise out of the agreement or breach thereof and either party shall request that the matter shall be settled by arbitration, the matter shall be settled exclusively by arbitration in accordance with the rules then obtaining of the International Chamber of Commerce, Paris, France, by a single arbitrator, if the parties shall agree upon one, or by one arbitrator appointed by each party and a third arbitrator appointed by the other arbitrators. In case of any failure of a party to make an appointment referred to above within four weeks after notice of the controversy, such appointment will be made by said chamber. All arbitration proceedings shall be held in Paris, France, and each party agrees to comply in all respects with any award made in any such proceeding and to the entry of a judgment in any jurisdiction upon any award rendered in such proceeding. The laws of the State of Illinois, U.S.A. shall apply to and govern this agreement, its interpretation and performance.

Id. at 2452 n.1.

sale, Alberto-Culver commenced an action for damages and other relief, alleging that it had been defrauded in violation of section 10(b) of the Securities Exchange Act of 1934⁶ and Rule 10b-5⁷ promulgated thereunder. Scherk moved to dismiss or alternatively to stay the action pending arbitration in Paris pursuant to the terms of the agreement.⁸ Alberto-Culver in turn sought to enjoin the prosecution of arbitration proceedings. Relying heavily upon the 1953 Supreme Court decision in *Wilko v. Swan*,⁹ the federal district court denied Scherk's motion and issued a preliminary injunction restraining him from proceeding with arbitration.¹⁰ The Court of Appeals for the Seventh Circuit affirmed on the basis of *Wilko*.¹¹ The Supreme Court reversed, *holding* that an agreement to arbitrate disputes arising out of such an international commercial transaction is to be respected and enforced by the federal courts, *Scherk v. Alberto-Culver Co.*, 94 S. Ct. 2449 (1974).

Arbitration and forum selection clauses have historically been viewed with disfavor by American courts. Initially, many courts declined to enforce such clauses on the ground that they were contrary to public policy or that their effect was to oust the jurisdiction of the court.¹² This judicial hostility was gradually overcome by legislation. The New York Arbitration Act of 1920,¹³ the first of the modern arbitration statutes,¹⁴ provided

6. 15 U.S.C. § 78j (1970).

7. 17 C.F.R. § 240.10b-5 (1974) (employment of manipulative and deceptive devices).

8. Although Scherk had earlier taken steps to initiate arbitration, he did not file a formal request with the International Chamber of Commerce until nearly five months after the commencement of Alberto-Culver's action in the federal district court. 94 S. Ct. at 2452 n.2.

9. 346 U.S. 427 (1953).

10. See 94 S. Ct. at 2452.

11. *Alberto-Culver Co. v. Scherk*, 484 F.2d 611 (7th Cir. 1973).

12. E.g., *Tetsuuma Kisen K.K. v. Prescott*, 4 F.2d 670 (9th Cir. 1925) (clause requiring arbitration as a condition precedent to a court action held void and unenforceable); *United States Asphalt Ref. Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006 (S.D.N.Y. 1915) (valid arbitration clause under the English Arbitration Act held unenforceable as an attempt to oust the jurisdiction of the American court). See Annot., 56 A.L.R.2d 300 (1957); W. STURGES, *COMMERCIAL ARBITRATIONS AND AWARDS* § 15, at 45; § 76, at 237-38 (1930); 6 S. WILLISTON, *CONTRACTS* §1919, at 5360 (1938). The courts in the United States adopted this principle from England. See *Vynior's Case*, 77 Eng. Rep. 597 (D.B. 1609). See also *Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109 (1924); *Haskell v. McClintic-Marshall Co.*, 289 F. 405 (9th Cir. 1923); *Cotalis v. Nazides*, 308 Ill. 152, 139 N.E. 95 (1923); *Meacham v. Jamestown F. & C.R.R.*, 211 N.Y. 346, 105 N.E. 653 (1914).

13. N.Y. CIV. PRAC. LAW §§ 7501-14 (McKinney 1963).

14. See *Sonderby, Commercial Arbitration: Enforcement of an*

that agreements to arbitrate future disputes would be irrevocable and established a procedure for enforcing such agreements.¹⁵ The Federal Arbitration Act of 1925,¹⁶ patterned after the New York Act, made arbitration agreements involving maritime transactions and interstate and foreign commerce valid, irrevocable, and enforceable. It also provided for a stay of action in federal courts on issues referable to arbitration under such agreements.¹⁷

The Supreme Court has recognized, however, that certain values are so important that arbitration must not be allowed to override them. In *Wilko v. Swan*,¹⁸ the Court enunciated what has come to be called the public policy exception to the Federal Arbitration Act.¹⁹ *Wilko* involved an action against a securities brokerage firm to recover damages under the Securities Act of 1933,²⁰ for alleged misrepresentation in the sale of securities. The defendant brokerage firm moved to stay the trial until arbitration had proceeded in accordance with the terms of an agreement between the parties. The Supreme Court held that the agreement to arbitrate was unenforceable as applied to future claims arising under the Securities Act. The Court observed that such an arbitration agreement would deprive the customer of the advantageous judicial remedy afforded by the Act, while the Act itself specifically provided that remedies thereunder may not be waived by contract.²¹ The *Wilko* Court recognized that the policy of the Arbitration Act to secure a prompt and economical solution to commercial controversies was coming into conflict with the policy of the Securities Act to protect the rights of investors.²² Its decision resolved the conflict in favor of the rights of investors²³ and announced the general rule that if an agree-

Agreement to Arbitrate Future Disputes, 5 JOHN MARSHALL J. 72 (1971-72).

15. *Id.* at 75.

16. 9 U.S.C. § 1 *et seq.* (1970). Under the Act, an arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.* § 2.

17. *Id.* § 3. See *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956).

18. 346 U.S. 427 (1953).

19. See *Sonderby*, *supra* note 14, at 90-92.

20. 15 U.S.C. § 77a *et seq.* (1970).

21. 15 U.S.C. § 77n (1970).

22. 346 U.S. at 438.

23. It appears that traditional judicial hostility toward arbitration may also have played an important part in the decision. The Court pointed out that arbitrators do not need a legal background to be chosen, arbitration proceedings are not required to have a complete record, an award may be made without explanation, interpretations of

ment for arbitration contravenes a specific provision of another federal statute, the specific provision will prevail and the arbitration agreement will not be enforced.²⁴

The *Wilko* rule has not been applied to every arbitration agreement involving securities regulation. For example, a dispute between two broker-dealers of an exchange has been deemed outside the public policy exception on the ground that the rules of the exchange, enacted for self-regulation, require arbitration between the disputing parties.²⁵ Even a nonmember broker-dealer has been able to force a member of an exchange to arbitrate.²⁶ Similarly, *Wilko* has been interpreted as limited to agreements to arbitrate future disputes, leaving parties free to submit controversies to arbitration at the time they arise.²⁷ Finally, courts have refused to apply *Wilko* when the parties to the agreement are sophisticated businessmen with relatively equal bargaining power dealing at "arms-length."²⁸

In 1971, the Supreme Court implied the existence of a new factor that might be weighed in determining the applicability of the *Wilko* rule to arbitration cases. In the context of a forum selection case, the Court held that the international characteristics of an agreement tipped the balance in favor of upholding contractual provisions. *The Bremen v. Zapata Off-Shore Co.*²⁹ involved a private international towage contract that provided for resolution of all disputes in the London Court of Justice. When a dispute arose, the American company ignored the forum selection clause and brought suit in an American court. The Supreme Court held that in the light of present day commercial realities and expanding international trade, the forum selection clause should control in the absence of a compelling reason to set it aside.³⁰ The court of appeals had cited a Supreme Court

the law by arbitrators are not subject to judicial review, and the power to vacate an award is limited. 346 U.S. at 436-37.

24. For cases applying *Wilko* to other claims arising under the Securities Act of 1933, see *Pawgan v. Silverstein*, 265 F. Supp. 898 (S.D.N.Y. 1967); *Fuller v. Dilbert*, 32 F.R.D. 60 (S.D.N.Y. 1962).

25. *Brown v. Gilligan, Will & Co.*, 287 F. Supp. 766 (S.D.N.Y. 1968). See also *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir. 1972).

26. *Axelrod & Co. v. Hordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971).

27. *Reader v. Hirsch & Co.*, 197 F. Supp. 111, 117 (S.D.N.Y. 1961) (dictum).

28. *GCA Corp. v. Coler*, [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,339 (S.D.N.Y. 1972).

29. 407 U.S. 1 (1971).

30. *Id.* at 15.

precedent involving a domestic towing contract³¹ and had been reluctant to concede jurisdiction to the London court for fear that it would enforce an exculpatory clause in the contract which would violate American public policy.³² In limiting the scope of its domestic precedent and refusing to invoke public policy to set aside an international *choice of forum* agreement, the Supreme Court intimated that characteristics associated with an international agreement might be sufficient to overcome the *Wilko* public policy exception to the enforcement of *arbitration* as well.³³ In *Scherk* the court confirmed that intimation.

Wilko had dealt only with the purchase of securities by an American investor from an American broker-dealer on an American exchange. In contrast, *Scherk* involved a "truly international agreement."³⁴ The *Scherk* Court found that this resulted in "crucial differences" between the cases.³⁵ Most important was that the international context of *Scherk* produced an uncertainty as to the applicable law that was not present in *Wilko*. The Court believed that a "contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is . . . an almost indispensable precondition to the achievement of the orderliness and predictability essential to any international business transaction."³⁶ Without such a provision, the parties could delay proceedings by seeking an injunction, followed by an unlimited number of cross-injunctions issued from sympathetic forums. The Court was eager to avoid "the dicey atmosphere of such a legal no-man's land [which] would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements."³⁷

The Court reinforced its reasoning by noting the strong congressional endorsement of international arbitration implicit in the recent acceptance of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.³⁸ This Convention was appended to the Federal Arbitration Act

31. *Bisso v. Inland Waterways Corp.*, 349 U.S. 85 (1955).

32. *Zapata Off-Shore Co. v. M/S Bremen*, 428 F.2d 888, 895 (5th Cir. 1970).

33. 407 U.S. at 12-13.

34. 94 S. Ct. at 2455. See note 2 *supra*.

35. 94 S. Ct. at 2455.

36. *Id.*

37. *Id.* at 2456.

38. *Opened for signature* June 10, 1958, [1970] 3 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 3.

of 1925³⁹ to provide that all international arbitration agreements and awards would be specifically, speedily, and uniformly enforced in federal courts. Article II(1) of the Convention requires each contracting state to recognize and enforce written arbitration agreements for present or future disputes with respect to a defined legal relationship, whether or not it is contractual, if the dispute is capable of settlement by arbitration.⁴⁰ This language is intended to apply to agreements to arbitrate future unknown disputes as well as existing controversies, and means that the courts of a country must refrain from deciding a controversy that is covered by a valid arbitration clause to which the Convention applies.⁴¹ While the Convention was not strictly applicable in *Scherk*,⁴² it provided a strong indication of congressional policy.⁴³

In addition to its reliance on the distinctive international implications of the transaction, the *Scherk* Court observed that the investor protection policies enunciated in *Wilko*⁴⁴ did not compel extension of the *Wilko* rule to the facts of *Scherk*. The securities legislation was designed to protect the ordinary investor who deals with a sophisticated broker-dealer under circumstances of great disparity in either information or bargaining power. *Wilko* had involved such circumstances. But quite different considerations emerge in the application of Rule 10b-5⁴⁵ to negotiated transactions between businessmen.⁴⁶ Such transactions might well include an independent audit or other verification of the

39. 9 U.S.C. §§ 201-08 (1970). See text accompanying notes 16-17 *supra*.

40. 9 U.S.C. § 201 (1970).

41. See Asken, *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, 7-8 (1971). The restraint is subject to certain specified exceptions. See, e.g., text accompanying note 51 *infra*.

42. The implementing legislation had not yet taken effect. See 9 U.S.C. §§ 201-08 (1970).

43. See *Scherk v. Alberto-Culver Co.*, 94 S. Ct. 2449, 2457 n.15 (1974).

44. See text accompanying notes 18-24 *supra*.

45. 17 C.F.R. § 240.10b-5 (1974) (employment of manipulative and deceptive devices).

46. See *GCA Corp. v. Coler*, [1971-1972 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,339 (S.D.N.Y. 1972). Such considerations might not have been sufficient to support the result in *Scherk*, however, were it not for the international features of the case. *Bisso v. Inland Waterways Corp.*, 349 U.S. 85 (1955) (domestic contract between businessmen); cf. *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1971) (international contract between businessmen). See text accompanying notes 28-34 *supra*.

property being purchased or sold, and the sale of securities might be merely the particular form in which the parties elect to cast their transaction. In large and complex transactions the parties might contemplate the possibility of future controversy, and thus the method of resolving future disputes would itself be a proper subject of negotiation. In the international arena, the inability to effectively specify a neutral forum might affect the price of a sale.⁴⁷ Furthermore, application of the *Wilko* rule in an international context would not necessarily even provide the protection intended by *Wilko*, since prompt action by the party seeking arbitration could still conceivably prevent recourse to the courts.⁴⁸

Four dissenting justices were dissatisfied with the "‘international contract’ talisman"⁴⁹ used to distinguish *Scherk* from *Wilko*. They found the *Wilko* rule and the anti-waiver provision of the Securities Exchange Act of 1934 to be controlling and would have upheld the injunction against the arbitration proceedings because such proceedings would have been offensive to the public policy of the United States.⁵⁰ Justice Douglas pointed out for the minority that the United Nations Convention itself provides that a court need not enforce an agreement to arbitrate which is contrary to its public policy.⁵¹ But this view tends to regard American public policy as embodied only in the Securities Exchange Act. *Wilko* had recognized that there were two competing public policies⁵² and had simply held in favor of investor protection. Since that time public policy favoring arbitration had grown, especially in the international arena, as demonstrated by the American accession to the United Nations Convention. This growth in public policy was properly reflected in the *Scherk* majority opinion.⁵³

The precise effect of *Scherk v. Alberto-Culver Co.* remains to be seen. It may be relegated to the unseemly status of an exception to the *Wilko* exception, or it may become established

47. See *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 13-14; *Alberto-Culver Co. v. Scherk*, 484 F.2d 611, 617 (1973) (dissenting opinion).

48. See text accompanying note 37 *supra*.

49. 94 S. Ct. at 2461 (Douglas, J., dissenting).

50. *Id.* at 2460-61.

51. *Id.* at 2462. See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. V 2(b), opened for signature June 10, 1958, [1970] 3 U.S.T. 2517, 2520; T.I.A.S. No. 6997, 330 U.N.T.S. 3.

52. 346 U.S. at 438.

53. 94 S. Ct. at 2457 n.15.

as a rule in itself. There is strong indication in the majority opinion that *Scherk* will become the general rule in international agreements, with exceptions made only upon a very clear showing of the *Wilko* considerations of disproportionate bargaining power.⁵⁴ While *Wilko* had placed the burden of proof upon the party trying to enforce arbitration in a securities transaction, *Scherk* would thus place the burden upon the party attempting to invoke *Wilko* considerations to enjoin arbitration in an international transaction. Such a result would be in harmony with the language of the United Nations Convention cited by Justice Douglas.⁵⁵ The Convention declares enforceability of international arbitration agreements to be the general rule, with an exception available when compelled by public policy. The effectiveness of the Convention would be impaired if the public policy provision were employed too freely by the contracting countries.⁵⁶ Interpreted as recognizing a general rule of enforceability, *Scherk* will undoubtedly provide desirable stability in international commercial law by signalling the readiness of the United States to abide by the United Nations Convention⁵⁷ without excessive reliance on the public policy exception. Since it took the United States twelve years to ratify the Convention,⁵⁸ other countries may understandably be wary of the position the United States will take in its enforcement. *Scherk* could go a long way toward dispelling such doubts.

54. *Id.* at 2456 n.11.

55. See text accompanying note 51 *supra*.

56. When a state is eager to defeat on public policy grounds an international arbitration agreement that is sought to be enforced by a foreign party, its citizens should expect to be subject to the same treatment in foreign courts. Quigley, *Convention on Foreign Arbitral Awards*, 58 A.B.A.J. 821, 825 (1972).

57. The Convention has already been invoked to force one American business to abide by the decision of a foreign arbitration panel. *Island Territory of Curacao v. Solitron Devices, Inc.*, 356 F. Supp. 1 (S.D.N.Y. 1973).

58. Asken, *supra* note 41, at 1.