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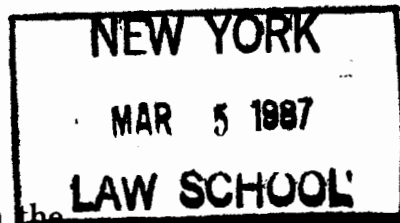
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Peter J. Lipperman

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A Proposed Blueprint for Achieving Cooperation in Policing Transborder Securities Fraud Brad Begin

The Jurisprudence of the Foreign Claims Settlement Commission: Vietnam Claims

A Proposal for a Revised Income Tax Definition of Resident Alien Individual

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Choosing the Substantive Law to Apply in International Commercial Arbitration

DAVID J. BRANSON*
RICHARD E. WALLACE, JR.**

A contract in international commerce should contain a choice of law clause in order to secure a neutral and predictable standard for resolving disputes arising out of that contract. It is not only advisable to include such a clause, but it is also permissible to seek advantage in choosing the substantive law. Thus, the adroit lawyer can often obtain considerable advantage for his client in the drafting process.

For example, if the subcontract for a construction project specifies that New York law will govern disputes, the subcontractor may secure final payment from the general contractor before the general contractor has been paid by the project owner. This remains true even if the subcontract expressly states that final payment from the general contractor is conditional on payment from the owner.¹ In contrast, the laws of a majority of U.S. states would en-

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1. *Schuler-Haas Elec. Corp. v. Aetna Cas. & Sur. Co.*, 40 N.Y.2d 883, 885, 357 N.E.2d 1003, 1003, 389 N.Y.S.2d 348, 348-49 (1976); *Sturdy Concrete Corp. v. Nab Constr. Corp.*, 65 A.D.2d 262, 411 N.Y.S.2d 637 (N.Y. App. Div. 1978) (per curiam); see *Dyer Co. v. Bishop Int'l Eng'g Co.*, 303 F.2d 655 (6th Cir. 1962). The New York Lien Law imposes a trust on all funds paid or to be paid by an owner of a construction project to a contractor, and makes subcontractors beneficiaries of the trust. The law grants a subcontractor the right to recover even monies not yet paid from owner to contractor, because these monies are considered

force the contract language and postpone payment to the subcontractor until the condition is satisfied, or until a reasonable time has passed permitting the contractor to collect from the owner.² In this situation, therefore, a properly drafted choice of law clause could have a dispositive effect on the outcome of a dispute.

Consider further a contract for a project in a Middle Eastern country that selects the law of Delaware to govern disputes. In the event of a dispute, Delaware law will award an aggrieved party prejudgment interest at a rate five points above the Federal Reserve discount rate from the date of breach.³ In marked contrast, however, the application of Islamic law in some countries might well result in the denial of *any* prejudgment interest.⁴

The advantage to be gained or lost from a choice of law may be particularly important in sales contracts. One commentator has demonstrated with the following example:

B made an offer on a purchase order form to buy a barrel of glue from S. His offer made no mention of warranties other than a line on the back of the form stating that the contract will be performed with "normal conditions of warranty." S sent an acknowledgment form stating, "we sell our products without any warranties as to quality, but we shall replace them if defective." B did not object to this acceptance. The glue was delivered. B accepted the glue, paid for it and used it. It did not stick and B suffered extensive damages.⁵

part of the trust. ("[A]ny right to receive payment at a future time shall be deemed a right of action therefore and an asset of the trust even though it is contingent upon performance or upon some other event . . .") N.Y. Lien Law § 70(1)(a) (McKinney 1966). See, e.g., *Matter of Astrove Plumbing & Heating Corp.*, 96 Misc. 2d 420, 409 N.Y.S.2d 341 (N.Y. Sup. Ct. 1978).

2. See, e.g., *Havens Steel Co. v. Randolph Eng'g Co.*, 613 F. Supp. 514, 539 (D. Mo. 1985); *Seal Tite Corp. v. Ehret, Inc.*, 589 F. Supp. 701, 704-06 (D.N.J. 1984); *Midland Eng'g Co. v. John A. Hall Constr. Co.*, 398 F. Supp. 981, 993-94 (D. Ind. 1975).

3. Del. Code Ann. tit. 6, § 2301(a) (1984 Supp.) ("[w]here there is no expressed contract rate, the legal rate of interest shall be 5% over the Federal Reserve discount rate including any surcharge as of the time from which interest is due").

4. Compare *id.* with Sudanese Civil Procedure Code, Art. 110 (1983) ("under no circumstances shall the Court award a judgment for the payment of interest"). *Riba*, the charging of interest, is prohibited under Islam according to the Quran and other sources. Thus, any interest is illegal in Islamic nations such as modern-day Iran. S. Hassan Amin, *Islamic Law in the Contemporary World* 85 (1985).

5. Vergne, *The 'Battle of the Forms' Under the 1980 United Nations Convention on Contracts for the International Sale of Goods*, 33 *Am. J. Comp. L.* 233, 239 (1985) [hereinafter *Vergne*].

Depending on the applicable law, the result would only be the acceptance of a counteroffer, however, a buyer's term would be fully liable.⁷ The cause of the breach would be the breach of the clause.⁸

Similarly, in other cases, the cause of the breach would be the breach of the clause. For example, in cases involving goods that cannot be returned, his option to rescind the contract under the Uniform Commercial Code would minimize the damage to the buyer who accepted the contract with French law. The buyer would not be able to return any portion of the goods.

A choice of law clause in a contract is a U.S. state law. The U.S. state law is the adversary's law.

6. *Id.* at 241. See also *id.* at 969 (Lawton L.J. suggests that it is best to determine whether they have differences between the laws).

7. Vergne, *supra* note 5, 596 F.2d 924 (9th Cir. 1979) in interpreting a choice of law clause in *Carnac Textiles v. ...* arbitration clause.

8. Vergne, *supra* note 5.

9. G. Treitel, *supra* note 5, U.C.C. § 2-601 (c).

10. *Id.*

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Depending on the law chosen, this hypothetical renders dramati-
cally different results. Under English law, the seller of the glue
would only be required to replace the glue because the buyer's ac-
ceptance of delivery would operate as an acceptance of the seller's
counteroffer.⁶ Under the United States Uniform Commercial Code,
however, a U.S. court could find that a contract including the
buyer's terms had been concluded and that the seller was therefore
fully liable.⁷ Finally, under French law, the seller would prevail be-
cause the buyer had been made aware of the differing warranty
clause.⁸

Similarly, a choice of law clause can affect available remedies be-
cause different legal regimes allow different remedies in contract
cases. For example, if a buyer receives a shipment containing some
goods that conform to the contract specifications and some that do
not, his options will vary depending on the governing law. If the
contract indicates that the law of a U.S. state will govern, or that
the Uniform Commercial Code applies, the buyer could either ter-
minate the entire contract or terminate it with respect to "any
commercial unit" thereof.⁹ If West German law governs, however,
the buyer would not have this choice and could only terminate the
contract with respect to the nonconforming goods.¹⁰ Finally, if
French law applies, the buyer might not be allowed to terminate
any portion of the contract absent a court judgment.¹¹

A choice of law can also make or break a party's claim for resti-
tution or unjust enrichment. Thus, if a contract specifies the law of
a U.S. state, an aggrieved party may claim the full extent of his
adversary's unjust enrichment, even if the enrichment is due to an

6. *Id.* at 241. See *Butler Machine Tool Co. v. Ex-Cell-O Corp.*, 1 All E.R. 965 (1979), at 969 (Lawton L.J.). While the opinion espouses the "mirror-image" rule, Lord Denning suggests that it is better to consider the documents and conduct of the parties in determining whether they have "revealed agreement on all material points, even though there may be differences between the forms and conditions printed on the back of them." *Id.* at 968.

7. Vergne, *supra* note 5, at 244. See, e.g., *Idaho Power Co. v. Westinghouse Electric Corp.*, 596 F.2d 924 (9th Cir. 1979) (illustrating the movement away from the "mirror-image" rule in interpreting a supply contract); *In re arbitration between Marlene Indus. Corp. and Carnac Textiles Inc.*, 45 N.Y.2d 327, 380 N.E.2d 239, 408 N.Y.S.2d 410 (1978) (validity of arbitration clause in contract between merchants).

8. Vergne, *supra* note 5, at 252-53.

9. G. Treitel, *International Encyclopedia of Comparative Law* § 16-175 (1976) (quoting U.C.C. § 2-601 (a), (c)).

10. *Id.*

11. A. von Mehren, *International Encyclopedia of Comparative Law* § 1-125 (1980).

innocent windfall.¹² If the contract designates West German law and the adversary acted innocently, however, the aggrieved party may only recover whatever remains of the enrichment when the claim is brought.¹³

As this brief outline indicates, a choice of law clause can determine the outcome of almost any international contract dispute. In contrast, absent a choice of law clause, most contractual disputes will be unpredictable, needlessly protracted, and unduly expensive.

I. APPLICABLE LAW ABSENT A CHOICE OF LAW

Parties often fail to designate what law will govern their disputes, usually because they cannot agree on a choice of law, or because they simply overlook the issue.¹⁴ In these cases, the parties

12. Restatement of the Law of Restitution § 149 (1937).

13. Dawson, Restitution Without Enrichment, 61 B.U.L. Rev. 563-64 (1981) ("[T]hose who acquire enrichment when unaware that it was unjust cease to be liable to the extent they are 'no longer enriched.'" (quoting Burgerliches Gesetzbuch [BGB], art. 818(3))).

14. Occasionally, however, parties to international agreements make a conscious decision not to be bound by the laws of any state or nation, but rather to have their disputes resolved according to what is just and good, *ex aequo et bono*. Although this is permissible, such an approach to dispute resolution vastly reduces the ability of the parties to predict the outcome of a dispute.

There are two ways for parties to pursue this approach. One is to describe the law to be applied as equity, or as traditional notions of fairness and justice, or *ex aequo et bono*. The other is to provide that the arbitrator shall act as an *amiable compositeur*, i.e., one who judges according to natural law and equity. Given the lack of precision with which the terms equity and *ex aequo et bono* have been defined, the first approach is inherently likely to produce uncertainty. Agreements that provide for the arbitrator to act as an *amiable compositeur* can create equal uncertainty. Indeed, one commentator has noted that although "[t]he institution of *amiable compositeur* is well-known in civil law systems, where it is expressly recognized (although not defined) . . . [i]n common law systems it poses great theoretical difficulties." Jarvin, The sources and limits of the arbitrator's powers, 2 Arb. Int'l 140, 157 (1986); see also Lando, The law applicable to the merits of the dispute, 2 Arb. Int'l 104, 110-12 (1986) [hereinafter Lando] (discussing six possible results when the parties allow the arbitrator to choose the law to govern their dispute).

Nonetheless, three major sets of arbitral rules (those of the International Chamber of Commerce (ICC), the International Center for the Settlement of Investment Disputes (ICSID), and the United Nations Convention on International Trade Laws (UNCITRAL)) expressly permit parties to direct that their disputes be decided by an *amiable compositeur* or pursuant to *ex aequo et bono*. See Rules for the International Chamber of Commerce Court of Arbitration, art. 13.4, (1975), reprinted in 15 I.L.M. 395 (1976) [hereinafter ICC Rules]; Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, March 18, 1965, art. 42, para. 3, 17 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 159, reprinted in 4 I.L.M. 532 (1965) [hereinafter ICSID Rules]; United Nations Convention on International Trade Laws Arbitration Rules, art. 33.2 (1976), reprinted in 15 I.L.M. 701 (1976) [hereinafter UNCITRAL Rules]. Moreover, American case law makes clear that an arbitrator "may do justice as he sees it, applying his own sense of law and

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leave too much to chance and risk incurring unnecessary costs and
needless delays in resolving conflicts problems.

The parties' failure to choose a law to govern their disputes
presents arbitrators with a myriad of choices; indeed, in such a sit-
uation an arbitral panel commences a proceeding with few guide-
lines. Under the International Chamber of Commerce (ICC) and
United Nations Convention on International Trade Laws (UNCI-
TRAL) rules of arbitration, for example, the arbitrators are di-
rected in such cases to apply the law designated by whatever con-
flicts rules the arbitrators deem appropriate.¹⁵ Under these
"guidelines," should the arbitrators look to the conflicts law of the
place of contract performance in order to determine which law will
govern? Or should they use the rules of the place of contract for-
mation, those of the forum where the contract was breached, or
some other conflicts rules?

Some authorities suggest that the arbitrators should apply the
law of the forum the parties have designated for their arbitration.
Courts in the United Kingdom and in the United States, for exam-
ple, have construed forum selection as an implicit choice of the fo-
rum's laws.¹⁶ Arbitrators could draw the same conclusion, though
they are not bound to do so.¹⁷

In an international case, the arbitrators are likely to be from dif-
ferent legal backgrounds and therefore adhere to widely differing

equity . . ." *Silverman v. Benmor Coats, Inc.*, 61 N.Y.2d 299, 308, 461 N.E.2d 1261, 1266,
473 N.Y.S.2d 774, 779 (1984).

15. ICC Rules, *supra* note 14, art. 13.3; ICSID Rules, *supra* note 14, art. 42.1.

16. See, e.g., *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 n.13 (1974) (Douglas, J.,
dissenting); *Lummus Co. v. Commonwealth Oil Ref. Co.*, 280 F.2d 915, 924 (1st Cir. 1960)
(dictum) (applying New York law), cert. denied, 364 U.S. 911 (1960); *In re Doughboy Indus.,*
Inc., 17 A.D.2d 216, 221 n.2, 233 N.Y.S.2d 488, 494 n.2 (N.Y. App. Div. 1962) (applying N.Y.
law); *Splosna Plovba of Piran v. Agrelak S.S. Corp.*, 381 F. Supp. 1368, 1370 (S.D.N.Y. 1974)
(applying British law). See generally *Lando*, *supra* note 14, at 108-09 (discussing the French,
British, and West German approaches to this question).

In the United Kingdom, the inference that choice of forum was implicitly a choice of law
was once deemed "irresistible"; it is now, however, said to be one factor, and not an irresist-
ible one. *Compagnie d'Armement Maritime S.A. v. Compagnie Tunisianna de Navigation*
S.A., [1971] App. Cas. 572, 596.

17. It has been argued that arbitrators should not draw this inference because parties
often choose forums for arbitration without any intention of submitting to the forums' laws.
For example, parties frequently choose a forum for its geographic convenience, or because it
is the site of an established arbitral institution—reasons having nothing to do with the sub-
stance of the dispute or an implicit choice of law. See generally Croff, *The Applicable Law*
in an International Commercial Arbitration: Is It Still a Conflict of Laws Problem?, 16 Int'l
Law. 613 (1982) (a review of different approaches to choice of law in international
arbitration).

conflicts principles. For example, in many locales, conflicts rules mandate that the law of the place of performance will govern.¹⁸ In other locales, however, the law of the place of contract formation governs.¹⁹ In Korea, Korean law governs if the offer is made in Korea; if it is unclear where the offer was made, Korean law will apply if the offeror is Korean.²⁰ Given these differences, and the failure of either the ICC or UNCITRAL rules to offer informative guidelines, the arbitrators may well require the parties to brief the conflicts issue, at considerable time and expense to the parties.

As indicated above, what law the arbitrators eventually decide to apply to a given case may well determine the outcome of the dispute or some significant portion of it. Moreover, the process of selecting the applicable law absent an agreed choice by the parties can be protracted, difficult and expensive. Thus, given these considerations, the parties should choose the governing law in advance both to assure predictability of dispute resolution as well as to avoid the time and expense required to resolve murky conflicts problems.

II. APPLICATION OF THE CHOSEN LAW

A choice of law establishes the *substantive* law that will govern the *substance* of the parties' disputes in an arbitral proceeding. A choice of a particular jurisdiction's laws does not, however, manifest a choice of that jurisdiction's rules on choices of law.²¹ Thus,

18. See Morris, *The Conflict of Laws* 210-11 (1980).

19. *Id.*

20. Conflict of Laws Act, art. 11, sec. 2, Law No. 966, promulgated Jan. 15, 1962, reprinted in *III Laws of the Republic of Korea* (4th ed. 1983), provides:

In respect of the formation and effect of a contract, the place of which the notice of an offer of the contract has been given shall be deemed the place of action. If, when the person who has received the offer of the contract has accepted such offer, it was impossible for him to ascertain the place at which an offer of a contract has been dispatched, the place of the domicile of the offeror shall be deemed the place of action.

21. Restatement (Second) of Conflicts of Laws § 187(3) comment h (1971). The Restatement § 4 distinguishes between "local law" and "law," the former being a state's body of law "exclusive of its Conflict of Laws rules," the latter being the "state's local law together with its rules of Conflict of Laws." *Id.* This distinction is further explained in the Restatement § 187 comment h, which states:

The reference, in the absence of a contrary indication of intention, is to the "local law" of the chosen state and not to that state's "law," which means the totality of its law including its choice-of-law rules. . . . To apply the "law" of the chosen state would introduce the uncertainties of choice of law into the proceedings and would serve to defeat the basic objectives, namely those of cer-

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in an arbitral forum, the substantive law of the chosen jurisdiction governs, even if under that jurisdiction's conflicts rules the law of a different jurisdiction would apply.

In contrast, the chosen law does not generally govern procedural matters in an arbitration, unless the parties so specify.²² It is clear that just as parties may choose the substantive law, so may they choose the procedural law. Indeed, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) suggests that the right to choose the procedural law should be absolute. That Convention provides that recognition and enforcement of an arbitral award may be denied upon proof that "the arbitral procedure was not in accordance with the agreement of the parties."²³

Various arbitral institutions treat this "right" differently but all permit either the parties or the arbitrators to vary the rules. The rules of the United Nations Commission on International Trade Law govern UNCITRAL arbitrations "subject to such modification as the parties may agree in writing."²⁴ Similarly, arbitrations before the American Arbitration Association (AAA) are governed by their own procedural rules, but those rules permit arbitrators to vary the procedures.²⁵ ICC arbitrations are governed by the ICC rules, but where those rules are silent the parties can choose another set of rules or create their own.²⁶ By definition, an ad hoc arbitration is governed by any procedural rules the parties may choose. Finally, the International Centre for the Settlement of Investment Disputes (ICSID) applies its own procedural rules in ICSID arbitrations "except as the parties otherwise agree"²⁷

tainty and predictability, which the choice-of-law provision was designed to achieve.

22. See, e.g., *American Food Management, Inc. v. Henson*, 105 Ill. App. 3d 141, 144-45, 434 N.E.2d 59, 62 (1982) (enforcing the choice of a foreign law to govern the merits of dispute, but applying the forum's law to determine the procedural standards for a preliminary injunction).

23. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. V, para. (d), 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38, reprinted in 9 U.S.C. § 201 note (1982) (emphasis added) [hereinafter *New York Convention*].

24. UNCITRAL Rules, *supra* note 14, art. 1.

25. American Arbitration Ass'n Commercial Arbitration Rules (1985), §§ 29, 37 [hereinafter *AAA Rules*].

26. ICC Rules, *supra* note 14, art. 11.

27. ICSID Rules, *supra* note 14, art. 42, para. 1.

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law to govern international and the world.²⁸ In Euro- an Convention on Commer- , parties are "free to deter- ed by the arbitrators to the is set forth in the rules of n,³⁰ as well as in the UNCI- adopted by Canada.³¹

vil law and common law countries, see s are generally resistant to arbitration traus, *Why International Commercial* . 21 (1978); Note, *International Com- cement of the Inter-American Conven- racuse J. Int'l L. & Com.* 169 (1983); Study of its Regional Development, 8 e, a product of the 19th century ensur- eard in local courts, permeates Latin n. See W. Bishop, *International Law*, 15, 291-305 (1955).

are generally enforceable, courts have turbed for failure by the arbitrators to cted, however, if the arbitrators show ch Oil, S.A. v. Transocean Gulf Oil Co., ov't of Republic of Korea v. New York In re A/S Siljestad v. Hideca Trading, .2d 391 (2d Cir. 1982); Fukaya Trading 78, 282-83 (E.D. La. 1971). Under the exceeded its powers" in reaching its upra note 14, art. 52(i)(b). Indeed, the n law, had annulled on the ground that the law, had exceeded their powers. See ublic of Cameroon, ICSID Case No. Arb/ nesia, ICSID Case No. Arb/81/1 (May llments of 'Final' ICSID Awards Raises 986, at 25, col. 1.

ration, April 21, 1961, art. VII, 484 e parties shall be free to determine the e 14, art. 33.1 ("[t]he arbitral tribunal ID Rules, supra note 14, art. 42, para. 1 nce with such rules of law as may be merican Arbitration Association (AAA) ce, the AAA upholds parties' choices of ernational Commercial Arbitration in ls. 1986) (discussing right of parties to h. 22 (1986), assented to June 17, 1986.

U.S. law also permits parties to choose the substantive law to apply in their international commercial arbitrations.³² Although the point now seems axiomatic, its historical roots are shallow. Moreover, even today there is no treaty or federal statutory provision in the United States authorizing parties to choose the law to govern their arbitrations.

Through the early part of this century, American courts regularly invalidated arbitration agreements as encroachments on the judicial province and hence contrary to public policy.³³ Courts also generally disapproved of contractual choices of law in any forum.³⁴

Notably, the law enacted in the Province of British Columbia changed the Model Law provision on what law governs absent a choice of law by the parties. The UNCITRAL Model Law requires the arbitrators to apply the law as determined by the conflicts rules they deem applicable; the British Columbia version permits arbitrators to skip the conflicts analysis and simply choose the governing law. *International Commercial Arbitration Act of British Columbia*, 1986, art. 28, para. 3; see generally Chiasson, *Canada: No Man's Land No More*, 3 *J. Int'l Arb.* 67 (1986) (discussing change in Canadian arbitration laws as result of enactment of New York Convention on Recognition and Enforcement of Foreign Arbitral Awards).

32. See, e.g., *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974). The laws of most other countries also permit choices of law. For a brief overview of the applicable rules in selected civil law and common law countries, see Croff, supra note 17, at 613.

33. See, e.g., *Home Ins. Co. v. Morse*, 87 U.S. (20 Wall.) 445 (1874) (concerning an insurance contract); *Tatsuuma Kisen Kabushiki Kaisha v. Prescott*, 4 F.2d 670 (9th Cir. 1925) (concerning a suit in admiralty); *Robert Grace Contracting Co. v. Chesapeake & Ohio N. Ry. Co.*, 281 F. 904 (6th Cir. 1922) (concerning a railroad construction contract); *Meacham v. Jamestown, Franklin & Clearfield R.R. Co.*, 211 N.Y. 346, 105 N.E. 653 (1914) (concerning a railroad contract). See also *Scherk v. Alberto-Culver Co.*, 417 U.S. at 510, 512 n.4 (referring to the United States Arbitration Act, ch. 213, 43 Stat. 883 (1925) (current version as amended at 9 U.S.C. §§ 1-14 (1982)) [hereinafter *Arbitration Act*], as "reversing centuries of judicial hostility to arbitration agreements").

34. See, e.g., *E. Gerli & Co. v. Cunard S.S. Co.*, 48 F.2d 115 (2d Cir. 1931), in which Judge Learned Hand strenuously objected to the parties' choices of law in general:

People cannot by agreement substitute the law of another place; they may of course incorporate any provisions they wish into their agreements—a statute like anything else—and when they do, courts will try to make sense out of the whole, so far as they can. But an agreement is not a contract, except as the law says it shall be, and to try to make it one is to pull on one's bootstraps. Some law must impose the obligation, and the parties have nothing whatever to do with that; no more than with whether their acts are torts or crimes.

Id. at 117. It is generally concluded that Judge Hand's dictum was overruled in *Hal Roach Studios, Inc. v. Film Classics, Inc.*, 156 F.2d 596, 598 (2d Cir. 1946) (law of jurisdiction may be chosen "so long as there is that sufficient relationship to make it reasonable that the law chosen should apply"). See *B.M. Heede, Inc. v. West India Machinery and Supply Co.*, 272 F. Supp. 236, 240 (S.D.N.Y. 1967). For a more general statement of the unfavorable attitude toward choice-of-law clauses in the early part of this century, see 2 J. Beale, *The Conflict of Laws* 1079-86 (1935) (permitting choice of law "practically makes a legislative body of any two persons who choose to get together and contract . . . [T]o allow them to free themselves from the power of the law which would otherwise apply to their acts . . . is absolutely

Thus, the courts constructed a double barrier parties had to cross in order to arbitrate under a chosen law.

With the enactment of the United States Arbitration Act (Arbitration Act) in 1925,³⁵ however, came a general but limited willingness to permit parties not only to arbitrate, but also to choose where to arbitrate and under what laws. Gradually, U.S. courts began to accept the parties' right to choose the substantive law to govern in arbitrations. This judicial acceptance is now evident in decisions of both federal and state courts. Perhaps the most important milestone in the development of this "right" is *Scherk v. Alberto-Culver Co.*,³⁶ in which the U.S. Supreme Court upheld an international commercial arbitration agreement that contained a choice of law clause.

In *Scherk*, Alberto-Culver, a Delaware corporation with its principal place of business in Illinois, contracted to buy all the stock and trademarks of two European subsidiaries of Scherk, a West German company.³⁷ The parties' written agreements provided that "any controversy or claim . . . aris[ing] out of this agreement or the breach thereof" would be settled by arbitration in Paris, France through the International Chamber of Commerce.³⁸ Moreover, the agreements provided that the "laws of the State of Illinois, U.S.A. shall apply to and govern this agreement, its interpretation and performance."³⁹ In addition to this language, the agreements also contained warranties whereby Scherk guaranteed unencumbered ownership of the trademarks.⁴⁰

Upon discovering alleged encumbrances on the trademarks, Alberto-Culver brought suit against Scherk in U.S. federal district court. Alberto-Culver claimed that Scherk had violated federal securities laws by fraudulently misrepresenting its trademark rights.⁴¹ The federal district and appellate courts rejected Scherk's efforts to stay the court proceedings and to compel arbitration;⁴² both courts held that federal securities laws granted Alberto-Culver a remedy in federal court that could not be foreclosed by an

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35. Arbitration Act, *supra* note 33.

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

37. *Id.* at 521.

38. *Id.* at 508.

39. *Id.* at 508 & n.1.

40. *Id.* at 508.

41. *Id.* at 509.

42. *Id.* at 509-10.

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arbitration agreement.⁴³ The Supreme Court disagreed.

In reaching its decision, the Court addressed two competing interests: those of Alberto-Culver, its shareholders and investors generally in the protections granted by federal securities laws, balanced against the interests of parties to international transactions in being able to determine where, and under what law, their disputes will be decided.⁴⁴ The Court found that the latter interests outweighed the former:

[U]ncertainty . . . concerning the law applicable to the resolution of disputes arising out of the contract . . . will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws and conflict-of-laws rules. A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction.

. . . The invalidation of such an agreement in the case before us would not only allow the respondent [Alberto-Culver] 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."⁴⁵

43. Id.

44. Id. at 516.

45. Id. at 516, 519 (footnote omitted) (quoting *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972)). The *Scherk* Court's endorsement of international arbitration seems particularly strong when compared with *Wilko v. Swan*, 346 U.S. 427 (1953). In *Wilko*, the Supreme Court held that an agreement to arbitrate could not preclude an action under the federal securities laws. Id. at 438. That case involved a purely domestic arbitration, and thus did not involve the federal interest in promoting international commerce that led to a different result in *Scherk*. The court later sought in *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), to distinguish *Wilko* from *Scherk* by noting that the claim which was held non-arbitrable in *Wilko* was based on the Securities Act of 1933, whereas the claim which was held arbitrable in *Scherk* was based on the Securities Exchange Act of 1934. That distinction is not tenable, however, as the dissenting opinion in *Scherk* makes clear. *Scherk v. Alberto-Culver*, 417 U.S. at 531-32 (Douglas, J., dissenting). As Justice Douglas points out, the real distinction between *Wilko* and *Scherk* is that the former case involved a domestic arbitration and the latter an international one. Id. Nevertheless, in domestic cases, courts

The Court held that the arbitration clause was binding,⁴⁶ and therefore ordered the parties to arbitrate in Paris under Illinois law, thus enforcing their choice of law. Interestingly, the Court mentioned in a footnote that "the designation of arbitration in a certain place might also be viewed as implicitly selecting the law of that place to apply to that transaction."⁴⁷ Presumably, then, the Court suggested that the *Scherk* arbitration would have been governed by the law of France had the parties failed to specify otherwise.

The Supreme Court reaffirmed its ruling in *Scherk* in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*⁴⁸ In *Mitsubishi*, Soler, a Puerto Rican car dealership, brought suit against Mitsubishi, a Japanese corporation, under the federal antitrust laws.⁴⁹ Soler's antitrust claims arose from an agreement between the parties that also contained an arbitration and choice-of-law clause specifying arbitration in Japan under Swiss law.⁵⁰ The Supreme Court held that the arbitration and choice-of-law clauses were valid and enforceable and therefore compelled arbitration in Japan pursuant to Swiss law.⁵¹ In doing so, the Court repudiated lower court precedent and held that antitrust claims were susceptible to arbitration.⁵² The Court also restated the considerations it followed in *Scherk*, noting "the emphatic federal policy in favor of arbitral dispute resolution . . . [which] applies with special force in the field of international commerce"⁵³

IV. REQUISITES FOR A VALID CHOICE OF LAW

The right of parties to choose the substantive law to apply in arbitration depends, in the first instance, on their right to choose arbitration as a form of dispute resolution at all. Arbitration is a

continue to differ on the arbitration of securities claims, and continue to rely on attenuated distinctions between the 1933 and 1934 Securities Acts. Compare *Phillips v. Merrill, Lynch, Pierce, Fenner & Smith*, 795 F.2d 1393 (8th Cir. 1986) (arbitration agreement held enforceable) with *Conover v. Dean Witter Reynolds, Inc.*, 794 F.2d 520 (9th Cir. 1986) (arbitration agreement held unenforceable).

46. *Scherk v. Alberto-Culver*, 417 U.S. 506, 519-20 (1974).

47. *Id.* at 519 n.13.

48. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 105 S. Ct. 3346 (1985).

49. *Id.* at 3350-51.

50. *Id.* at 3349, 3359 n.19.

51. *Id.* at 3355-60.

52. *Id.* at 3360.

53. *Id.* at 3356-57.

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contractually determined form of dispute resolution;⁵⁴ a party cannot be compelled to arbitrate a dispute unless it has agreed by contract to do so.⁵⁵ In the United States, whether parties to an international transaction have so agreed is a question of federal law and is governed by the United States Arbitration Act.

The Arbitration Act provides for the enforcement of arbitration agreements relating to virtually any maritime transaction,⁵⁶ any transaction involving a U.S. party in interstate or international commerce,⁵⁷ and any transaction within the scope of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention).⁵⁸ Stated generally, transactions within the scope of the New York Convention include all international and interstate commercial transactions, except those that are entirely between U.S. citizens *and* do not involve any significant contact with a foreign nation.⁵⁹ In short, the Arbitration Act provides for the enforcement of virtually all international arbitration agreements.

The Supreme Court has held that the Arbitration Act "creates a body of federal substantive law" that governs questions of arbitrability relating to interstate and international transactions, and that this law "governs . . . in either state or federal court."⁶⁰ Thus,

54. Arbitration is a creature of contract, and both the right and duty to arbitrate are "of contractual origin." *AT&T Technologies v. Communications Workers of America*, 106 S. Ct. 1415, 1418 (1986); See also *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 547 (1964) (the duty to arbitrate is of contractual origin).

55. See, e.g., *AT&T Technologies v. Communications Workers*, 106 S. Ct. at 1418 (labor arbitration); *Atkinson v. Sinclair Refining Co.*, 370 U.S. 238, 241 (1962) (labor arbitration); *Williams v. E.F. Hutton & Co., Inc.*, 753 F.2d 117, 119 (D.C. Cir. 1985) (securities claim); *Fortune, Alsweet and Eldridge, Inc. v. Daniel*, 724 F.2d 1355, 1356 (9th Cir. 1983) (construction contract). See also Arbitration Act, *supra* note 33, §§ 2, 202 (1982) (permitting courts to compel arbitration only if the parties have entered a valid arbitration agreement).

56. Arbitration Act, *supra* note 33, §§ 1-2 (1982) (providing for enforcement of agreements relating to "maritime transactions," which are defined to include "any . . . matters in foreign commerce which . . . would be embraced within admiralty jurisdiction").

57. *Id.* (providing for enforcement of agreements relating to "commerce," which is defined to include interstate and international commerce, with narrow exceptions for certain employment contracts).

58. *Id.* at § 203; New York Convention, *supra* note 23, art. I, para. 3. The Arbitration Act further provides that cases falling under the New York Convention may be removed from state to federal court. Arbitration Act, *supra* note 33, § 205.

59. Arbitration Act, *supra* note 33, § 202. This is the definition of the scope of the New York Convention that the U.S. enacted. The New York Convention merely permits, and does not require, signatories to restrict its scope to "commercial" transactions. New York Convention, *supra* note 23, art. X.

60. *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984) (quoting *Moses H. Cone Memorial*

in the United States, the Arbitration Act preempts any contrary state law and governs all questions regarding the validity, construction, interpretation and enforceability of international arbitration agreements.⁶¹ In describing the applicable federal law, courts have held that it is composed of "generally accepted principles of contract law."⁶² Because there is, however, little federal substantive law of contracts, courts have drawn these generally accepted principles from state contract law⁶³ and from such sources as the Uniform Commercial Code.⁶⁴

These general principles of contract law require that an arbitration agreement, like a typical contract, result from an offer and an acceptance and represent a meeting of the parties' minds.⁶⁵ More-

over, an agreement is not necessarily enforceable if it is contrary to national arbitration policy.

In the domestic context, a contract is not enforceable if it is contrary to public policy. Thus, a contract for the sale of goods is not enforceable if it is for the sale of goods that are to be decided by arbitration.

Hosp. v. Mercury Const. Corp., 460 U.S. 1, 24, 25 n.32 (1983)).

61. See, e.g., Guinness-Harp Corp. v. Jos. Schlitz Brewing Co., 613 F.2d 468 (2d Cir. 1980) (termination of distributorship agreement); Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk GmbH, 585 F.2d 39, 43 (3d Cir. 1978) (termination of distributorship agreement); Beromun Aktiengesellschaft v. Societa Industriale Agricola, 471 F. Supp. 1163 (S.D.N.Y. 1979) (breach of sale of goods contract); Ferrara S.p.A. v. United Grain Growers, 441 F. Supp. 778, 780-81 & n.2 (S.D.N.Y. 1977) (breach of sale of goods contract); Cone Mills Corp. v. August F. Nielson Co., 90 A.D.2d 31, 455 N.Y.S.2d 698 (N.Y. App. Div. 1977) (breach of warranty by suppliers). Federal law governs the validity and scope of international arbitration agreements because such agreements fall under the Arbitration Act. Agreements that do not fall under that Act are governed by state law, even where they are challenged in federal court. See, e.g., Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 253 F. Supp. 359, 363-64 (S.D.N.Y. 1966) (applying New York choice of law rules to a commodities futures contract dispute).

62. Rhone Mediterranee Compagnia v. Lauro, 555 F. Supp. 481, 485 (D.V.I. 1982), aff'd, 712 F.2d 50 (3d Cir. 1983) (quoting Ferrara, S.p.A. v. United Grain Growers, 441 F. Supp. 778, 780 (S.D.N.Y. 1977) (breach of sale of goods contract)).

63. See, e.g., E.B. Michaels v. Mariforum Shipping, S.A. 624 F.2d 411, 413 n.3 (2d Cir. 1980); Puerto Rico Maritime Shipping Auth. v. Star Lines Ltd., 454 F. Supp. 368, 372 n.6 (S.D.N.Y. 1978); Jos. Muller Corp. Zurich v. Commonwealth Petrochemicals, Inc., 334 F. Supp. 1013, 1020 (S.D.N.Y. 1971) (all applying New York case law).

64. See, e.g., Banque de Paris et des Pays-Bas v. Amoco Oil Co., 573 F. Supp. 1464, 1469 (S.D.N.Y. 1983) (relying upon U.C.C. § 9-318); Spring Hope Rockwool, Inc. v. Industrial Clean Air, Inc., 504 F. Supp. 1385, 1388 (E.D.N.C. 1981) (relying upon U.C.C. § 2-719); Beromun Aktiengesellschaft v. Societa Industriale Agricola, 471 F. Supp. 1163, 1170 (S.D.N.Y. 1979) (relying upon U.C.C. § 2-207).

65. E.g., Atlanta Shipping Corp. v. Cheswick-Flanders & Co., 463 F. Supp. 614, 617 (S.D.N.Y. 1978). See also C. Itoh & Co. v. Jordan International Co., 552 F.2d 1228, 1233-37 (7th Cir. 1977) (where a party has added an arbitration term as written confirmation of an oral offer or agreement without the other party's assent under § 2-207 of the U.C.C., the parties may have a valid contract, but the contract does not include the arbitration term); Hellenic Lines, Ltd. v. Louis Dreyfus Corp., 372 F.2d 753, 756 (2d Cir. 1967) (proof of duress may defeat arbitration agreement); Fairfield-Noble Corp. v. Pressman-Gutman Co., 475 F. Supp. 899, 902-03 (S.D.N.Y. 1979) (because the unilateral insertion of an arbitration clause is a material alteration of an agreement, under § 2-207 of the U.C.C., the clause does not become part of the agreement); Pacific Lumber & Shipping Co., Inc. v. Starr Shipping A/S,

464 F. Supp. 131 (S.D.N.Y. 1978) (lading by ocean carrier). Thus, where a buyer's sales contract entered a valid arbitration agreement with Jantzen, Inc.,

66. The Arbitration Act, 9 U.S.C. § 1, written agreement, note 25, §§ 7, 9 (agreement to arbitrate to ICSID arbitrators have "agreed in writing" (requiring only a written agreement).

According to the Act, though not signed, (E.D.N.Y. 1982); 1163, 1170 (S.D.N.Y. 1978).

Although arbitration may imply through a contract and which is not certified, denied, 380 F. Supp. 687, 690 (S.D.N.Y. 1982). E.g., Royal Dutch Productions, Ltd. (S.D.N.Y. 1982). (2d Cir. 1980) (the signature).

68. See, e.g., B. 41 (S.D.N.Y. 1967). 69. See generally 1982) (recognizing enacted protective statutes underlying such 459, 415 N.Y.S.2d to recognize arbit

preempts any contrary ruling on the validity, content or scope of international arbitration. Applicable federal law, generally accepted principles, however, little federal law drawn these generally accepted and from such sources

require that an arbitrator's decision result from an offer and an agreement of the parties' minds.⁶⁵ More-

over, an agreement to arbitrate must be written,⁶⁶ although not necessarily signed.⁶⁷ Finally, the arbitration agreement must not be contrary to a strong public policy.⁶⁸ Rarely, however, would international arbitration agreements be considered contrary to public policy.

In the domestic context, arbitration agreements have been held contrary to public policy only if they purport to require arbitration of disputes that involve public interests considered too important to be decided through private arbitration.⁶⁹ Examples of such disputes include cases brought under important federal statutes (in-

464 F. Supp. 1314, 1315 (D. Wash. 1979) (arbitration clause unilaterally placed on bill of lading by ocean carrier not valid). The meeting of the minds need not be perfect, however. Thus, where a buyer's purchase order specified arbitration before one tribunal and the seller's sales confirmation specified arbitration before another, it was held that they had entered a valid arbitration agreement, notwithstanding the differences. *Peters Fabrics, Inc. v. Jantzen, Inc.*, 582 F. Supp. 1287, 1291 (S.D.N.Y. 1984).

66. The Arbitration Act provides for enforcement only of written arbitration agreements. Arbitration Act, supra note 33, § 2. Similarly, the New York Convention applies only to written agreements. New York Convention, supra note 23, art. II. See also AAA Rules, supra note 25, §§ 7, 9 (requiring either "an arbitration provision in the contract" or "a written agreement to arbitrate"); ICSID Rules, supra note 14, art. 25 (requiring "consent in writing" to ICSID arbitration); UNCITRAL Rules, supra note 14, art. 1.1 (requiring that parties have "agreed in writing" to UNCITRAL arbitration). But see ICC Rules, supra note 14, art. 7 (requiring only a "prima facie agreement between the parties to arbitrate," and not expressly requiring that the agreement be written).

According to general common law principles, arbitration agreements must be written, although not signed. See, e.g., *Janmort Leasing, Inc. v. Euro-Car Int'l Inc.*, 475 F. Supp. 1282 (E.D.N.Y. 1982); *Beromun Aktiengesellschaft v. Societa Industriale Agricola*, 471 F. Supp. 1163, 1170 (S.D.N.Y. 1979); *Fox v. Merrill Lynch & Co.*, 453 F. Supp. 561, 564 (S.D.N.Y. 1978).

Although arbitration agreements must be written, parties may subsequently orally agree, or imply through their conduct, which disputes fall within their written agreement to arbitrate and which do not. E.g., *Ficek v. Southern Pacific Co.*, 338 F.2d 655, 656 (9th Cir. 1964), cert. denied, 380 U.S. 988 (1965); *Manes Org., Inc. v. Standard Dyeing & Finishing Co.*, 472 F. Supp. 687, 690-91 n.4 (S.D.N.Y. 1979).

67. E.g., *Royal Air Maroc v. Servair, Inc.*, 603 F. Supp. 836, 842 (S.D.N.Y. 1985); *Clar Productions, Ltd. v. Isram Motion Pictures Prod. Serv., Inc.*, 529 F. Supp. 381, 382-83 (S.D.N.Y. 1982). See also *McAllister Bros., Inc. v. A & S Transp. Co.*, 621 F.2d 519, 523-24 (2d Cir. 1980) (the plaintiff may be bound by an agreement to arbitrate even in absence of a signature).

68. See, e.g., *B.M. Heede, Inc. v. West India Mach. & Supply Co.*, 272 F. Supp. 236, 240-41 (S.D.N.Y. 1967).

69. See generally *Breyer v. First Nat'l Monetary Corp.*, 548 F. Supp. 955, 959 (D.N.J. 1982) (recognizing a judicially created exception to the Arbitration Act: where Congress has enacted protective legislation, the arbitration tribunal is insufficient to effectuate the policies underlying such legislation); *Sprinzen v. Nomberg*, 46 N.Y.2d 623, 630, 389 N.E.2d 456, 459, 415 N.Y.S.2d 974, 977 (1979) (listing several examples to illustrate New York's refusal to recognize arbitration awards if they are contrary to public policy).

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 termination of distributorship agree-
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cluding the Racketeer Influenced and Corrupt Organization Act (RICO)⁷⁰ and the Securities Exchange Act of 1934⁷¹), cases raising allegations of usury,⁷² cases under state blue-sky laws,⁷³ proceedings concerning liquidation of insurance companies,⁷⁴ and certain labor disputes.⁷⁵ Although disputes based on federal claims are generally nonarbitrable in the domestic context, such claims are deemed to be arbitrable in the international context.

Moreover, recent cases highlight the strength of the federal policy favoring enforcement of international arbitration agreements in foreign commerce. For example, in *Scherk and Mitsubishi*, the Supreme Court held that federal court enforcement of rights conferred by federal securities and antitrust laws was subordinate to the federal policy favoring enforcement of arbitration agreements in international cases.⁷⁶ In another recent case, *Southland Corp. v. Keating*,⁷⁷ the Supreme Court held that this federal policy outweighed a countervailing state statute, even though the underlying transaction involved only interstate, not international, commerce.⁷⁸

70. E.g., *McMahon v. Shearson/American Express, Inc.*, 788 F.2d 94, 98-99 (2d Cir. 1986) (addressing claim under the Racketeer Influenced and Corrupt Reorganization Act (RICO), 18 U.S.C. § 1962(c) (1982)).

71. *Id.* at 96-98 (addressing claim under the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982)).

72. *Rosenblum v. Steiner*, 43 N.Y.2d 896, 898, 374 N.E.2d 610, 611, 403 N.Y.S.2d 716, 717-18 (1978); *Durst v. Abrash*, 22 A.D.2d 39, 44, 253 N.Y.S.2d 351, 356 (N.Y. App. Div. 1964), *aff'd*, 17 N.Y.2d 445, 213 N.E.2d 887, 266 N.Y.S.2d 806 (1965).

73. See *State ex rel. Geil v. Corcoran*, 623 S.W.2d 557, 559-60 (Mo. Ct. App. 1981).

74. See *Knickerbocker Agency v. Holz*, 4 N.Y.2d 245, 250-53, 149 N.E.2d 885, 888-91, 173 N.Y.S.2d 602, 606-09 (1958).

75. See *Lewis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 431 F. Supp. 271, 275-78 (E.D. Pa. 1977); *Board of Education v. Areman*, 41 N.Y.2d 527, 362 N.E.2d 943, 394 N.Y.S.2d 143 (1977); *In re Cohoes City School District v. Cohoes Teachers Ass'n*, 40 N.Y.2d 774, 778, 358 N.E.2d 878, 880-81, 290 N.Y.S.2d 53, 55-56 (1976). But see *Arbitration Act*, *supra* note 33, § 1 (the Arbitration Act, by its terms, does not apply to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce").

76. See *supra* notes 36-53 and accompanying text. See also *AVC Nederland B.V. v. Atrium Inv. Partnership*, 740 F.2d 148, 157 n.15 (2d Cir. 1984) (rejecting a claim under the federal securities laws as barred by the parties' agreement providing that disputes arising thereunder be resolved through litigation in the Netherlands under Dutch law).

77. *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

78. *Id.* at 14. *Southland* concerned a California statute providing certain protections to franchisees, including the plaintiff. *Id.* at 5-11. The statute provided that any attempt to waive its protections would be void; on the basis of this language the California Supreme Court held that the arbitration agreement at issue was void because it would have precluded a judicial remedy under the statute. *Id.* at 10. The Supreme Court reversed, arguing that the Arbitration Act evinces a congressional intent "to foreclose state legislative attempts to un-

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transaction. In *I.S. Joseph Co. v. Toufic Aris & Fils*,⁸⁵ a French-based company contracted to buy from a Minnesota-based company goods to be shipped from Louisiana. Although the formation and performance of the contract had no reasonable relationship with New York, the contract contained an arbitration clause providing for arbitration in New York under New York law.⁸⁶ When a dispute arose, the Minnesota company sought to block arbitration in New York on the ground that no contract had been formed. It argued that Louisiana law should be applied to determine if a contract to arbitrate existed because New York law bore no reasonable relationship to the contract. In analyzing New York law, which then required that the chosen law bear a reasonable relationship to the parties or to the transaction in dispute,⁸⁷ the court broadly construed the term "transaction" to include the contract itself, and specifically the arbitration and choice-of-law clause.⁸⁸ Given this broad framework of analysis, the court ruled that the "transaction" was reasonably related to New York because the contract specified arbitration in New York under New York law.⁸⁹

This decision is flawed on at least two grounds. First, its logic seems circular and dubious. It is rarely if ever the case that the contract *itself* is the transaction to which the chosen law must bear a reasonable relation. Second, the decision strips the reasonable relationship rule of meaning, for if the contract states a choice of law, and the contract *is* the transaction, then the transaction is perforce reasonably related to the chosen law. This kind of legal artifice is wholly unnecessary. The court should have foregone its inquiry into the "reasonable relationship" issue and simply applied New York law, thereby giving force to the parties' clear intent.

As the above analysis indicates, neither the reasonable-relationship requirement, nor any other conflicts restriction, should apply in international arbitrations when the parties have explicitly chosen the law to govern their disputes. One of the chief purposes of

85. *I.S. Joseph Co. v. Toufic Aris & Fils*, 54 A.D.2d 665, 388 N.Y.S.2d 1 (N.Y. App. Div. 1976).

86. *Id.* at 665-66, 388 N.Y.S.2d at 2-3.

87. *Id.* at 666, 388 N.Y.S.2d at 3. New York has since enacted a statute that renders the reasonable rule inapplicable where parties to large transactions choose New York law. The statute provides that in a transaction involving more than \$250,000, a choice of New York law is effective "whether or not [the transaction] bears a reasonable relation to [New York]." N.Y. Gen. Oblig. Law § 5-1401(1) (McKinney Supp. 1985).

88. *I.S. Joseph Co., Inc. v. Toufic Aris & Fils*, 54 A.D.2d at 666, 388 N.Y.S.2d at 3.

89. *Id.*

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international arbitration is to afford parties a neutral forum where they can be governed by a neutral law of their choice.⁹⁰ It is therefore especially important that parties in international cases be permitted to choose a legal regime that bears no relationship to their transaction, for that will frequently be the only way they can ensure that the governing law is that of neither party and therefore apparently neutral. This effect would be frustrated if the reasonable-relationship rule, or some other conflicts rule, were applied to deny parties their right to choose the applicable law.

The reasonable-relationship rule is intended to assure some rational basis for the parties' choice. Requiring a relationship between the chosen law and the transaction is thus a shorthand method of testing whether the choice is rational.⁹¹ In international cases, however, the most rational choice will frequently be a neutral law with no relationship to the transaction. To apply a shorthand test in these cases would therefore be to elevate form over function.

It is interesting to note that in *Mitsubishi* the Supreme Court did not question whether the chosen law of Switzerland bore any relationship to the transaction in that case. Had the Court made such an inquiry, it would most likely have found the relationship insufficient, or not "reasonable" under ordinary domestic standards, because the real parties in interest, Soler Chrysler-Plymouth, Mitsubishi Heavy Industries, Inc., and Chrysler Corporation, had no relationship to Switzerland.⁹² Moreover, none of the contracts at issue were made or performed in Switzerland. Indeed, the transaction's only relationship with Switzerland was tenuous at best; Mitsubishi and Chrysler were doing business through a joint venture called Mitsubishi Motors Corporation, and Chrysler participated in the venture through a wholly owned subsidiary incorporated in Switzerland, Chrysler International, S.A.⁹³ Even absent any indicia of relation to the chosen law, however, the Court nonetheless enforced the parties' choice of Swiss law. By doing so without questioning the relationship of Swiss law to the case, the Supreme Court implied that the reasonable-relationship rule has no application in international transactions.

90. See *Scherk v. Alberto-Culver*, 417 U.S. 506, 516-19 (1974).

91. See, e.g., Restatement (Second) of Conflict of Laws § 187 comment f (1971).

92. *Mitsubishi v. Soler Chrysler-Plymouth*, 105 S. Ct. 3346, 3349 (1985).

93. *Id.*

V. THE OPEN QUESTION ON CHOICE OF LAW

Choices of law involve an issue that is so unsettled it is best presented as a question: Is the choice of one jurisdiction's law exclusive, or can that choice be limited such that the laws of another jurisdiction may still apply? This question was raised but left largely unanswered in *Scherk* and in *Mitsubishi*.⁹⁴

In *Scherk*, the Court upheld the parties' arbitration agreement, and ordered arbitration in Paris under Illinois law, even though Alberto-Culver had brought the case in federal court to assert rights not under Illinois law but under federal securities laws.⁹⁵ The Court thus clearly contemplated that the arbitrators would hear claims arising under Illinois contract law, including a claim of fraud in the inducement. The Court did not decide, however, whether the arbitrators should also decide Alberto-Culver's federal securities law claims.⁹⁶ By implication, therefore, the Court suggested that the arbitrators could simply refuse to hear Alberto-Culver's federal claims as falling outside the ambit of Illinois law. Thus, by agreeing to arbitrate all claims under Illinois law, Alberto-Culver would have waived its rights under the federal securities laws. Indeed, the dissenting opinion recognized that the arbitrators would not have to apply the federal securities laws but might do so by construing the choice-of-law clause broadly to include federal law as applied in Illinois.⁹⁷ If the arbitrators refused to construe the choice of law clause in this fashion, however, Alberto-Culver would not have been permitted to litigate its alleged federal securities claim.⁹⁸

The Supreme Court revisited the question in *Mitsubishi*, but again left it unanswered. In *Mitsubishi*, the Court upheld the parties' agreement to arbitrate in Japan under Swiss law,⁹⁹ even

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94. See *supra* notes 36-53 and accompanying text.

95. *Scherk v. Alberto-Culver*, 417 U.S. 506, 508, 513, 519-20 (1974).

96. *Id.* at 514 n.8, 516 n.9, 518 n.12 (1974).

97. *Id.* at 532 n.11 (Douglas, J., dissenting).

98. *Id.* Alberto-Culver submitted its federal securities claim as well as a breach of warranty claim to the arbitral panel in Paris. The arbitrators awarded Alberto-Culver damages based solely on its breach of warranty claim; they did not reach the federal securities claim due to the lower proof threshold required under the warranty claim. The arbitrators never decided, therefore, whether they were required to hear a federal securities claim in an arbitral proceeding based on state law. Interview with Frank Higgins, counsel for Alberto-Culver, Inc., in New York City (Nov. 12, 1986) (summary on file at the offices of the Virginia Journal of International Law).

99. *Mitsubishi v. Soler Chrysler-Plymouth*, 105 S. Ct. 3346, 3361 (1985).

100. *Id.* at 3350.

101. *Id.* at 3359 n. probably would not, c would decide those c

102. *Id.*

103. *Id.*

104. *Id.*

105. This dicta shc agreement should be enforced. If an ag party should be perri claims. See *infra* not

106. *AVC Nederland* 1984).

CHOICE OF LAW

is so unsettled it is best to leave one jurisdiction's law except where the laws of another jurisdiction was raised but left *Mitsubishi*.⁹⁴

The parties' arbitration agreement, Illinois law, even though the case was brought in federal court to assert the federal securities laws.⁹⁵

That the arbitrators would apply the law, including a claim of breach of contract, did not decide, however, the *Alberto-Culver*'s federal securities claim.

Therefore, the Court suggested that the arbitrators should refuse to hear *Alberto-Culver*'s federal securities claim under Illinois law, although the arbitrators under the federal securities laws recognized that the arbitrators should apply the federal securities laws but not the choice-of-law clause broadly to include the federal securities claim.⁹⁷

If the arbitrators refused to hear the claim in this fashion, however, the Court permitted *Alberto-Culver* to litigate its alleged federal securities claim.

The question in *Mitsubishi*, but the Court upheld the parties' choice of law under Swiss law,⁹⁸ even though the case was originally brought in federal court based on federal antitrust claims.¹⁰⁰

The United States, acting as *amicus curiae*, complained that the arbitrators in Japan would read the choice-of-law clause "not simply to govern interpretation of the contract terms, but wholly to displace American law"¹⁰¹ The Court did not address this issue, however, because the parties agreed at oral argument that U.S. law would govern the antitrust claims, notwithstanding their contractual choice of Swiss law.¹⁰² Thus, in the Court's words, it had "no occasion to speculate on this matter"¹⁰³

The Court did speculate, however, that if an arbitration and choice-of-law agreement were to bar a party's statutory rights under the antitrust laws, "[it] would have little hesitation in condemning the agreement as against public policy."¹⁰⁴ In effect, the Court implied that arbitrators would be required to hear antitrust claims under U.S. antitrust law, even if the parties earlier agreed that their disputes would be governed by another jurisdiction's laws. The Court's dicta also suggests that arbitral awards rendered absent a consideration of claimed antitrust violations would be unenforceable as based on an agreement that is void as against public policy.¹⁰⁵

Although one court described the question of the exclusivity of choices of law as "a somewhat recondite matter,"¹⁰⁶ it is also a matter of considerable practical concern. Indeed, this problematic issue may arise whenever the parties choose the laws of one state in a federal system, as in *Scherk*, or whenever one party asserts a claim based on an important statute not explicitly included in the chosen law, as in *Mitsubishi*.

Parties who select the law of a state in a federal system should

100. *Id.* at 3350.

101. *Id.* at 3359 n.19. The ICC, also as *amicus*, opined that the arbitrators might, but probably would not, construe the choice of Swiss law to cover the antitrust claims, and thus would decide those claims "under Swiss law rather than the U.S. Sherman Act." *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. This dicta should not be applied. Arbitration of the claims covered by the arbitration agreement should be permitted, and awards rendered pursuant to such arbitration should be enforced. If an aggrieved party's antitrust claims are not heard by the arbitrators, that party should be permitted to conduct a parallel court proceeding to litigate the antitrust claims. See *infra* note 113 and accompanying text.

106. *AVC Nederland B.V. v. Atrium Inv. Partnership*, 740 F.2d 148, 157 n.15 (2d Cir. 1984).

13, 519-20 (1974).

ities claim as well as a breach of warranties awarded *Alberto-Culver* damages did not reach the federal securities claim warranty claim. The arbitrators never heard a federal securities claim in an arbitration. Frank Higgins, counsel for *Alberto-Culver*, on file at the offices of the Virginia

Ct. 3346, 3361 (1985).

be held to arbitrate only pursuant to the law of that state, and not under the federal law applying in that state. A clear choice of state law should not be held to include federal laws. This is a simple principle easily derived from contract interpretation. For example, the law of Illinois is clearly distinguishable from U.S. federal law. Merely because parties might assert rights under federal laws in federal courts located in Illinois does not make those laws "the laws of Illinois" for purposes of a choice of law. Thus, when parties choose the law of a particular state, as in *Scherk*, they should not be deemed to have intended to include U.S. federal law. As discussed above,¹⁰⁷ by implying that Alberto-Culver's federal securities law claims fell outside the scope of Illinois law, the Court in *Scherk* apparently agreed with this analysis. Indeed, the Court surely could have held that a choice of Illinois law must include federal law, but it did not.

As suggested by the dissent in *Scherk*, however, an arbitral panel faced with this issue could reach a different result.¹⁰⁸ Thus, a panel could well hold that a choice of state law includes the federal law as applied in that state. The panel might determine that the parties intended that the arbitrators hear all claims that could be heard in that state, which surely would include claims based on federal law. There is, therefore, a considerable degree of uncertainty in this area.

Parties can avoid this uncertainty, and the time and expense involved in briefing the problem, by expressly addressing the issue in their choice of law clause. Thus, parties can explicitly indicate whether their choice of state or foreign law includes or excludes U.S. federal law. By making their intent undeniably clear, the parties can avoid potential disputes over whether the arbitrators should entertain claims based on the Moss-Magnuson Act, civil RICO, or the securities laws, as well as those based on a long list of other federal causes of action.

Of course, some parties will want to arbitrate federal claims of this sort and others will not. What posture a party chooses will generally depend on whether that party stands to gain or lose from an assertion of rights conferred by federal law. In contracts for the sale of businesses, for example, buyers would probably want the protection of federal securities laws, whereas sellers would proba-

bly want to arbitrate, and therefore, but reading "Under relevant federal law, exclude such claims probably warranted the Moss-Magnuson Act, other issues, wrongful allocation. Given that and in favor of the former to

Whether parties want what of an award, whether a choice of statutory law. *Mitsubishi*,¹⁰⁹ based on the contract to rule on the issue if an arbitrator chooses statutory rights. hesitation in the decision. "109 Thus, the law under the

On the other hand, to foreclose the issue on the securities statutes.¹¹⁰ The claims fall out if they are not required to be further issue apparent to be further

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107. See supra notes 48-53 and accompanying text.

108. See supra note 97 and accompanying text.

109. *Mitsubishi v. Minors*, supra note 104 at 104.

110. In this regard, see *Chemtex v. RICO*, supra note 104 at 104, where the court held that the RICO claim to arbitrate was not enforceable because the parties had not agreed to arbitrate such claims.

the law of that state, and not state. A clear choice of state federal laws. This is a simple interpretation. For example, liable from U.S. federal law. rights under federal laws in s not make those laws "the ce of law. Thus, when parties s in *Scherk*, they should not de U.S. federal law. As dis- erto-Culver's federal securi- of Illinois law, the Court in analysis. Indeed, the Court of Illinois law must include

Scherk, however, an arbitral a different result.¹⁰⁸ Thus, a state law includes the federal el might determine that the near all claims that could be ld include claims based on nsiderable degree of uncer-

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o arbitrate federal claims of posture a party chooses will y stands to gain or lose from eral law. In contracts for the s would probably want the whereas sellers would proba-

bly want to avoid the application of those laws. In these situations, therefore, buyers should negotiate for the inclusion of language reading "United States federal law" or "the law of X state and relevant federal laws." Sellers, on the other hand, should seek to exclude such laws expressly. Along similar lines, sellers would probably want to exclude the application of consumer laws such as the Moss-Magnuson Act. Complex distribution contracts raise other issues, including the possibility of claims of price fixing or wrongful allocation of markets, that implicate the antitrust laws. Given that antitrust claims run generally against manufacturers and in favor of distributors, the latter should seek to include and the former to exclude the antitrust laws.

Whether parties may *exclude* federal laws at will remains somewhat of an open question, however. Broadly stated, the issue is whether a choice of one jurisdiction's laws precludes the assertion of statutory claims conferred by another jurisdiction's laws. In *Mitsubishi*, for example, the chosen law was Swiss but a claim based on the U.S. antitrust laws was made. Although not required to rule on the issue directly, the Court was emphatic in noting that if an arbitration and choice-of-law agreement were to bar a party's statutory rights under the *antitrust* laws, "[it] would have little hesitation in condemning the agreement as against public policy."¹⁰⁹ Thus, a choice of law clause may not foreclose claims arising under the U.S. federal antitrust laws.

On the other hand, however, *Scherk* seemingly permits parties to foreclose either arbitration or litigation of federal claims based on the securities laws, RICO, Moss-Magnuson and other federal statutes.¹¹⁰ The Court in *Scherk* implicitly recognized that if these claims fall outside the ambit of the chosen state's laws, arbitrators are not required to hear them. Thus, the resolution of this difficult issue apparently depends on the importance of the policies sought to be furthered by the statute upon which the claim is based.

There is a rational distinction in allowing parties to arbitrate their claims and forego U.S. litigation of securities, Moss-Magnuson and RICO claims, while not permitting that result in

109. *Mitsubishi v. Soler Chrysler-Plymouth*, 105 S. Ct. 3346, 3359 n.19 (1985); see also supra note 104 and accompanying text.

110. In this regard, it is particularly noteworthy that in *Development Bank of the Philippines v. Chemtex Fibers, Inc.*, 617 F. Supp. 55, 57 (S.D.N.Y. 1985), the court referred a RICO claim to arbitration without discussing the choice of law designated in the contract or whether the defendant had agreed to arbitrate that claim.

antitrust cases. Although any wrongdoing affects society in at least an attenuated manner, it can be argued that the securities fraud alleged in *Scherk*, or consumer warranty or civil RICO claims, are injuries where the primary harm is to the individual claimant. If that claimant made a contract in international commerce limiting rights protected by federal law, he should be left to his bargain.

Antitrust violations, on the other hand, primarily affect U.S. consumers in the form of higher prices. If foreign manufacturers fix prices in sales to U.S. distributors, or illegally conspire to terminate U.S. distributors in order to fix prices, U.S. courts cannot allow them to escape accountability simply because they insist that their U.S. distributors agree to arbitrate disputes arising out of those contracts. Avoidance of the antitrust laws thus injures more than the individual distributor, it directly injures U.S. consumers. In sum, the antitrust laws embody particularly important public policies that the Court has said must be vindicated. The Court has not, however, indicated whether these policies must be vindicated in arbitration or in litigation, only that they may not be foreclosed.

The parties are therefore free to choose where such claims will be pursued and decided. Moreover, they can, and should, make this choice sooner rather than later, as the parties discovered in *Mitsubishi*. Thus, parties can contractually agree to arbitrate all claims, to arbitrate only contract claims and to litigate all federal claims, or to arbitrate all claims except antitrust claims, which must then be litigated. What combination the parties should choose again requires an analysis of their positions and of the nature of the different proceedings.

Mitsubishi, for example, had good reason to insist that Soler's antitrust claims be submitted to arbitration rather than decided by litigation. An arbitration under Swiss law, in Japan, and before Japanese arbitrators, is far more burdensome for an entity like Soler than for a colossus such as *Mitsubishi*. Indeed, not only has *Mitsubishi* been able to avoid facing a jury in Puerto Rico but Soler, having declared bankruptcy, has been unable to present any of its claims to the arbitral panel in Tokyo.¹¹¹ Thus, *Mitsubishi's* decision to agree to arbitration of Soler's antitrust claims, a seeming concession at the time, has been to its considerable

advantage.¹¹²

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111. Telephone interview with Wayne Cross, Counsel for *Mitsubishi* (Nov. 6, 1986) (copy on file at the offices of the Virginia Journal of International Law).

112. See supra
113. Carbonea
(1986).

advantage.¹¹²

As this discussion indicates, the tactical considerations in this area are broad and complex. Suppose two European arbitrators and their American colleague, sitting in Geneva, are trying to manage an arbitration involving U.S. antitrust claims. It is quite likely that this kind of arbitration will not go smoothly for a number of reasons. First, when the parties agreed to arbitrate antitrust claims they probably also implicitly agreed to discovery on a scale not generally employed, or permitted, in Europe. Second, the European arbitrators, like the Japanese arbitrators in *Mitsubishi*, will most likely have little or no expertise in the substance or procedure of antitrust claims. Third, their training may even run contrary to allowing such claims. Swiss law, for example, prohibits punitive or treble damages. Thus, presuming an arbitrator could be persuaded to make such an award, this might well be grounds upon which a Swiss court could order an annulment. These are but a few of the factors that should be considered before deciding whether to agree to arbitrate antitrust claims. Regardless of an anticipated position as plaintiff or defendant, arbitration carries with it potential risks that should be assessed.

VI. CONCLUSION

One commentator has recently stated that:

Given the Court's holding [in *Mitsubishi*] most, if not all, international contracts will now contain provisions specifying that eventual antitrust claims will be submitted to arbitration. The quest for neutrality and self-determination in transnational commercial dealings makes such a development nearly inevitable.¹¹³

This is probably a considerable overstatement; there is no reason that most antitrust claims should "inevitably" be arbitrated rather than litigated. Indeed, it is wise to remember that the Court in *Mitsubishi* did not require but merely permitted the arbitration of antitrust claims. Similarly, in *Scherk*, the Court indicated that a variety of federal claims could be arbitrated rather than litigated. Thus, whether to provide for the arbitration of antitrust or other

¹¹² See supra note 102 and accompanying text.

¹¹³ Carboneau, *Mitsubishi: the folly of quixotic internationalism*, 2 *Arb. Int'l* 116, 126 (1986).

for *Mitsubishi* (Nov. 6, 1986) (copy onal Law).

federal claims is a strategic decision that should be taken only after careful consideration of the factors discussed above. Moreover, the choice is not an "either or" one; parallel arbitration and litigation can be perfectly proper. If Soler Chrysler-Plymouth, for example, could turn back the clock, it might try to pursue just such a strategy through carefully drafted choice of law and arbitration clauses.

A Proprietary Cooperation

Few topics have been more controversial than the protection of parties from both national and international application of a clash of national laws. Unlike many other areas of law, the principles of law are not uniform. In contrast, the laws of different countries are valuing business differently and blocking

* Associate with
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1. See, e.g., Free
2. "Secrecy laws
through confidential
information as the
19, 1984, at 32, col.
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(1986). For an exc
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Possible Response
Cap. Mkt. L. 1, 30