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Enforcement of Arbitration Agreements in the United States and in the Asia-Pacific Region

JOHN McDERMOTT*

Resolving international trade disputes through arbitration involves several discreet steps. The first step, of course, is for the parties to agree to resolve their disputes—present or future—by arbitration rather than by some other method or by reaching no agreement, thereby leaving the dispute to litigation. The second step is to draft an arbitration agreement. The third step may involve enforcing that agreement; the fourth would be the arbitration itself. And finally, the last step, would be the enforcement of the resulting award.

The negotiation process sometimes creates problems because dispute resolution is often an afterthought to the substantive part of the agreement. Frequently, some “boiler plate” language is added to the contract without a great deal of thought. The use of vague or imprecise language may raise problems when it becomes time to enforce the agreement.

The enforcement of an agreement to arbitrate may be, in a sense, a contradiction in terms, since the parties have agreed to arbitrate their dispute. Why should it be necessary for them to enforce that agreement? But for reasons possibly relating to who is handling the dispute, “litigators” or “transactional” lawyers, these kinds of problems do occur from time to time. I would like to specifically address problems relating to enforcing the arbitration agreement, primarily from the point of view of the types of issues which are subject to arbitration and the mechanisms available in the United States and in the Pacific Rim for seeking judicial assistance in the enforcement of the agreement.

Challenges to an agreement to arbitrate can be based on a number of grounds: that the arbitration provision is void or unenforceable; that the entire contract is void or unenforceable; that the issues being presented for arbitration are beyond the scope of the arbi-

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tration agreement or that those issues are not resolvable by arbitration. In addition, one party may contend that the other party has waived its right to seek arbitration, perhaps by participating in existing litigation. Time does not permit discussion of all of these issues, so I will limit my talk to the kinds of issues which are arbitrable.

Obviously, the scope of the arbitration clause will determine to some degree what is or is not subject to arbitration. One must remember that arbitration is a contractual arrangement, not a statutory one. Thus, if the parties do not agree to arbitrate certain kinds of disputes, they will generally, at least in private arbitration (as opposed to court annexed arbitration), not be subject to arbitration. But even if both parties have signed a broad arbitration agreement—an agreement to arbitrate all disputes that arise out of or relate to this transaction—there may be issues that still are not arbitrable.

The New York Convention for the Enforcement of Foreign Arbitrable Awards (New York Convention), which, despite its title, also includes provisions dealing with the enforcement of arbitration agreements, recognizes that all issues will not be subject to arbitration. Even countries (Contracting Parties) which have signed the New York Convention are allowed to decline enforcement of an arbitration agreement as to matters not capable of settlement by arbitration. It seems clear then that the New York Convention contemplates that the “enforcing nation” will use its own law, rather than the law chosen by the parties to govern the substance of the dispute, to determine whether or not a particular issue is subject to resolution by arbitration. This, in turn, creates a choice of law problem.

Choosing the applicable law to be used to determine whether an issue is arbitrable presents an even more difficult problem when the country in which arbitration is being sought has not only a federal or national body of law, but a body of state law as well, such as exists in the United States, and to a much lesser degree, in such Pacific Rim countries as Australia and Malaysia. The question becomes, does state law determine whether an issue is arbitrable or does federal law determine whether an issue is arbitrable? Until quite recently, this was a major problem in the United States. As recent as 1976, fifteen states would not enforce agreements to arbitrate future disputes and two would not even enforce agreements to arbitrate existing disputes. Even those states that would allow arbitration of most disputes would not arbitrate all disputes, and often would not arbitrate those disputes that involved public policy embodied in state statutes. California

presents a typical example. The California Supreme Court held that the California Franchise Investment Law was designed to protect franchisees and to give them a judicial remedy in case they had a claim against the franchisor. Thus, when an agreement between a franchisee and a franchisor contained an arbitration clause, the California Supreme Court held that clause was unenforceable since the statute required that there would be a judicial remedy available to the franchisee.

In a 1985 Supreme Court decision, *Southland Corp. v. Keating* (465 U.S. 1 (1984)) one of the members of the 1985 trilogy, the Supreme Court of the United States decided that federal rather than state law determines whether specific issues are arbitrable in commercial disputes. The Court determined that given the strong policy behind federal arbitration, no state statute, nor any policy behind a state statute, could preclude the arbitration of a dispute, provided that the parties had agreed to arbitrate that dispute. But even under the Federal Arbitration Act, there were issues and claims which would not seem to be arbitrable. In *Wilco v. Swan* (346 U.S. 427 (1953)), the U.S. Supreme Court held that despite the use of a broad arbitration agreement, a claim under the 1933 Securities Act was not arbitrable, or at least it was not arbitrable in a domestic setting.

Scherk v. Alberto Culver Co., decided twenty years later, involved a claim under the "1934 Act." In an international setting, the Supreme Court held that the arbitration agreement was enforceable. The Court focused on the need to enforce agreements to arbitrate in international disputes. These two cases made it difficult for United States courts and lawyers to determine which issues were and which issues were not arbitrable. It was not clear whether the distinction made between these two turned on whether the claim was based on the 1933 or the 1934 act, or whether the difference was the distinction between domestic or international disputes.

In one of the other cases in the "1985 trilogy," the *Mitsubishi* case, the Supreme Court held that federal antitrust issues were arbitrable in an international dispute, although the Court pointed out that this holding was not necessarily applicable to domestic disputes. This decision created the possibility that international agreements involving claims based on federal securities law and federal antitrust law were subject to arbitration, although domestic agreements involving the same issues might not be. In a more recent case, *Shearson v. McMahon*, the U.S. Supreme Court determined that even a domestic se-

curities dispute was subject to arbitration. In doing so, the Supreme Court criticized the basis behind the *Wilco* decision (the earlier non arbitration decision), suggesting that it was really out of step with modern arbitration techniques and approaches. The result of all of this seems to be that, at least with respect to international disputes, virtually all issues are subject to arbitration and, with respect to domestic disputes, they may all be subject to arbitration.

The situation is not, however, the same in the rest of the world. The law in a number of countries in the Pacific Basin is substantially different with respect to statutory claims. In Australia for example, even though there are few federal restrictions on the claims that can be subject to arbitration, the arbitrability of many claims is determined by state law, not federal law. There are a number of state laws, particularly those dealing with consumer affairs, for which arbitration is deemed to be contrary to local public policy.

Japanese law, on the other hand, is based on a civil law tradition, with its fundamental conceptual distinction between public law and private law. The distinction is important with respect to international commercial dispute resolution because only private legal disputes are subject to resolution by the parties by way of compromise and settlement. Under Japanese law, only issues that can be compromised by the parties can be arbitrated. Although the distinction between public law and private law under the civil law tends to blur, it's quite clear that basic contract issues fall within the domain of the private law, issues that can be compromised and issues that can be arbitrated. But economic regulatory law, such as antitrust law, falls under the category of public law and those claims are not subject to compromise by the parties and therefore are not subject to arbitration. Issues involving, for example, antitrust, trademark, bankruptcy and patent law are not subject to arbitration in the majority of Pacific Rim countries. Entering into an arbitration agreement will be of little value if the party seeking to arbitrate cannot do so.

At early common law, arbitration agreements were not enforceable even when they were deemed valid; the English common law courts would not enforce the agreement by precluding the parties from litigating the dispute in court. The Federal Arbitration Act changed that and reversed centuries of judicial hostility toward arbitration agreements. Section four of the Federal Arbitration Act allows a party to seek a court order directing the recalcitrant party to arbitrate the dispute. Section three, on the other hand, serves the

party who wants to arbitrate but is brought into court through a lawsuit filed by the party who no longer wishes to honor his arbitration agreement. Section three requires the court to stay litigation pending the resolution of the dispute by arbitration. This provision is consistent with the New York Convention which requires contracting states to create a mechanism for enforcing arbitration agreements.

Although nearly all of the Asian-Pacific countries have acceded to the New York Convention, except for Pakistan which has not and Taiwan which cannot, some have not implemented their accession to the New York Convention and have no mechanism for enforcing arbitration agreements. For example, Korea has no implementing legislation and there seems to be no basis upon which a court will stay a suit brought in violation of the arbitration agreement. The situation is even worse, for example, in Indonesia where if any arbitration law exists, and it is not clear that it does, it is more than 140 years old. It has been reported that in some of the less developed countries, Pakistan for example, courts have refused to enforce arbitration agreements when they have determined that the forum chosen by the parties will create a serious hardship for the local party. There may be a growing tendency for domestic courts in less developed countries to refuse to enforce arbitration agreements where the place chosen for arbitration is convenient only to the foreign party.

In conclusion, it seems probable that most arbitration agreements are enforceable as to all private law issues and even as to many public law issues in common law countries. In civil law countries, like Japan, Korea, and Taiwan, there is at least, in theory, a mechanism for enforcing arbitration agreements. But in some Pacific Rim countries, it is very difficult to obtain judicial enforcement of the agreement. One solution may be to choose a site for arbitration that is convenient to both parties and not one that is only convenient to the western party.

