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International Arbitration - Scherk v. Alberto-Culver Co., The Exemption of International Contracts from the Wilko Doctrine Voiding Agreements to Arbitrate Securities Disputes

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INTRODUCTION

Arbitration may be defined as a voluntary agreement by the parties to a contract which provides that any controversy arising out of the contract will be settled by a neutral body or panel provided for in the contract, rather than by litigation in the courts. Arbitration has been long approved and widely used in the settlement of commercial disputes in a speedy and efficient manner by arbitrators familiar with the customs and practices of the trade, without the formalities and complexities of judicial proceedings.¹

When a controversy arises between two parties who have made an agreement in connection with the purchase of securities to arbitrate future disputes, a court is faced with the difficult problem of reconciling the right of the plaintiff to have his dispute determined in a judicial forum and the right of the defendant to resort to arbitration. In Wilko v. Swan,² the United States Supreme Court held that section 14 of the Securities Act of 1933³ voided an agreement between the seller and purchaser of securities to arbitrate all future controversies arising from their transactions. In resolving the conflict between the Federal Arbitration Act⁴ and the Securities Act of 1933,⁵ the Court stated

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² 346 U.S. 427 (1953).
³ 15 U.S.C. § 77n (1933). It provides:
   Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.
⁴ 9 U.S.C. §§ 1-14 (1970). Before the enactment of this statute, the federal "common law" of arbitration was held to be that agreements to submit future disputes to arbitration were revocable and unenforceable. United States Asphalt Refining Co. v. Trinidad Lake Petroleum Co., 222 F. 1006 (S.D.N.Y. 1915).

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that these acts involved two congressional policies which are not easily reconcilable. On the one hand, Congress has manifested an intention to promote the use of arbitration as a prompt, economical and adequate method of resolving controversies where the parties are willing to accept a non-judicial solution. On the other hand, Congress has enacted the Securities Act to protect the rights of investors and has forbidden the waiver of any of those rights. The Court concluded that the public policy considerations involved in the Securities Act invalidate an arbitration agreement made before the controversy arose.6

The resolution of the conflicting congressional policies is further complicated where the securities dispute occurs in the context of an international contract. In such a situation, the resolution of the conflicts between various policies must be made through the consideration of not only domestic goals, but international goals as well.

In June, 1974, the Supreme Court decided the case of Scherk v. Alberto-Culver Co.,7 which concerned the enforceability of arbitration clauses in an international contract involving a securities transaction. The Court held that the Wilko doctrine was inapplicable to an international contract negotiated by knowledgeable businessmen advised by competent legal counsel.8 This article will examine the Scherk decision in light of Wilko, international developments, and domestic legislation in the area of commercial arbitration subsequent to the Wilko decision, in order to appraise the soundness and the desirability of the Supreme Court’s rationale with respect to the “international contract” exemption from the Wilko doctrine. A proper understanding of the questions involved requires an introduction to the controlling statutes.

THE RELEVANT U.S. CODE PROVISIONS

Section 10(b) of the Securities Exchange Act9 makes it unlawful for any person by use of instrumentalities of interstate commerce or

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6. 346 U.S. at 438.

   (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of
the mails to use or employ, in connection with the purchase or sale of any security, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. Rule 10b-5, promulgated by the SEC in 1942 to implement section 10(b) of the Securities Exchange Act, makes it unlawful for any person to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made not misleading, in connection with the purchase or sale of any security. The fundamental purpose of section 10(b) and rule 10b-5 was to substitute a philosophy of full disclosure for the philosophy of caveat emptor, and thus to achieve a high standard of business ethics in securities transactions.

Rule 10b-5 has absorbed most of the general anti-fraud provisions in the federal securities laws, and is by now generally recognized as the most potent and versatile instrument in the armamentarium of federal securities regulation. It has been applied to numerous and widely diverse categories of securities transactions, including insider trading on the basis of undisclosed material information, insider “tipping” of information to selected friends and contacts, misleading corporate publicity, and a variety of forms of broker-dealer misconduct.

The jurisdictional provision of the Securities Exchange Act, section 27, provides that the federal district courts shall have exclusive jurisdiction of all violations of the Act; and the anti-waiver provision,

such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

10. 17 C.F.R. § 240.10b-5 (1973). It provides:
   It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
   (a) To employ any device, scheme, or artifice to defraud,


12. Note, Rule 10(b) and the Outside Director's Dilemma, 35 U. Pitt. L. Rev. 818, 821 (1974).


   The district courts of the United States .. shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder.
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section 29(a),\textsuperscript{15} voids any condition, stipulation, or provision binding any person to waive compliance with any provision of the Act or the rules thereunder.\textsuperscript{16} Agreements to arbitrate future securities disputes have been held to constitute unenforceable stipulations or provisions attempting to deprive the federal courts of exclusive jurisdiction in such matters.\textsuperscript{17}

The courts have regularly held that foreign nationals are subject to section 10(b) and rule 10b-5 of the Securities Exchange Act and are accountable in the federal courts for securities act violations committed either in whole or in substantial part within the United States to the injury of American investors.\textsuperscript{18}

It appears, therefore, that the 1934 Act allows an American plaintiff alleging that it has been defrauded by a foreign national in violation of the Act to bring suit in the federal district courts, whenever there are sufficient minimal contacts with the United States, notwithstanding any arbitration agreement made before the dispute arose.

Subsequent to the \textit{Wilko} decision,\textsuperscript{19} on June 10, 1958, a special conference of the United Nations Economic and Social Council adopted the Convention of the Recognition and Enforcement of For-

\textsuperscript{15} 15 U.S.C. § 78cc(a) (1934). It provides:
Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

\textsuperscript{16} This section is quite similar to section 14 of the Securities Act of 1933 which was involved in \textit{Wilko}. See note 3 \textit{supra}. The Court in \textit{Scherk} stated that "[w]hile the two sections are not identical, the variations in their wording seem irrelevant to the issue presented in this case." 417 U.S. at 514 n.7.


\textsuperscript{19} In \textit{Wilko}, the relevant section of the Federal Arbitration Act which favoured the enforcement of arbitration agreements is section 3, 9 U.S.C. § 3 (1970), which provides:
If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.
eign Arbitral Awards.\textsuperscript{20} In 1970, the United States acceded to the treaty,\textsuperscript{21} and Congress passed Chapter 2 of the United States Arbitration Act,\textsuperscript{22} in order to implement the Convention. Section 1\textsuperscript{23} of the new chapter provides for the enforcement of the United Nations convention in the American courts.

Thus, when a dispute arises and one party desires to force a recalcitrant party to abide by his agreement to resolve the dispute through arbitration, the recalcitrant party may be compelled to appear and participate in the arbitral procedure under section 1 of Article II of the Convention,\textsuperscript{24} which recognizes such an agreement. And, when a defendant has been served with process by the plaintiff initiating judicial proceedings with respect to the subject matter of the arbitral agreement, in disregard of the plaintiff's agreement to resolve the matter by arbitration, the defendant may move the court to stay litigation while arbitration proceedings are carried out. This is accomplished by utilizing section 3 of Article II of the Convention,\textsuperscript{25} which directs the courts to refer the parties to arbitration. Section 6\textsuperscript{26} of the new chapter also authorizes the federal courts to direct the arbitration to be held outside the United States, if the parties have so provided.

The Convention provided that the recognition and enforcement of arbitration agreements or awards may be refused if the arbitration concerns a subject matter not capable of settlement by arbitration,\textsuperscript{27} if the agreement is null, void, or inoperative,\textsuperscript{28} if the arbitration is contrary to the public policy of the enforcing country,\textsuperscript{29} or if the agree-

\begin{footnotesize}
The Convention on the Recognition and Enforcement of Foreign Arbitral Awards of June 10, 1958, shall be enforced in United States courts in accordance with this chapter.
24. Id., section 1 of Article II. It provides:
Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which might arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.
25. Id., section 3 of Article II. It provides:
The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.
A court having jurisdiction under this chapter may direct that arbitration be held in accordance with the agreement at any place therein provided for, whether that place is within or without the United States.
27. 9 U.S.C. § 201 (1970), section 1 of Article II and section 2(a) of Article V.
29. 9 U.S.C. § 201 (1970), section 2(b) of Article V.
\end{footnotesize}
ment is not valid under the laws to which the parties have subjected it.\textsuperscript{30}

It appears, therefore, that the Federal Arbitration Act requires that a dispute should be arbitrated, even outside the United States if the parties have so provided, unless the agreement to arbitrate is not enforceable under one or more of the grounds stated above.

The issue in \textit{Scherk v. Alberto-Culver Co.} was whether an arbitration clause in an international contract involving a securities transaction, negotiated by parties of equal bargaining power, is enforceable if the plaintiff alleges that it has been defrauded in the acquisition of certain businesses in violation of the Securities Exchange Act. In resolving this issue, the Court considered the two congressional policies which are manifested by the enactment of the Securities Exchange Act of 1934, providing for judicial settlements of all disputes involving securities transactions, and the enactment of the Federal Arbitration Act and the 1970 implementation of the Untied Nations Convention, providing for the referral of the parties to arbitration in accordance with their agreement to arbitrate all disputes which might arise between them in the future.

\textbf{STATEMENT OF THE CASE}

The plaintiff, Alberto-Culver Co., is an American company incorporated under the laws of Delaware with its principle office in Melrose Park, Illinois. It manufactures and distributes toiletries and hair products in national and international markets. The defendant, Fritz Scherk, is a German citizen residing at the time of trial in Switzerland. Prior to the transactions in issue, Scherk was engaged in the manufacture and sale of cosmetic products in Western Europe. The principle manufacturing operations were conducted by Scherk in facilities situated in Berlin, Germany, and owned by Scherk through a sole proprietorship called Firma Ludwig Scherk (FLS). Scherk also owned interrelated business entities known as Scherk Establissement Vaduz (SEV), a Lichtenstein entity, and Lodeva Herstellung und Vertrieb Kosmetischer Artikel GMBH (Lodeva), a German entity, both of which have no corresponding counterparts in the United States. SEV was operated by Scherk as a holding company licensing the sale and distribution of Scherk’s cosmetics on an international basis under a variety of trademarks. Lodeva was dormant and remained so at the time of trial.

\textsuperscript{30} 9 U.S.C. § 201 (1970), section 1(a) of Article V.
During the 1960's, Alberto-Culver decided to expand its overseas operations, and in June, 1967, it contacted Scherk in Germany to explore the possibility that Scherk might sell his European cosmetic business. In November, 1967, a representative of Alberto-Culver visited Scherk in Germany to pursue negotiations for such acquisition. In December, 1967, the president of Alberto-Culver met with a representative of Scherk in Chicago, Illinois. The negotiations were terminated at that point.

In February, 1968, Alberto-Culver contacted Scherk in Berlin and negotiations were subsequently resumed. An agreement in principle was reached at this time concerning the basic terms for Alberto-Culver's acquisition of Scherk's business entities, SEV, FLS, and Lodeva; the details of the agreement were hammered out at Alberto-Culver's main office in late May and early July, 1968. Scherk was present in Illinois for this latter meeting. A written contract was ultimately prepared and signed in Vienna, Austria, by Scherk in February, 1969. The contract contained a number of express warranties whereby Scherk guaranteed the sole and unencumbered ownership of his trademarks. As to the acquisition of SEV, the contract contained an arbitration clause which provided:

The parties agree that if any controversy or claim shall arise out of this agreement or the 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 shall 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.\(^\text{31}\)

The arbitration clauses relating to the transfer of the other two business entities of Scherk were similar to the above clause.

The closing of the transaction was accomplished in Geneva, Switzerland, in June, 1969. Nearly one year later, Alberto-Culver discovered that the trademark rights purchased from Scherk were subject to

\[^{31}\text{Scherk v. Alberto-Culver Co., 417 U.S. at 508 n.1 (emphasis added).}\]
substantial encumbrances. A dispute arose, and Alberto-Culver attempted to rescind the contract; it tendered the businesses to Scherk, who refused to accept the tender.

Scherk first took steps to institute arbitration in early 1971; however, a request for arbitration was not filed with the International Chamber of Commerce until November 9, 1971. Alberto-Culver commenced this action for damages and other relief in the District Court for the Northern District of Illinois on June 11, 1971, alleging that it was defrauded in the acquisition of these businesses in violation of section 10(b) of the Securities Exchange Act and rule 10b-5 as promulgated thereunder. In response, Scherk filed a motion to dismiss the action for want of personal and subject matter jurisdiction as well as on the basis of forum non conveniens, or, in the alternative, to stay the action pending arbitration in Paris pursuant to the agreement of the parties. Alberto-Culver opposed this motion and sought a preliminary injunction restraining the prosecution of arbitration proceedings. The district court denied Scherk's motion to dismiss, and granted a preliminary order enjoining Scherk from proceeding with arbitration. In taking these actions, the district court relied entirely on the Supreme Court's decision in Wilko v. Swan, which held that an agreement to arbitrate could not preclude a buyer of securities from seeking a judicial remedy under the Securities Act, in view of the language of section 14 of the Act, barring "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter . . . ."

The Court of Appeals for the Seventh Circuit, with Judge Stevens dissenting, affirmed upon what it considered the controlling authority of the Wilko decision. In a 5 to 4 decision, the Supreme Court reversed and remanded, holding that, in the context of the international agreement which the purchase and sale of business represented, the arbitration clause would be enforced.

**Resolving the Conflict Between Two Congressional Policies**

In *Wilko v. Swan*, a customer brought suit for damages under sec-

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34. The memorandum opinion of the district court is unreported.
36. Alberto-Culver Co. v. Scherk, 484 F.2d 611 (7th Cir. 1973).
tion 12(2) of the Securities Act against a brokerage house alleging that his purchase of stock was induced by false representations concerning the value of the shares. The defendant responded that the plaintiff, Wilko, had agreed to submit all controversies arising out of the purchase to arbitration, and moved to stay the trial of the action pursuant to section 3 of the Arbitration Act until arbitration was completed in accordance with the terms of the agreement.

The Court found that two congressional policies, not easily reconcilable, were involved. On the one hand, the Federal Arbitration Act stressed the need for avoiding the delay and expense of litigation, and directed that such agreements be valid, irrevocable and enforceable in federal courts. On the other hand, the Securities Act was designed to protect the investors by requiring issuers, underwriters and dealers to make full and fair disclosure of the character of securities sold in interstate and foreign commerce and to prevent fraud in their sale by creating a special right to recover for misrepresentation.

The Court decided that the intention of Congress concerning the sale of securities would be more readily attained by holding that the anti-waiver provision of the Securities Act invalidates an agreement for arbitration of issues arising under the Act.

The Wilko doctrine has regularly been applied to claims arising under the Securities and Exchange Act because of the similarity between the anti-waiver language of section 29(a) of the Securities and Exchange Act and section 14 of the Securities Act.

The Court in Wilko took a dim view of arbitration and decided

37. 15 U.S.C. § 77l (1933). It provides:

Any person who—

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.


39. 346 U.S. at 431, 438.


41. See notes 3 and 16 supra.

42. English courts traditionally considered irrevocable arbitration agreements as
that the exercise of judicial direction is required in order to protect the
investors and assure the effectiveness of the Securities Act.\textsuperscript{43} The
Court noted that arbitrators are often laymen who make their awards
without explanation of their reasons, that they do not make a com-
plete record of their proceedings, and that the Federal Arbitration
Act does not authorize judicial review of the arbitration awards to
correct any erroneous interpretation of the statutes by the arbitra-
tors.\textsuperscript{44}

Alberto-Culver argued that the \textit{Wilko} doctrine makes its agree-
ment to arbitrate disputes arising under the contract with Scherk simi-
larly unenforceable in view of its contentions that Scherk's conduct
constituted violations of the Securities Exchange Act.\textsuperscript{45} It pointed to
the "infirmities of arbitration" as applied to its dispute with Scherk in
that successful prosecution of a section 10(b) claim almost always re-
quires extensive pre-trial discovery, but arbitration may not provide
for any discovery; and in that the wide choice of venue granted by the
Securities Exchange Act would be defeated if prior agreements to
arbitrate Securities Exchange Act violations were enforced.\textsuperscript{46}

In regard to this contention, it should be noted that the \textit{Wilko} case
involved a clear disparity of bargaining power between an ordinary

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  \item "ousting" the courts of jurisdiction, and refused to enforce such agreements for this rea-
son. This view was adopted by American courts as part of the common law up to the
1st Sess. 1, 2 (1924).}
  \item 346 U.S. at 437.
  \item \textit{Id.} at 436-37. The English law, unlike the Federal Arbitration Act, authorizes
judicial determination of legal issues arising during the course of an arbitration proceed-
ing. \textit{Id.} at 437. A recent article proposed that Congress should adopt some of the pro-
visions of the English law. \textit{Comment, Commercial Arbitration Under the Federal
  \item See other criticisms of arbitration in Alexander v. Gardner-Denver Co., 415 U.S. 36
(1974), decided only 4 months before \textit{Scherk}, where the Court stated:

Moreover, the factfinding process in arbitration usually is not equivalent to
judicial factfinding. The record of the arbitration proceedings is not as com-
plete; the usual rules of evidence do not apply; and rights and procedures com-
mon to civil trials, such as discovery, compulsory process, cross-examination,
and testimony under oath, are often severely limited or unavailable. \textit{See
U.S., at 435-437. And as this Court has recognized, "[a]rbitrators have no
obligation to the court to give their reasons for an award." United Steelwork-
ers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593, at 598. In-
deed, it is the informality of arbitral procedure that enables it to function as
an efficient, inexpensive and expeditious means for dispute resolution. This
same characteristic, however, makes arbitration a less appropriate forum . . .

\item \textit{Id.} at 57-8.
  \item 45. The Court did not decide the question whether the acquisition of Scherk's busi-
ess was a securities transaction within the meaning of section 10(b) and rule 10b-5
of the Securities Exchange Act, since Scherk did not assign the adverse ruling on that
question as error. 417 U.S. at 514 n.8. The dissent considered the promissory notes
issued by Alberto-Culver for Scherk's assets to be "securities." \textit{Id.} at 523.
\end{itemize}

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customer pitted against a big brokerage house, and that the arbitration agreement was contained in a standard form margin contract.\textsuperscript{47} As the Securities and Exchange Commission argued in its \textit{amicus} brief in \textit{Wilko}, "[t]he Securities Act of 1933 was designed primarily to protect the less-informed members of the public against the professionals."\textsuperscript{48} This argument is supported by the presidential message to Congress urging the passage of the Securities Act so as to add to the ancient rule of \textit{caveat emptor} the further doctrine of "let the seller also beware,"\textsuperscript{49} and by the decisions of numerous federal courts.\textsuperscript{50}

Of course, it can hardly be said that the agreement in \textit{Scherk} involved a disparity of bargaining power or a form contract. The negotiations were conducted over a period of nearly 2 years by skilled lawyers and businessmen representing both parties. As Judge Stevens pointed out in his dissent in the court of appeals:

\begin{quote}
[I]n transactions which are sufficiently large and complex that the parties typically contemplate the possibility of future controversy, the method of resolving forseeable disputes is itself a proper subject of bargaining. In the international market, the inability to agree on a neutral forum quite clearly may have an impact on the price of the transaction, or even the acceptability of a prospective purchaser.\textsuperscript{51}
\end{quote}

It could, therefore, be argued that the rule of \textit{Wilko v. Swan} does not apply to an international agreement where no disparity in either information or bargaining power is likely to be present, and that the parties to such an agreement should be required to honour their bargain.\textsuperscript{52}

\begin{footnotes}
\item[47] 346 U.S. at 429. \textit{But see} the dissenting opinion of Justice Frankfurter concluding that the record did not show that "the plaintiff [Wilko] in opening an account had no choice but to accept the arbitration stipulation . . ." \textit{Id.} at 439-40.
\item[49] 346 U.S. at 430-31.
\item[51] Alberto-Culver Co. v. Scherk, 484 F.2d 611, 617 (7th Cir. 1973) (Stevens, J., dissenting).
\item[52] For practical reasons, the rule of \textit{Wilko v. Swan} may still be applied to \textit{domestic} agreements even when there is no evidence of disparity in information or bargaining power. As Alberto-Culver pointed out:

In each case the district court would be required to inquire into the relative sophistication of the parties [and] the disparity in their bargaining power [such that] substantial discovery would clearly be necessary, and in many cases the district court would actually be deeply enmeshed in the merits of the section 10(b) controversy before it could even decide the question of arbitrability.

\end{footnotes}
However, the Court did not rule on the issue of whether the decision in *Wilko* should be limited to situations where the parties exhibit a disparity of bargaining power, because of its disposition of the case on other grounds. The Court found "significant" and "crucial" differences between the agreement involved in *Wilko* and the one involved in *Scherk*; Wilko's contract to purchase securities from Swan was a domestic agreement, whereas Alberto-Culver's contract to purchase the business entities belonging to Scherk was a "truly international agreement." The international contract was defined as "any contract touching two or more countries."

The two decades that followed the *Wilko* decision have seen some dramatic changes in the number of international agreements involving American businessmen. In 1950, United States direct investment abroad is estimated as having totalled $11.8 billion, but by 1960 the amount had nearly tripled to $31.9 billion. In 1970, United States foreign investments totalled $78.1 billion, and by 1972 the amount had reached $94.0 billion which represents an increase of approximately 700 percent over the 1950 amount. While United States investments abroad have been increasing significantly, foreign investments in this country have also been on the rise. The book value of foreign direct investments in the United States increased from $3.3 billion in 1950 to $6.9 billion in 1960 and eventually to $14.4 billion in 1972, which represents an increase of approximately 340 percent over the 1950 amount.

Businessmen have traditionally preferred arbitration over litigation; they regard arbitration as a process which combines finality of decision with speed, low cost, and flexibility in the selection of principles and mercantile customs to be used in solving a problem. In international transactions, there is an additional reason for choosing arbitration, namely arbitration is often superior to adjudication of local

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53. *Id.* at 512 n.6.
54. *Id.* at 515.
55. *Id.* at 516.
57. *BUREAU OF CENSUS, DEPT OF COMMERCE, STATISTICAL ABSTRACTS OF THE UNITED STATES* 782 (1974); 1974 *INT'L ECONOMIC REPORT OF THE PRESIDENT* 62. Western European countries hold the vast majority of foreign direct investment in the United States, over 70%; Canada accounts for another 25%, with the rest widely scattered among other countries. *Id.* at 59. The recent relative shift of financial power to the oil-producing countries will probably result in a sharp climb in foreign investments in the United States in future years. See, e.g., Friedman, *Who's Afraid of Foreign Take-overs?*, N.Y. Times, Feb. 16, 1975, § 3 (Business and Finance), at 1, col. 4.
courts in terms of: (1) neutrality of forum; (2) avoidance of personal jurisdiction problems; and (3) enforcement of the award.\textsuperscript{58}

To meet the expanding international activities of American businessmen, and with the support from the bar, industry, labour and business,\textsuperscript{59} President Johnson, in 1968, urged Congress to enact Chapter 2 of the Arbitration Act,\textsuperscript{60} the implementing legislation required before the United States could ratify the United Nations Convention which had been first promulgated in 1958.\textsuperscript{61} By 1970, the United States had become a party to it.\textsuperscript{62}

The Supreme Court also has recognized the indispensability of an advance agreement by parties engaged in international transactions with respect to the manner in which future disputes may be settled.\textsuperscript{63} In \textit{M/S Bremen v. Zapata Off-Shore Co.},\textsuperscript{64} a German corporation (Unterweser) agreed to tow the off-shore drilling rig of an American corporation (Zapata) for Louisiana to the Adriatic Sea under a contract providing that "[a]ny dispute arising must be treated before the London Court of Justice."\textsuperscript{65} The rig was seriously damaged in a severe storm and was towed to Tampa, Florida, where Zapata sued Unterweser in federal district court, alleging negligent towage and breach of contract. Unterweser moved to dismiss or stay the suit, and sued Zapata in the High Court of Justice in London. The district court


\textsuperscript{60} 9 U.S.C. §§ 201-08 (1970).


\textsuperscript{62} That the enforcement of international arbitration is raised to the level of government policy is supported by the U.S.-U.S.S.R. Trade Agreement of 1972 which provided that:

\begin{quote}
Both governments encourage the adoption of arbitration for the settlement of disputes arising out of international commercial transactions concluded between natural and legal persons of the United States of America and foreign trade organizations of the Union of Soviet Socialist Republics.
\end{quote}


Similar expressions of policy are included in the U.S.-Polish Trade Agreements of 1972. \textit{See DEP'T OF COMMERCE NEWS FACT SHEET, JOINT AMERICAN-POLISH TRADE COMMISSION, 2d Sess., November 4-5, 1972.}

\textsuperscript{63} Judicial support for arbitration was slow to manifest itself. Alberto-Culver Co. \textit{v. Scherk}, 484 F.2d 611, 616 n.2 (1973) (Stevens, J., dissenting). In the opinion of Judge Stevens, "[s]ince 1953 the policy of encouraging the settlement of disputes by arbitration has received increasingly strong [judicial] endorsement . . . ." \textit{Id.} at 616 (citations omitted).

\textsuperscript{64} 407 U.S. 1 (1972).

\textsuperscript{65} \textit{Id.} at 2.
denied Unterweser's motion to stay the action pending determination of the London suit, and enjoined Unterweser from prosecuting the London suit. The Court of Appeals for the Fifth Circuit affirmed, and on petition for rehearing en banc, adopted the panel's judgment. On certiorari, the Supreme Court vacated the judgment of the court of appeals. Chief Justice Burger, expressing the views of seven members of the Court, stated:

For at least two decades we have witnessed an expansion of overseas commercial activities by business enterprises based in the United States. The barrier of distance that once tended to confine a business concern to a modest territory no longer does so. Here we see an American company with special expertise contracting with a foreign company to tow a complex machine thousands of miles across seas and oceans. The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts.

Thus, the reasoning of the Court in support of its favourable view of forum-selection clauses was based chiefly on the express need to facilitate international commerce. The same reasoning in fact should apply to arbitration agreements in international transactions. In the absence of excessive bargaining power, the parties are entitled to certainty in arranging their affairs. The view that a dispute arising in the United States must be resolved in United States courts is "provincial."

The Court in Schenk held that an agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause that determines not only the situs of the suit but also the procedure to be used in resolving the dispute.

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67. *428 F.2d 888* (5th Cir. 1970).
68. *466 F.2d 907* (5th Cir. 1971).
69. *407 U.S. at 8-9.*
70. *Id.* at 12.
71. As Judge Stevens pointed out in the court of appeals:

[T]he *Zapata* case did not involve the sale of securities and therefore is not controlling here. Moreover, the Chief Justice expressly limited his opinion to international agreements "unaffected by fraud." 407 U.S. at 12. Nevertheless, I believe the policy considerations which underlie [*Zapata*] are relevant here.

484 F.2d at 616 n.3.

Justice Stewart, writing for the majority of the Supreme Court in *Scherk*, further explained that the fraud qualification of *Zapata* "does not mean that any time a dispute arising out of a transaction is based upon an allegation of fraud, as, in this case, the clause is unenforceable. Rather, it means that an arbitration or forum-selection clause in a contract is not enforceable if the inclusion of that clause in the contract was the product of fraud or coercion." *417 U.S. at 519 n.14.*
Thus, the Court held that the public policy favouring enforcement of an arbitration agreement in an international commercial contract entered into between parties of equal bargaining power outweighs the domestic policy expressed in the Securities Exchange Act granting to the courts exclusive jurisdiction of cases involving fraud in the sale of securities.

THE CONCERN OF THE DISSENT

Justice Douglas filed a strong dissenting opinion in which three other justices joined. The main features of the dissent will be analyzed below.

The dissent considered the Wilko doctrine to be peculiarly appropriate in the Scherk situation where an American plaintiff has alleged a violation of the securities law by a foreign national, especially since huge foreign investments are being made in American companies. "American standards of fairness," the dissent insisted, should govern the destinies of American investors.

This reasoning is not very persuasive. Since the American companies have also made massive capital investments overseas, it surely does not follow that "American standards of fairness" should apply worldwide so as to protect the American investors. In international contracts both parties desire a neutral forum, preferably one which is equally convenient to each party. This would remove some of the inherent bias or advantage gained by a plaintiff litigating in his "home territory." So long as the parties were of equal bargaining power and dealt with each other at arm's length, there is no reason why they should not be bound by their agreement. This is not a case where a sizeable brokerage house is attempting to avoid the Securities Act by enforcing a fine-print arbitration clause against an ordinary purchaser of securities, where no countervailing policy is present. The policy considerations involved in resolving international commercial disputes should transcend what the courts feel to be "American standards of fairness," so as to stimulate and encourage world trade. The majority rightly felt that to insist that "American standards of fairness" must govern, when the parties have agreed to adjudicate else-

73. 417 U.S. at 528 (Douglas, J., dissenting).
74. In 1972, United States foreign investments amounted to approximately 6.5 times the foreign investments in the United States. See the materials cited in notes 56 and 57 supra.
where, demeans the standard of justice elsewhere in the world and unneces-
sarily exalts the primacy of United States law over the laws of other coun-
tries.\textsuperscript{75}

The second major concern of the dissent is that the international contract "talisman" might be invoked in a situation where, for exam-
ple, an interest in a foreign company was sold to an ordinary Ameri-
can customer, with the arbitration clause appearing in a fine print form contract.\textsuperscript{76} This, of course, is a serious consideration since the application of the \textit{Scherk} doctrine to such an "international contract" would force the average customer, in the words of the dissent, "to ar-
bitration in Paris to vindicate his rights."\textsuperscript{77} In dicta, the Court said that "situations may arise where the contacts with foreign countries are so insignificant or attenuated that the holding in \textit{Wilko} would mean-
fully apply."\textsuperscript{78} Thus, the Court has limited the \textit{Scherk} doc-
trine to those contracts which are truly of international character; any potential abuses of this doctrine may be dealt with accordingly by the courts.

The most important argument proffered by the dissent is that nei-
ther the United Nations Convention on the Recognition and Enforce-
ment of Arbitral Awards nor the Federal Arbitration Act justifies aban-
donment of the public policy that securities claims be heard ex-
clusively by the courts simply because a contract has an international character.\textsuperscript{79} It is submitted that this contention is not justified for the following reasons.

There are four distinct situations in which the Convention permits the non-recognition and non-enforcement of arbitral agreements and awards:

1. where the arbitration concerns "a subject matter [not] capable of settlement by arbitration;"\textsuperscript{80}
2. where the "agreement is null and void, inoperative or in-
capable of being performed;"\textsuperscript{81}
3. where the arbitration is "contrary to the public policy of that country;"\textsuperscript{82}

\textsuperscript{75} 417 U.S. at 517 n.11.
\textsuperscript{76} Id. at 529.
\textsuperscript{77} Id.
\textsuperscript{78} Id. at 517 n.11.
\textsuperscript{79} Id. at 524.
\textsuperscript{80} 9 U.S.C. § 201 (1970), section 1 of Article II and section 2(a) of Article V.
\textsuperscript{81} Id., section 3 of Article II.
\textsuperscript{82} Id., section 2(b) of Article V.
The first ground was chosen by the Convention "in order to take proper account of the laws in force in many countries which prohibit the submission of certain questions to arbitration." This ground seems to be inapplicable in Scherk since there is no statute, not even the Securities Exchange Act, which expressly prohibits the submission to arbitration of a particular question or subject.

Under the second ground, the Securities Exchange Act becomes relevant because of its anti-waiver provision which might make the arbitration agreement null and void. Under the fourth ground, Illinois law is applicable since the parties subjected their agreement to that law; however, according to conflict of laws doctrines, the Illinois law provision includes federal law. Therefore, in this case the outcome would be similar under either the second or the fourth ground.

The dissent argued that section 29(a) of the Securities Exchange Act, the anti-waiver provision, makes agreements to arbitrate liabilities under section 10(b) of the 1934 Act "void" and "inoperative." The majority, however, held that the agreement to arbitrate would be null and void only "if the inclusion of [the arbitration] clause in the contract was the product of fraud or coercion." This holding seems to be justified since the Convention intended the coverage of arbitration agreements to be very broad and it excluded only "nugatory" contracts.

As to the third ground, the public policy provision, the dissent argued that section 29(a) of the Securities Exchange Act and the

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83. Id., section 1(a) of Article V.
86. Regarding the second ground of non-recognition of arbitration agreements, the Convention did not define the law which governs the issue of whether the arbitral agreement is "null and void, inoperative or incapable of being performed." Presumably, the law specified by the parties in their agreement should govern. Absent such a specification, the forum state may look to its own law and policy, or to the law of the place of execution of the agreement, or to the law of the place where the dispute arose. See Quigley, supra note 58, at 1064.
87. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 4(1) and comment 4b to § 4(1) (1971); Boyer v. Atchison, T. & S.F. Ry., 38 Ill. 2d 31, 230 N.E.2d 173 (1967) (holding that the Federal Safety Appliance Act is as much a part of the law and policy of the states as are their own laws enacted by the state legislatures).
89. 15 U.S.C. § 78j(b) (1934).
90. 417 U.S. at 527.
91. Id. at 519 n.14.
Wilko doctrine make clear that there is an overriding public policy to give the courts exclusive jurisdiction of securities claims.93

It is true that the court of an enforcing country may refuse enforcement of an arbitration agreement which it finds contrary to its public policy. In so doing, however, the exercise of the utmost good faith is necessary. It has been said that the public policy provision "in effect relegates the efficacy of the convention to the good faith of the contracting states."94 Therefore, if the United States is overready to defeat, on public policy grounds, an international arbitration agreement sought to be enforced by a foreign contracting party, it would expose its own nationals to the risk of being subjected to the same treatment in the courts of foreign enforcing countries.95

Finally, the dissent seems to create the impression that the arbitration clause will leave Alberto-Culver without a remedy. However, once the federal proceedings are stayed, Alberto-Culver can assert the rule 10b-5 claim against Scherk in the forum where it specifically agreed to settle all of its disputes with Scherk, the International Chamber of Commerce in Paris.96 Who is to say that an arbitrated settlement would be less favourable than a successful suit under the securities laws? In fact, some parties may fare better in arbitration than in litigation where judicially interpreted statutes may limit damages or standing to sue in certain instances.97 Thus, such parties could take an unfair advantage by agreeing to arbitration with intent to abide by it only in those instances where litigation would be less advantageous. This type of international forum shopping is far from the desirable course of conduct required to handle delicate international trade relations.

CONCLUSION

The Court in Scherk was faced with the problem of reconciling two

93. 417 U.S. at 530-31 n.10.
96. Justice Douglas considered that even if the ICC applies Rule 10b-5, "Alberto-Culver's victory would be Pyrrhic" since the ICC might not understand the rule. 417 U.S. at 532 n.11. However, Scherck pointed out that: [T]he gist of Alberto-Culver's Rule 10b-5 case is:
1. Did Mr. Scherk lie to Alberto-Culver about his trademarks?
2. If so, was the lie about a material fact . . . ?
3. If so, was Alberto-Culver deceived by the lie?
conflicting congressional policies: the first protects the rights of purchasers of securities and voids any attempted waiver of those rights; and the second encourages the arbitration of international commercial disputes. The decision of the Court favouring the policy of enforcing arbitration clauses in international commercial agreements made in an arm's length negotiation by experienced businessmen, over the policy of giving the federal courts exclusive jurisdiction in securities claims, recognizes that an arbitration agreement is almost indispensable to achieve the orderliness and predictability essential to any international business transaction.\(^9\)

The decision of the Court is likely to result in a substantial increase in the practice of businessmen to opt for arbitration as the exclusive method of settling their disputes, thus avoiding the complex and uncertain proceedings of foreign courts. The alternative suggested by the dissent, namely, exclusive federal court jurisdiction in all securities disputes, is a provincial approach based on the supremacy of United States law over the laws of other countries. Such an approach could provoke similar reactions by the other member states to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards and ruin the Convention's constructive approach to the settlement of international disputes.

It can only be hoped that the courts in the other member states to the United Nations Convention\(^9\) will follow the rationale set forth by

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98. 417 U.S. at 516.
99. States which are parties to the Convention are:

- Austria
- Botswana
- Bulgaria
- Central African Republic
- Czechoslovakia
- Denmark
- Ecuador
- Egypt
- Finland
- France
- Ghana
- Greece
- Hungary
- India
- Israel
- Italy
- Japan
- Khmer Rep.
- Korea

It is expected that the United Kingdom will accede to the Convention in the near future.


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the United States Supreme Court and refrain from a parochial refusal to enforce an international arbitration agreement, by resolving conflicting concepts of public policy in favour of the recognition of commercial arbitration agreements as a necessary element in maintaining vital international trade.\textsuperscript{100}

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\textsuperscript{100} See Holtzmann, \textit{Arbitration in East-West Trade}, 9 \textit{Int'l Lawyer} 77, 81 (1975).