

## RECENT DEVELOPMENTS

ENFORCEMENT OF ARBITRATION AGREEMENTS: THE SEVERABILITY DOCTRINE IN THE INTERNATIONAL ARENA—*Republic of Nicaragua v. Standard Fruit Co.*, 937 F.2d 469 (9th Cir. 1991).

### I. FACTS

Standard Fruit Company (SFC)<sup>1</sup> began operating its business of production and purchase of bananas in western Nicaragua in 1970.<sup>2</sup> From 1970 to October 1982, SFC, the largest banana importer in the United States,<sup>3</sup> operated by entering into limited partnership agreements with sixteen different banana plantation owners in the Chinandega Province of Nicaragua. SFC had exclusive fruit purchase agreements with each partnership, under which each partnership promised to sell all export-quality bananas from its plantations to SFC.<sup>4</sup>

SFC's operations became jeopardized in 1979 when the Sandinistas overthrew the Somoza government in Nicaragua, forming a new "Government of National Reconstruction."<sup>5</sup> The Sandinistas legalized unions and nationalized the banana export trade, placing it in the hands of the state-run company, Embanica.<sup>6</sup> The Sandinistas planned

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<sup>1</sup> Standard Fruit Company [hereinafter SFC] is a wholly-owned subsidiary of Standard Fruit & Steamship Company [hereinafter Steamship] which in turn is a wholly-owned subsidiary of Hawaii-based Castle & Cooke, Inc. [hereinafter C & C]. Steamship purchases bananas from SFC and distributes them in the United States. *Republic of Nicar. v. Standard Fruit Co.*, 937 F.2d 469, 471-472 (9th Cir. 1991). The bananas are marketed in the United States under the Dole label. Raymond Bonner, *New Nicaraguan Banana War*, N.Y. TIMES, Nov. 18, 1982, at D1.

<sup>2</sup> Stephen Kinzer, *U.S. Agency to Decide a Claim on Nicaragua*, N.Y. TIMES, July 1, 1986, at A4.

<sup>3</sup> SFC bought about \$24 million dollars worth of bananas from Nicaragua annually, which is about one third the number of bananas it places in western United States markets. Ward Sinclair, *Slip in the Banana Trade*, WASH. POST, Jan. 31, 1981, at A1.

<sup>4</sup> SFC held a 20% equity interest in the partnerships and the plantation owners held an 80% equity interest in the partnerships. SFC leased the plantations from their owners and assigned the leases to the partnerships. *Standard Fruit*, 937 F.2d at 472.

<sup>5</sup> *Id.*

<sup>6</sup> Tim Coone, *Setting Out to Build a Republic on Bananas*, FIN. TIMES, May 8, 1991, § 1, at 32. After the Sandinista takeover, production at SFC's farms fell by nearly half. Kinzer, *supra* note 2, at A4.

to transfer SFC's shares in the partnerships to the new Nicaraguan government.<sup>7</sup>

On December 20, 1980, Nicaragua issued "Decree No. 608," outlining its plan to take over the production and marketing of all Nicaraguan bananas.<sup>8</sup> To effectuate the monopolization of the banana trade, the decree provided that all plantation leases would be transferred to a new government agency, and all pre-existing lease, partnership, and fruit purchase contracts were nullified. SFC interpreted the decree as an expropriation of its business.<sup>9</sup> SFC immediately ceased all operations in Nicaragua, leaving ripe bananas hanging on the trees.<sup>10</sup>

Recognizing that the situation had reached crisis proportions,<sup>11</sup> the Nicaraguan government requested a "summit meeting" at which SFC, its two parent companies, and the Nicaraguan government could work out their differences. The meeting began on January 9, 1981 in San Francisco, and ended after three intense days of negotiations with the signing of a "Memorandum of Intent" on January 11, 1981.<sup>12</sup>

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<sup>7</sup> The new government discussed these issues with General Manager James Sousane, SFC's representative in Nicaragua, for over a year. On June 23, 1980, Nicaraguan Minister of Foreign Trade Alejandro Martinez Cuenca sent Sousane a memo outlining a set of basic guiding principles for the new contractual relationship between Nicaragua and SFC, including the transfer proposal. SFC objected to the transfer proposal on the grounds that it could not transfer its 20% share without the consent of its partners. Negotiations continued on this point until December 20, 1980. *Standard Fruit*, 937 F.2d at 472.

<sup>8</sup> According to the new Nicaraguan government, the takeover was a means of improving conditions for some 5,000 low-paid, poorly housed banana workers. Sinclair, *supra* note 3, at A1.

<sup>9</sup> *Standard Fruit*, 937 F.2d at 472.

<sup>10</sup> *Id.* at 473.

<sup>11</sup> The Nicaraguan government recognized the crisis despite bold statements by Luis Carrion Cruz, the Interior Undersecretary of the new leftist government. According to Cruz, "This (termination) will not affect the national economy. We prefer to eat the bananas before we allow the imperialists to impose their will upon the Nicaraguan people." UPI, Dec. 31, 1980 (International Section), *available in* LEXIS, Nexis Library, UPI File. Cruz was also quoted as saying, "Even if we have to eat every last banana, we are not going to allow these imperialists to humiliate the revolution." Sinclair, *supra* note 3, at A1.

<sup>12</sup> *Standard Fruit*, 937 F.2d at 472. The Memorandum was executed by two officers of C & C, two officers of Steamship, two Nicaraguan Ministers of Trade, and a member of the ruling junta of Nicaragua. Sousane and other SFC representatives participated in the negotiations. They did not, however, sign the document because of the prior exclusive contracts with the banana plantations. They claimed they were not able to commit to the Memorandum until resolving their prior partnership commitments or obtaining the consent of their partners. *Id.* at 472 n.3.

The Memorandum, termed an "agreement in principle," provided for the renegotiation and replacement of four operating contracts<sup>13</sup> between SFC and "the competent Nicaraguan national entity."<sup>14</sup> The Memorandum established the essential elements of the fruit purchase contract<sup>15</sup> and rescinded Decree No. 608 for five years. Additionally, the Memorandum contained an arbitration provision.<sup>16</sup>

Within a week after the signing of the Memorandum, SFC returned to Nicaragua. SFC resumed operations and began negotiating with Nicaraguan officials regarding the four contracts envisioned in the Memorandum.<sup>17</sup> Although many subsequent drafts of these four documents were exchanged, none was ever finalized. Both Nicaragua and SFC complied with the terms of the Memorandum as though it were binding throughout the ongoing negotiations and for the duration of the next twenty-two months.<sup>18</sup> On October 25, 1982, SFC left Nicaragua permanently.<sup>19</sup>

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<sup>13</sup> The terms of these future contracts were to include a detailed fruit purchase contract, a technical assistance contract, the transfer of SFC's shares in the plantation partnerships, and Nicaragua's purchase of SFC's assets in Nicaragua. *Id.* at 472-73. Nicaragua took ownership of SFC's land and offices in Nicaragua. Nicaragua agreed to use SFC to distribute its bananas, and SFC promised to train Nicaraguans in the business. Kinzer, *supra* note 2, at A4.

<sup>14</sup> The government had set up an entity called "BANANIC" to work with SFC and the partnerships. In mid-1981, a new government agency, called the Programa Bananero de Occidente or EMBANOC, was created. EMBANOC dealt with SFC until its final departure from Nicaragua in October 1982. *Standard Fruit*, 937 F.2d at 472 n.4.

<sup>15</sup> The price of the bananas was set at \$4.30 per box, less specified deductions. The length of the contract was set at five years although no dates were specified. *Id.* at 473.

<sup>16</sup> The arbitration clause provided that:

any and all disputes arising under the arrangements contemplated hereunder . . . will be referred to mutually agreed mechanisms or procedures of international arbitration, such as the rules of the London Arbitration Association.

*Id.* at 473. Nicaragua admitted during the district court proceeding that the clause refers to an association which does not exist. However, Nicaragua introduced a letter into evidence written by Robert Moore, C & C's Vice-President and General Counsel, and also principal draftsman of the Memorandum. The letter appeared to suggest that C & C intended the clause to be binding and that the parties intentionally left it vague because they could not remember the name of the London arbitration agency. *Id.* Additionally, Mr. Moore had attached to his letter, "a very explicit page-long 'substitute arbitration clause' providing for arbitration in London pursuant to the Arbitration Act of Great Britain." *Id.* at 473 n.5. The Ninth Circuit noted that the District Court had disregarded this evidence. *Id.* at 473.

<sup>17</sup> The four contracts provided for technical assistance, fruit purchase, share transfers, and asset buy-outs. *Id.*

<sup>18</sup> For instance, SFC bought over \$30 million worth of bananas at the Memo-

It was not until nearly four years later that Nicaragua filed a \$35 million breach of contract action against SFC in the Northern District of California on October 21, 1986.<sup>20</sup> The District Court ruled that the Nicaraguan government had no formal contract with SFC and denied Nicaragua's motion to compel arbitration in accordance with the arbitration clause contained in the Memorandum of Intent. After applying a three-part test for arbitrability,<sup>21</sup> the district court held that the Memorandum as a whole was not a binding contract, thus rendering the arbitration clause unenforceable. According to the court, the arbitration clause was not a present agreement to arbitrate, but merely "a provision declaring the expectations of the parties that contracts to be negotiated later would include agreements to arbitrate."<sup>22</sup>

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randum's price of \$4.30 instead of the \$1.26 it had been paying prior to the Memorandum. Nicaragua, in turn, began allowing the \$.75 deduction for asset buy-back, debt reduction, and technical assistance contemplated by the Memorandum, for a total rebate of over \$3.5 million over the two years. *Id.*

<sup>19</sup> Nicaragua and SFC have given conflicting explanations for SFC's permanent departure in 1982. The Nicaraguans charged that SFC's decision to pull out of Nicaragua was "part of an effort by the Reagan Administration to destabilize the Sandinista Government." C & C denied the accusation, pointing to financial reasons for its withdrawal. Kinzer, *supra* note 2, at A4. The motivating economic factor was based on the price of bananas, which had fallen below production costs because of oversupply. SFC claimed that its loss of \$65 million in 1982 prompted its cessation of operations in Nicaragua. Tim Comme, *Standard Fruit Pulls Out of Nicaragua*, FIN. TIMES, Oct. 29, 1982, § II, at 24. SFC also later claimed de facto expropriation as the reason for its withdrawal from Nicaragua, and filed a claim with the Overseas Private Investment Corporation (OPIC) for indemnification. In the subsequent OPIC investigation, Sandinista Agricultural Minister Jaime Wheelock Roman changed his story. Roman attempted to refute this claim by citing purely economic motivations for SFC's withdrawal. Kinzer, *supra* note 2, at A4.

<sup>20</sup> The \$35.5 million suit alleges that SFC and C & C reneged on a 1980 agreement to buy all of Nicaragua's banana output for 5 years. Nicaragua sought damages of \$28.5 million for bananas that SFC would have bought during the three remaining years of its contract, \$1.1 million for bananas allegedly shipped but not paid for, and an additional \$5.9 million in unspecified damages. SFC argued that its operations were expropriated, and filed a \$3 million claim with OPIC. Peter Ford, *Nicaragua Sues Standard Fruit for Dollars 35M Over Banana Deal*, FIN. TIMES, Oct. 23, 1986, § I, at 40. The suit also alleges that the banana workers were treated harshly by SFC. *Nicaragua Suit Says U.S. Reneged on Banana Contract*, UPI, Oct. 22, 1986 (Domestic News Section), available in LEXIS, Nexis Library, UPI File.

<sup>21</sup> "First, whether the parties entered into a contract; second, that the contract included an agreement to arbitrate disputes; and third, that the disputes covered by the arbitration agreement included those which are before the court." *Standard Fruit*, 937 F.2d at 474.

<sup>22</sup> *Id.* The attorney for Nicaragua expressed concern over what he termed "troubling and unorthodox" behavior by U.S. District Judge John P. Vukasin in ques-

On appeal, *held*, reversed and remanded.<sup>23</sup> After making a preliminary determination that a contractual relationship exists between the parties, and that the contract contains a valid arbitration provision governing the dispute in issue, a court must refer all other disputes to arbitration. *Nicaragua v. Standard Fruit Co.*, 937 F.2d 469 (9th Cir. 1991).

## II. LEGAL BACKGROUND

The expansion of the global economy has escalated the importance of arbitration as a viable alternative to judicial resolution of international commercial disputes. Accordingly, arbitration clauses<sup>24</sup> have become an integral part of international contracts because of the speed, flexibility, economy, and neutrality associated with arbitration.<sup>25</sup> The use of arbitration dates at least as far back as the Middle Ages, when arbitration furnished the nearly exclusive means for the settlement of business disputes between English merchants.<sup>26</sup> Subsequently, business communities of the trading countries of the West, including the United States, adopted this ancient practice most effectively through organized commercial groups. These modern or-

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tioning an SFC witness off-the-record about his opinion of a key Nicaraguan witness. Pamela A. MacLean, UPI, April 15, 1988 (Regional News Section), *available in* LEXIS, Nexis Library, UPI File.

<sup>23</sup> *Standard Fruit*, 937 F.2d at 481. The district court's decision was reversed so that the arbitration clause would be enforced as to C & C and Steamship. The decision was remanded in order for the district court to make a preliminary determination whether or not a contractual relationship existed between SFC and Nicaragua. If there was such a relationship, SFC would be directed to arbitrate with its two parent companies.

<sup>24</sup> An arbitration clause is a contractual provision that represents the parties' voluntary decision to submit disputes arising from their contract to impartial agencies or individuals. The parties agree to accept the decision as final and binding. S. WILLISTON & W. JAEGER, *WILLISTON ON CONTRACTS* § 1918, at 3 (3d ed. 1976).

<sup>25</sup> See Peter D. Ehrenhaft, *Effective International Commercial Arbitration*, 9 *LAW & POL'Y INT'L BUS.* 1191, 1194 (1977) (arbitration is inexpensive, informal, quick, private, and convenient); Steven A. Meyerowitz, *The Arbitration Alternative*, A.B.A. J., Feb. 1985, at 78, 79 (arbitration is faster, less costly, private, and informal as compared to litigation); Celia R. Taylor, *National Iranian Oil Co. v. Ashland Oil, Inc.: All Dressed Up and Nowhere to Arbitrate*, 63 *N.Y.U. L. REV.* 1142, 1146 (1988) (arbitration perceived as quicker because it allows parties to avoid crowded court calendars and affords flexibility with predictability of outcome). *But see* Henry P. deVries, *International Commercial Arbitration: A Contractual Substitute for National Courts*, 57 *TUL. L. REV.* 42, 61 (1982) (advantages of speed, economy, and informality exist in domestic arbitration, but not in international arbitration).

<sup>26</sup> Julius H. Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 *VA. L. REV.* 265, 266 (1926).

ganizations sanctioned refusals to arbitrate or honor an arbitration award through disciplinary proceedings or expulsion rather than court action.<sup>27</sup>

Despite the business community's appreciation for the virtues of arbitration, United States courts have historically refused to honor agreements to arbitrate.<sup>28</sup> United States courts adopted this dubious precedent from the English common law.<sup>29</sup> English courts had traditionally refused to enforce agreements to arbitrate on the grounds that such agreements "ousted" their jurisdiction, rendering such agreements void as contrary to public policy.<sup>30</sup> Events following World War I slowly but effectively extinguished the ouster view.

World War I was followed by an expansion in world trade, during which the trading countries of the West enacted various arbitration statutes.<sup>31</sup> The Geneva Arbitration Treaties of 1923<sup>32</sup> and 1927<sup>33</sup> were enacted by various countries throughout the world, but they were not adopted by the United States.<sup>34</sup> Although New York enacted the first arbitration statute in the United States in 1920,<sup>35</sup> other United States courts continued to follow the English common law precedent

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<sup>27</sup> Soia Mentschikoff, *Commercial Arbitration*, 61 COLUM. L. REV. 846, 854-56 (1961); deVries, *supra* note 25, at 43.

<sup>28</sup> See *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 985 (2d Cir. 1942) (one factor explaining the English judiciary's hostility towards arbitration was that English judges' salaries came largely from litigation fees); *Home Ins. Co. of N.Y. v. Morse*, 87 U.S. 445, 457-58 (1874) (agreements made in advance of dispute to oust courts of jurisdiction are illegal and void); *Mitchell v. Dougherty*, 90 F. 639, 644-45 (3d Cir. 1898) (agreements made prior to dispute are unenforceable as they oust courts of jurisdiction); *Carbon Black Export, Inc. v. The S.S. Monrosa*, 254 F.2d 297, 300-01 (5th Cir. 1958) (agreements in advance of controversy oust courts of jurisdiction and are void as contrary to public policy).

<sup>29</sup> Stephen P. Bedell et. al., *Arbitrability: Current Developments in the Interpretation and Enforceability of Arbitration Agreements*, 13 J. CONTEMP. L. 1, 1 (1987); see also *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511 n.4 (1974) (ouster view adopted by American courts as part of common law up to the time of the Federal Arbitration Act of 1925).

<sup>30</sup> deVries, *supra* note 25, at 50 n.38; see also Mentschikoff, *supra* note 27, at 856.

<sup>31</sup> deVries, *supra* note 25, at 50-51.

<sup>32</sup> Geneva Protocol on Arbitration Clauses, Sept. 24, 1923, 27 L.N.T.S. 158.

<sup>33</sup> Geneva Convention on the Execution of Foreign Arbitral Awards, Sept. 26, 1927, 92 L.N.T.S. 302.

<sup>34</sup> The Geneva Treaties of 1923 and 1927 have been superseded by the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (signed by the United States and codified at 9 U.S.C. §§ 201-208 (Supp. 1991)).

<sup>35</sup> N.Y. CIV. PRAC. LAW §§ 7501-7514 (Consol. 1988).

which was considered too authoritative to be overturned absent a legislative directive.<sup>36</sup>

#### A. *The Federal Arbitration Act of 1925*

The enactment of the Federal Arbitration Act of 1925 (FAA)<sup>37</sup> reversed the trend of judicial hostility towards arbitration, reflecting Congress' intent to establish a strong federal policy in favor of arbitration.<sup>38</sup> The FAA was designed to allow contracting parties to avoid "the costliness and delays of litigation," and to place arbitration agreements "upon the same footing as other contracts . . . ."<sup>39</sup> Accordingly, the FAA provides for the enforcement of arbitration agreements, mandating that such agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."<sup>40</sup>

The FAA enforces arbitration agreements in contracts involving maritime transactions and contracts evidencing transactions involving interstate or foreign commerce.<sup>41</sup> The FAA enables a party to petition a United States district court for an order compelling arbitration if another party refuses to honor an arbitration agreement.<sup>42</sup> In order to direct the parties to arbitrate, the court must be satisfied that the arbitration agreement itself is not in issue.<sup>43</sup> The FAA also provides for the ap-

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<sup>36</sup> See *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219 n.6 (1985) (citing H.R. REP. NO. 96, 68th Cong., 1st Sess. 1-2 (1924)).

<sup>37</sup> Federal Arbitration Act of 1925, Pub. L. No. 68-101, 43 Stat. 883 (current version codified at 9 U.S.C. §§ 1-14 (1982)).

<sup>38</sup> *Perry v. Thomas*, 482 U.S. 483, 490 (1987) (the FAA embodies a clear federal policy of requiring arbitration); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) (strong federal policy in favor of arbitration requires holding federal securities claims arbitrable); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985) (doubts concerning arbitrability of issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language or a defense to arbitrability) (quoting *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983)). See also Comment, *Arbitration—Doctrine of Separability—United States Arbitration Act—Enforcement of Arbitration Clause Required Although Principal Contract May Be Voidable*, 43 N.Y.U. L. REV. 565, 569 (1968) (stating that strong national policy favoring arbitration has been adopted and should be fully implemented).

<sup>39</sup> H.R. REP. NO. 96, 68th Cong., 1st Sess. 1-2 (1924).

<sup>40</sup> 9 U.S.C. § 2 (1982).

<sup>41</sup> 9 U.S.C. § 1 (1982).

<sup>42</sup> 9 U.S.C. § 4 (1982).

<sup>43</sup> *Id.* Section 4 provides:

The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not

pointment of arbitrators if none are specified in the agreement,<sup>44</sup> and for district court confirmation of an arbitral award.<sup>45</sup> Finally, the FAA promotes arbitration by requiring courts to stay litigation that is commenced in disregard of arbitration agreements.<sup>46</sup> In order to grant a stay, the court must first be satisfied that the issue involved is encompassed within the scope of the arbitration clause.<sup>47</sup>

Although United States courts were more inclined to uphold arbitration agreements after enactment of the FAA in 1925, it was years before courts consistently began to enforce arbitration agreements.<sup>48</sup> A crucial development that tilted the balance in favor of enforcing arbitration agreements occurred when the United States finally acceded to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (Convention) in 1970.<sup>49</sup>

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in issue, the court shall make an order directing the parties to proceed to arbitration . . . . If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof.

<sup>44</sup> 9 U.S.C. § 5 (1982).

<sup>45</sup> 9 U.S.C. § 9 (1982). The court entering a judgment on the award will be the court specified by the parties in their agreement. If no court has been named, the district court in the district in which the award was given has the authority to confirm the award.

<sup>46</sup> 9 U.S.C. § 3 (1982).

<sup>47</sup> *Id.* Section 3 provides in part:

If any suit or proceeding be brought in any of the courts of the United States . . . 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 . . . stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . .

<sup>48</sup> See, e.g., *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (claim under antitrust laws is a matter of paramount public interest and inappropriate for arbitration); *Wilko v. Swan*, 346 U.S. 427 (1953) (Section 14 of the Securities Act of 1933 prohibits arbitration agreements, and federal laws governing the sale of securities should be governed exclusively by the courts). Cf. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (holding antitrust claim arbitrable); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) (holding securities claim arbitrable). See also Cohen & Dayton, *supra* note 26, at 281 (expressing the prevailing view that some issues are more appropriate for arbitration than others).

<sup>49</sup> Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 3 [hereinafter Convention]. The United States participated in the 1958 negotiations but did not accede to the Convention until 1970. The delayed accession was based in part on concern that certain Convention provisions conflicted with domestic law. H.R. REP. No. 1181, 91st Cong., 2d Sess. 1-2, reprinted in 1970 U.S.C.C.A.N. 3601, 3601-02. The decision to ratify the Convention was a result of increased support of governmental, commercial, and private groups that favored international arbitration. S. REP. No. 702, 91st Cong., 2d Sess. 2-3 (1970); H.R. REP. No. 1181, 91st Cong., 2d Session 1-2 (1970).



### B. The Federal Arbitration Act of 1970

In 1970, Congress ratified and implemented the Convention by adding Chapter 2 to the Federal Arbitration Act (the Act).<sup>50</sup> The Convention's primary objective was to encourage and facilitate international arbitration by recognizing international arbitration agreements and providing uniform standards.<sup>51</sup> Chapter 2 of the FAA mandates that the Convention "shall be enforced in United States Courts."<sup>52</sup>

Chapter 2 applies to arbitration agreements and awards arising out of commercial legal relationships, whether contractual or not.<sup>53</sup> The FAA will not apply if both parties are United States citizens unless the transaction involves property located abroad or involves at least one foreign state.<sup>54</sup> Federal district courts have jurisdiction regardless of the amount in controversy.<sup>55</sup> Actions may be removed from state to district courts where the subject matter of the action relates to an arbitration agreement or award falling under Chapter 2.<sup>56</sup> Finally, Chapter 2 provides for the enforcement of forum selection clauses under the agreement, the appointment of arbitrators,<sup>57</sup> and entry of judgment on arbitral awards.<sup>58</sup>

The most significant articles of the Convention encompassed in Chapter 2 are Articles II and V, which provide defenses for parties seeking to avoid enforcement of an arbitration agreement or award. Article II(1) expressly compels the courts of a contracting state to recognize arbitration agreements, provided that the dispute concerns a subject matter capable of arbitration.<sup>59</sup> Pursuant to Article II(3),

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<sup>50</sup> Act of July 31, 1970, Pub. L. No. 91-368, 84 Stat. 692 (codified at 9 U.S.C. §§ 201-208 (1982)).

<sup>51</sup> S. EXEC. DOC. NO. E., 90th Cong., 2d Sess. (1968); Jill A. Pietrowski, *Enforcing International Commercial Arbitration Agreements—Post-Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 36 AM. U. L. REV. 57, 64 (1986); Ronald E.M. Goodman, *Arbitrability & Antitrust: Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 23 COLUM. J. TRANSNAT'L L. 655, 657 (1985).

<sup>52</sup> 9 U.S.C. § 201 (1982).

<sup>53</sup> 9 U.S.C. § 202 (1982).

<sup>54</sup> *Id.*

<sup>55</sup> 9 U.S.C. § 203 (1982).

<sup>56</sup> 9 U.S.C. § 205 (1982).

<sup>57</sup> 9 U.S.C. § 203 (1982).

<sup>58</sup> 9 U.S.C. § 206 (1982). The Act allows a party to have an arbitration award falling under the Act confirmed within three years after the award was made unless an article V defense applies. 9 U.S.C. § 207 (1982).

<sup>59</sup> Convention, *supra* note 49. Article II subsection 1 provides:

Each Contracting State shall recognize an agreement in writing under which

the court is required to refer the parties to arbitration unless the court finds the "said agreement is null and void, inoperative or incapable of being performed."<sup>60</sup>

Article V provides mechanisms to avoid arbitration awards by listing grounds under which a court may refuse to recognize an award.<sup>61</sup> However, Article V expressly allows avoidance of awards only, and makes no reference to arbitration agreements. Article V(1)(a) permits refusal to enforce an award if the agreement itself is void either according to the stipulated law or, in the alternative, according to the law of the country where the award was made.<sup>62</sup> Moreover, Article V(2)(a) specifically allows a court to refuse enforcement of an arbitration award if it determines that the subject matter of the dispute is incapable of settlement by arbitration under the law of the country where enforcement is sought.<sup>63</sup> Article V(2)(b) extends the scope of award enforcement defenses even further by permitting a court to refuse to compel arbitration if submitting the issue to arbitration would be contrary to the public policy of the country where the enforcement is sought.<sup>64</sup>

### C. *Impact of the 1970 Federal Arbitration Act*

The enactment of the 1958 Convention as Chapter 2 of the FAA in 1970 has led to an even wider acceptance and enforcement of arbitration agreements and awards.<sup>65</sup> In addition to echoing the only available defense in Chapter 1,<sup>66</sup> Article II(3) of Chapter 2 expressly

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the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, *concerning a subject matter capable of settlement by arbitration*. (emphasis added).

<sup>60</sup> Convention, *supra* note 49, art. II(3). The subsection further provides in relevant part: "The court of a Contracting State . . . 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*." *Id.* (emphasis added).

<sup>61</sup> Convention, *supra* note 49, art. V.

<sup>62</sup> Convention, *supra* note 49, art. V(1)(a).

<sup>63</sup> Convention, *supra* note 49, art. V(2)(a).

<sup>64</sup> Convention, *supra* note 49, art. V(2)(b).

<sup>65</sup> See *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 640 (1985) (international arbitration of antitrust claims ordered under FAA); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519-20 (1974) (arbitration clause governing international trademark claim brought under securities law enforced). See generally, Pietrowski, *supra* note 51 (noting growing willingness of United States courts to submit contract disputes to arbitration).

<sup>66</sup> 9 U.S.C. § 2 provides that arbitration agreements are enforceable except "upon such grounds as exist at law or in equity for the revocation of any contract." Compare this with the language of article II(3) of the Convention, *supra* note 60.

provides for a subject matter defense.<sup>67</sup> In the interim between Chapter 1 and Chapter 2, the lack of subject matter defenses in Chapter 1 led to judicial creation of those defenses. Thus, despite the FAA's explicit directive that arbitration agreements shall be enforceable, courts refused to enforce certain arbitration clauses in order to preserve exclusive federal jurisdiction over certain claims<sup>68</sup> or to better implement the policies of other federal statutes.<sup>69</sup> Disputes rendered inarbitrable due to subject matter included antitrust,<sup>70</sup> federal securities,<sup>71</sup> patent,<sup>72</sup> and bankruptcy.<sup>73</sup>

Even with the new legislative tolerance evinced by the enactment of Chapter 2, the courts' allowance of subject matter defenses to avoid agreements to arbitrate was short-lived. In an attempt to prod the lower courts in the direction of strict enforcement of arbitration clauses, the line of recent Supreme Court opinions regarding arbitrability strips the defense of nonarbitrable subject matter of its effectiveness.<sup>74</sup> Following the Supreme Court's directive, the Second

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<sup>67</sup> For language of Convention, art. II(1), *see supra* note 59.

<sup>68</sup> *See, e.g.*, *Byrd v. Dean Witter Reynolds, Inc.*, 726 F.2d 552 (9th Cir. 1984), *rev'd*, 470 U.S. 213 (1985); *Belke v. Merrill, Lynch, Pierce, Fenner & Smith*, 693 F.2d 1023 (11th Cir. 1982); *Miley v. Oppenheimer & Co.*, 637 F.2d 318 (5th Cir. 1981) (all refusing to enforce claims covered by arbitration clauses in order to preserve exclusive federal jurisdiction over related federal securities claims).

<sup>69</sup> *See, e.g.*, *Applied Digital Technology v. Continental Casualty Co.*, 576 F.2d 116 (7th Cir. 1978); *Allegaert v. Perot*, 548 F.2d 432 (2d Cir. 1977), *cert. denied*, 432 U.S. 910 (1977); *Merrill, Lynch, Pierce, Fenner & Smith v. Moore*, 590 F.2d 823 (10th Cir. 1978); *S.A. Mineraco da Trinidad-Samitri v. Utah Int'l, Inc.*, 576 F. Supp. 566 (S.D.N.Y. 1983) (all holding arbitration clauses unenforceable in the areas of antitrust, bankruptcy, 10b-5 claims, and RICO respectively).

<sup>70</sup> *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (determining perceived problems of arbitrator competence, hostility to antitrust claims, inability to deter future violations, and the public nature of antitrust litigation renders arbitration inappropriate for antitrust claims).

<sup>71</sup> *Wilko v. Swan*, 346 U.S. 427 (1953), *overruled by Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477 (1989); *Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 720 F.2d 1446 (5th Cir. 1982); *Miley v. Oppenheimer & Co.*, 637 F.2d 318 (5th Cir. 1981) (all exempting Securities Act of 1933 claims from arbitration).

<sup>72</sup> *Beckman Instruments, Inc. v. Technical Dev. Corp.*, 433 F.2d 55 (7th Cir. 1970) (holding issues concerning the validity of a U.S. patent incapable of determination through arbitration proceedings); *accord Hanes Corp. v. Millard*, 531 F.2d 585 (D.C. Cir. 1976); *Foster Wheeler Corp. v. Babcock & Wilcox Co.*, 440 F.Supp. 897 (S.D.N.Y. 1977).

<sup>73</sup> *Zimmerman v. Continental Airlines, Inc.*, 712 F.2d 55 (3d Cir. 1983), *cert. denied*, 464 U.S. 1038 (1984); *In re Wm. S. Newman Brewing Co.*, 87 B.R. 236 (Bankr. N.D.N.Y. 1988).

<sup>74</sup> *See, e.g.*, *Perry v. Thomas*, 482 U.S. 483 (1987) (FAA pre-empts state labor

Circuit held that international comity concerns<sup>75</sup> override the traditional nonarbitrability of bankruptcy.<sup>76</sup> Similarly, Congress has amended patent law to provide for arbitration of patent validity and infringement issues.<sup>77</sup> Finally, although many of the Supreme Court decisions dealt with international contracts, a broadening of issue arbitrability in the domestic arena<sup>78</sup> has accompanied the broadening of issue arbitrability in the international arena.<sup>79</sup>

In contracts between the United States and entities of foreign nations, most subject matter defenses no longer carry any weight, despite the Convention's allowance of such defenses.<sup>80</sup> The indisputable trend reflects the judicial determination that international con-

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law provisions); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985) (antitrust claim arbitrable irrespective of public policy concerns); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985) (enforcing an arbitration clause even though it involved traditionally nonenforceable subject matter of securities claims); *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (FAA preempts state laws invalidating arbitration clauses otherwise valid under the FAA); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) (upholding liberal federal policy favoring arbitration agreements); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974) (holding securities claims arbitrable); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (holding claims of fraud in the inducement of the contract must be arbitrated when the questioned contract contains an arbitration clause).

<sup>75</sup> See *infra* note 81 for an explanation of international comity.

<sup>76</sup> *Fotochrome, Inc. v. Copal Co.*, 517 F.2d 512, 516 (2d Cir. 1975) (emphasizing the Convention's underlying policy of supporting international arbitration at the expense of national public policy).

<sup>77</sup> 35 U.S.C. § 294 (1982); see also Carmichael, *The Arbitration of Patent Disputes*, 38 ARB. J. 1, 6 (1983) (discussing the new legislation's role in encouraging the inclusion of arbitration clauses in patent license agreements and contracts).

<sup>78</sup> *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 222 (1985) (requiring rigorous enforcement of arbitration agreements in the domestic context); *Southland Corp. v. Keating*, 465 U.S. 1, 15-16 (1984) (acknowledging that the Act creates a body of federal substantive law applicable in both federal and state courts); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (holding that the Act guarantees federal policy of enforcement of private arbitration agreements).

<sup>79</sup> For opinions broadening issue arbitrability in the international contracts, see *infra* note 102.

<sup>80</sup> See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985) (international comity concerns mandate arbitration of an international claim notwithstanding conflicting domestic policy); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 515-516 (1974) (international nature of contract involved in securities laws claim overrode prescriptive domestic policy); *Parsons & Whittemore Overseas Co. v. Societe General de L'Industrie du Papier (RAKTA)*, 508 F.2d 969, 974 (2d Cir. 1974) (transnational policy concerns underlying arbitration agreement require a stricter view of nonarbitrability than in the domestic context).

cerns, such as comity,<sup>81</sup> override domestic policy.<sup>82</sup> The force behind this trend is a growing awareness that the growth of international trade depends upon the ability to ensure the neutrality and predictability that is associated with arbitration, especially in international disputes.<sup>83</sup>

Moreover, public policy in favor of international arbitration is strong.<sup>84</sup> Courts distinguish public policy from national policy, construing the public policy limitation in the Convention narrowly<sup>85</sup> by applying it only where enforcement would violate the forum state's most basic notions of morality and justice.<sup>86</sup> Accordingly, many courts

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<sup>81</sup> The Supreme Court has defined "comity" as a jurisprudential principle that seeks to reconcile United States' laws not only with directly conflicting laws of other foreign nations, but also with the requirements of an "international legal order" capable of resolving conflicts arising out of international trade. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 632 (1985).

The Third Circuit has defined comity as:

a recognition which one nation extends within its own territory to the legislative, executive, or judicial acts of another. It is not a rule of law, but one of practice, convenience, and expediency . . . [I]t is a nation's expression of understanding which demonstrates due regard both to international duty and convenience and to the rights of persons protected by its laws.

*Somportex Ltd. v. Philadelphia Chewing Gum Corp.*, 453 F.2d 435, 440 (3d Cir. 1971), *cert. denied*, 405 U.S. 1017 (1972).

<sup>82</sup> See *Mannington Mills, Inc. v. Congoleum Corp.* 595 F.2d 1287, 1296 (3d Cir. 1979) (noting importance of comity concerns, reciprocity, and judicial limitations when antitrust dispute involves foreign nations); *Timberlane Lumber Co. v. Bank of Am.*, 549 F.2d 597, 612 (9th Cir. 1976) (emphasizing role of international comity and fairness in regulating foreign commerce); *accord* *Teledyne, Inc. v. Kone, Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1990).

<sup>83</sup> See, e.g., *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 516 (1974) (noting that choice-of-law and choice-of-forum contractual provision is an almost indispensable prerequisite to achievement of orderliness and predictability essential to any international business transaction); *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 11-12 (1972) (observing that although business executives prefer to have disputes resolved in their own courts, that choice is not usually available, and neutral forum with expertise in the subject matter is the next best choice); *Hanes Corp. v. Millard*, 531 F.2d 585, 599 (D.C. Cir. 1976) (stating that arbitration eliminates uncertainty and unpredictability).

<sup>84</sup> See *supra* note 38 for opinions expressing the emphatic federal policy in favor of arbitration.

<sup>85</sup> The Arbitral Convention provides a public policy defense to enforcement of arbitral awards. Convention, *supra* note 49, at art. V(2)(b).

<sup>86</sup> *Fotochrome, Inc. v. Copal Co.*, 517 F.2d 512, 516 (2d Cir. 1975) (insisting that the public policy defense was not intended to "enshrine the vagaries of international politics under the rubric of 'public policy.'") (citing *Parsons & Whittemore Overseas Co. v. Societe Generale de L'Industrie du Papier (RAKTA)*, 508 F.2d 969, 974 (1974)).

have strictly limited the nonarbitrability standards in the international context to agreements whose performance is illegal or voidable under internationally recognized contract principles.<sup>87</sup>

#### *D. Prima Paint and the Severability Doctrine*

In addition to the issues of public policy and subject matter arbitrability, the issue of severability has a significant impact on the interpretation and enforcement of arbitration agreements. The severability doctrine provides that an arbitration clause is an agreement independent of its container contract.<sup>88</sup> The promise to arbitrate by both parties is considered sufficient consideration for an arbitration agreement to be binding and independent.<sup>89</sup>

Severability generally hinges upon what potential disputes are encompassed within the language of the arbitration clause.<sup>90</sup> If a party desires that all possible disputes be arbitrated, and that the arbitration clause be severable, a "broad" arbitration clause should be included in the contract.<sup>91</sup> If a party merely intends for certain disputes such

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<sup>87</sup> *Ledee v. Ceramiche Rago*, 684 F.2d 184, 187 (1st Cir. 1982) (determining that the Convention's "null and void" clause applies only to defenses such as fraud, mistake, duress, and waiver that can be applied neutrally on an international scale); *Antco Shipping Co. v. Sidemar*, 417 F. Supp. 207, 215 (S.D.N.Y. 1976), *aff'd*, 553 F.2d 93 (2d Cir. 1977) (concluding that international contracts are subject to arbitration, despite United States public policy against restrictive trade practices and boycotts, unless obligation or remedy is prohibited by pertinent statute or other declaration of public policy).

<sup>88</sup> Under the severability doctrine, the validity of an arbitration clause and the validity of its container contract are independent questions. Comment, *supra* note 38, at 566.

<sup>89</sup> See, e.g., *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348, 350 (7th Cir. 1983). An illustration of the court's reasoning is helpful: "The agreement to arbitrate and the agreement to buy and sell motors are separate. Sauer's promise to arbitrate was given in exchange for White's promise to arbitrate and each promise was sufficient consideration for the other." *Id.*

<sup>90</sup> The phrase "arising under" is usually considered to be "relatively narrow as arbitration clauses go." *Sinva, Inc., v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 253 F. Supp. 359, 364 (S.D.N.Y. 1966).

In *In re Kinoshita & Co.*, 287 F.2d 951, 953 (2d Cir. 1961), Judge Medina determined that when an arbitration clause "refers to disputes or controversies 'under' or 'arising out of' the contract," arbitration is limited to "disputes and controversies relating to the interpretation of the contract and matters of performance." Judge Medina's rationale was that the phrase "arising under" is narrower in scope than the phrase "arising out of or relating to," the standard language recommended by the American Arbitration Association. *Id.*

<sup>91</sup> A broad arbitration clause allows the court to compel arbitration and permits the arbitrator to decide whether the dispute is arbitrable. Such clauses are drafted in broad terms and intended to cover a broad range of disputes. See, e.g., Robert

as contract terms or performance to be arbitrated, a "narrow" arbitration clause should be included in the contract instead.<sup>92</sup> Therefore, if a clause is not broad enough to cover the dispute, courts generally conclude that the parties did not intend it to be arbitrable.<sup>93</sup> The underlying rationale is that because arbitration is a matter of contract, a party cannot be required to arbitrate any dispute which he has not agreed to arbitrate.<sup>94</sup>

An encouraging breakthrough for proponents of arbitration came with the Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*<sup>95</sup> In *Prima Paint*, the plaintiff claimed that a consulting agreement between the plaintiff and the defendant was induced by fraud. Despite specific representations of financial strength by the defendants, the defendants went into bankruptcy a week after the agreement was signed.<sup>96</sup> The Supreme Court determined that the issue of fraud was a controversy arising out of the consulting agree-

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Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 404 (2d Cir. 1959) (broad arbitration clause before the court stating, "[a]ny complaint, controversy, or question which may arise with respect to this contract that cannot be settled by the parties thereto, shall be referred to arbitration"); Acevedo Maldonado v. PPG Indus., Inc., 514 F.2d 614, 616 (1st Cir. 1975) (clause read, "[a]ny controversy or claim arising out of or relating to this agreement"); Altshul Stern & Co., Inc. v. Mitsui Bussan Kaisha, Ltd., 385 F.2d 158, 159 (2d Cir. 1967) (clause read, "any dispute . . . arising out of or relating to this contract or the breach thereof"); Georgia Power Co., v. Cimarron Coal Corp., 526 F.2d 101, 106 (6th Cir. 1975) (holding that pursuant to an arbitration clause which read "any controversy . . . arising under this Agreement," no "provision of the contract [was] wholly outside of the arbitration provision"), *cert. denied*, 425 U.S. 952 (1976).

<sup>92</sup> See, e.g., *Mediterranean Enterprises, Inc., v. Ssangyong Construction Co., Ltd.*, 708 F.2d 1458, 1463 (9th Cir. 1983) (determining that the phrase "arising hereunder" meant "arising under the contract itself" and "matters or claims independent of the contract or collateral" to the contract were not included in the scope of the clause). Some clauses are even more specific as to the disputes to be covered. See *Prudential Lines v. Exxon Corp.*, 704 F.2d 59, 61 (2d Cir. 1983) (one clause covered any dispute between owner and charter "in respect to the responsibility for repairs, renewals or replacements, or as to the condition of the vessel at the time of redelivery . . .").

<sup>93</sup> See *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1139 (9th Cir. 1991); *AT & T Technologies, Inc. v. Communications Workers*, 475 U.S. 643, 648 (1986) (both citing *Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960) and *Steelworkers v. American Mfg. Co.*, 363 U.S. 564, 570-571 (1960) ("[a]rbitration is a matter of contract and a party cannot be required to submit any dispute which he has not agreed to so submit.")).

<sup>94</sup> *Steelworkers v. American Mfg. Co.*, 363 U.S. 564, 570-571 (1960).

<sup>95</sup> 388 U.S. 395 (1967).

<sup>96</sup> *Id.* at 397-98.

ment, and thus a dispute covered by the agreement's broad arbitration clause.<sup>97</sup>

The Court held that unless the parties clearly intend otherwise, arbitration clauses are "separable" from the contracts in which they are embedded.<sup>98</sup> The Court's reasoning turned upon section 4 of the Act, which mandates that arbitration proceed once a court is satisfied that the existence of the arbitration clause itself is not in issue.<sup>99</sup> Accordingly, the Court held that issues going to the making of the arbitration clause itself are for the courts to decide, but disputes as to fraud in the making of the contract as a whole are for the arbitrators to decide.<sup>100</sup> Thus, the clear directive of the Court's decision in *Prima Paint* was that in order to successfully avoid arbitrating a claim of fraudulent inducement, litigants opposing arbitration must direct their attacks only against the arbitration clause itself.<sup>101</sup>

Although the language of *Prima Paint* referred specifically to fraud in the inducement, several courts have extended this rationale to encompass contract rescission on grounds such as frustration of purpose, mutual mistake, duress, unconscionability, and coercion.<sup>102</sup> Many

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<sup>97</sup> The broad arbitration clause read in part:

Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration in the City of New York, in accordance with the rules then obtaining of the American Arbitration Association.

*Id.* at 398.

<sup>98</sup> *Id.* at 402. The Court relied in part on *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959) for this view. In *Lawrence*, the Second Circuit, faced with a factual situation analogous to that in *Prima Paint*, determined that the agreement to arbitrate was "separable" from the rest of the contract and independently enforceable as a matter of substantive law. Therefore, the court concluded that the issue of fraudulent inducement of the contract's making was an issue for the arbitrators.

<sup>99</sup> 9 U.S.C. § 4 (1982). Section 4 provides in relevant part:

The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

<sup>100</sup> *Prima Paint*, 388 U.S. at 403-04.

<sup>101</sup> See *Mosely v. Electronic & Missile Facilities, Inc.*, 374 U.S. 167 (1963) (arbitration clause attacked and held to be part of a fraudulent scheme); *American Airlines, Inc. v. Louisville Jefferson County Air Bd.*, 269 F.2d 811, 817 (6th Cir. 1959) (arbitration agreement invalid because agreeing to arbitrate was an *ultra vires* act).

<sup>102</sup> See, e.g., *Unionmutual Stock Life Ins. Co. v. Beneficial Life Ins. Co.*, 774 F.2d 524, 529 (1st Cir. 1985) (*Prima Paint* rationale applies to frustration of purpose and mutual mistake); *Hall v. Prudential-Bache Sec., Inc.*, 662 F. Supp. 468, 471 n. 1 (C.D. Cal. 1987) (disputes involving duress, unconscionability, coercion, or confusion in signing agreement must be arbitrated).



courts expand upon *Prima Paint*'s holding even further, holding that issues related to the making of the contract, and thus its validity, are subject to arbitration unless the arbitration clause itself is attacked.<sup>103</sup>

Other courts refuse to interpret *Prima Paint* so broadly, reading *Prima Paint* as limited to challenges seeking to avoid or rescind a contract.<sup>104</sup> Under this narrower interpretation, challenges to the making of the contract are not arbitrable, as proponents of this view equate the "making" of the contract with the "very existence" of the contract.<sup>105</sup> Pursuant to this approach, the arbitration clause is severable when a voidable contract is alleged,<sup>106</sup> but not when a contract's validity is challenged.<sup>107</sup>

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<sup>103</sup> *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1989) ("[t]he teaching of *Prima Paint* is that a federal court must not remove from the arbitrators consideration of a substantive challenge to a contract unless there has been an independent challenge to the making of the arbitration clause itself") (quoting *Unionmutual Stock Life Ins. Co. v. Beneficial Life Ins. Co.*, 744 F.2d 524, 529 (1st Cir. 1985)); *Rhoades v. Powell*, 644 F. Supp. 645 (E.D. Cal. 1986) (the *Prima Paint* doctrine extends to all challenges to the making of a contract); see also Robert Coulson, *Prima Paint: An Arbitration Milestone*, 22 ARB. J. 237, 241 (1967) (observing that henceforth, when confronted with an arbitration clause in a contract falling under the FAA, courts will consider only the validity and coverage of the agreement).

<sup>104</sup> See, e.g., *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1140 (1991) (*Prima Paint* is limited to challenges seeking to avoid or rescind a contract, not to challenges going to the making of a contract); *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51 (3d Cir. 1980) (issues related to the making of the contract are not arbitrable); *Pollux Marine Agencies v. Louis Dreyfus Corp.*, 455 F. Supp. 211 (S.D.N.Y. 1978) (denying arbitration on the ground that a challenge to the entire contract goes to the making of the arbitration clause).

<sup>105</sup> *Three Valleys*, 925 F.2d at 1140 (9th Cir. 1991) (challenges to the making of a contract go to the very existence of a contract). See also *Camping Construction Co. v. Dist. Council of Iron Workers Local 378*, 915 F.2d 1333, 1340 (9th Cir. 1990) (it is for the courts to determine whether a contract ever existed); *I.S. Joseph Co. v. Michigan Sugar Co.*, 803 F.2d 396, 400 (8th Cir. 1986) (enforceability of the arbitration clause is a question for the court when one party denies the existence of a contract); *Nat'l R.R. Passenger Corp. v. Boston & Maine Corp.*, 850 F.2d 756, 761 (D.C.Cir. 1988) (there is no authority to order a party to arbitrate if there was never an agreement to arbitrate); *Heinhuis v. Venture Assocs.*, No. CIV.A.90-2148, 1991 WL 111011 (E.D.La. 1991) (the preliminary question as to the existence of a contractual relationship which could make the arbitration agreement enforceable is a question for the court).

<sup>106</sup> Voidable contracts are those "where one party was an infant, or where the contract was induced by fraud, mistake or duress, or where breach of warranty or other promise justifies the aggrieved party in putting an end to the contract." RESTATEMENT (SECOND) OF CONTRACTS § 7 cmt. b (1981).

<sup>107</sup> *Three Valleys*, 925 F.2d at 1140.

The reasoning underlying the narrow view echoes Justice Black's dissent in *Prima Paint*, in which he expressed concern that the Act should be interpreted so as not to allow "bootstrapping," arguing that "if there has never been any valid contract, then there is not now and has never been anything to arbitrate."<sup>108</sup> Several commentators also agree with Justice Black, expressing difficulty in understanding how an arbitration clause can be valid if the entire contract containing it is void.<sup>109</sup>

### III. ANALYSIS

Congressional legislation, international commitments, and Supreme Court rulings express and mandate the strong United States policy favoring arbitration. Enforcing arbitration agreements benefits the international business community by allowing swift and efficient dispute resolution in the manner chosen by the parties.<sup>110</sup> Additionally, the international trade community has long favored arbitration because of its "simplicity, informality, and expedition."<sup>111</sup> The inclusion of an arbitration clause in an international commercial contract is now an almost universal practice.<sup>112</sup>

*Prima Paint* was a landmark case in establishing wide acceptance of the severability doctrine. *Standard Fruit* has added to the severability doctrine's effectiveness by clearing up unresolved issues created by subsequent inconsistent interpretations of *Prima Paint*. The Ninth

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<sup>108</sup> *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 425 (1967).

<sup>109</sup> See, e.g., Herbert M. Lord, *Arbitration in the U.S.*, 9 MAR. LAW 227 (1984) (finding Justice Black's dissent more persuasive than the majority's holding); Comment, *supra* note 38, at 567 (arguing that it is difficult to see how if the entire contract is void, the arbitration clause can nevertheless be valid); see also Daniel G. Collins, *Arbitration and the Uniform Commercial Code*, 21 ARB. J. 193, 214 (1966) (stating that the doctrine that an arbitration clause is separable from the rest of the contract appears to be basically at odds with the UCC's conception of an integrated transaction).

<sup>110</sup> Celia R. Taylor, *National Iranian Oil Co. v. Ashland Oil, Inc.: All Dressed Up and Nowhere to Arbitrate*, 63 N.Y.U. L. REV. 1142, 1146-1147 (1988).

<sup>111</sup> *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 631 (1985).

<sup>112</sup> Kerr, *International Arbitration v. Litigation*, 1980 J. BUS. L. 164, 164 (1980).

Despite the wide practice of commercial arbitration in the United States today, the United States was slow to adopt this practice as compared to other nations. Chief Justice Burger has observed that there is widespread use of private arbitration in England and on the Continent. Furthermore, jury trials are virtually nonexistent in Europe and European business people, lawyers, and judges cannot understand the failure to use arbitration more widely in the United States. Warren E. Burger, *Using Arbitration to Achieve Justice*, 40 ARB. J. 3, 5 (1985).

Circuit has gone further than any other in clearly drawing the line indicating where the contract's "existence" ends and where its "making," or the validity and thus severability, begins. Additionally, *Standard Fruit* provides a directive for contracting parties to ensure that intentions to arbitrate or not to arbitrate are construed by courts accordingly. Moreover, *Standard Fruit* applies the severability doctrine on an international scale, emphasizing international comity and arbitration's invaluable role in the continued growth of international trade.

#### A. *Cleaning up Prima Paint's Mess*

The Ninth Circuit in *Standard Fruit* held that *Prima Paint* demands that arbitration clauses be severable from their container contracts unless there is a clear intent to the contrary.<sup>113</sup> The Ninth Circuit determined that section 2 of the FAA expressly requires arbitration unless the arbitration agreement is not part of a contract evidencing interstate commerce, or the arbitration agreement is revocable "upon such grounds as exist at law or in equity for the revocation of any contract."<sup>114</sup>

The court also looked to section 4 of the FAA, noting that section 4 requires a court to order arbitration if it is satisfied that "the making of the agreement for arbitration . . . is not in issue."<sup>115</sup> Therefore, the Ninth Circuit concluded that a court "can only determine whether a written arbitration agreement exists, and if it does, enforce it 'in accordance with its terms.'"<sup>116</sup> An arbitration clause may thus be enforced even though the rest of the contract is later held invalid by the arbitrator.<sup>117</sup>

Several recent decisions appear to conflict with *Prima Paint*, including the Ninth Circuit's decision in *Three Valleys Mun. Water District v. E.F. Hutton & Co.*<sup>118</sup> and the district court's decision in

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<sup>113</sup> Republic of Nicar. v. Standard Fruit Co., 937 F.2d at 476.

<sup>114</sup> 9 U.S.C. § 2 (1982). The purpose of this section is to place arbitration on the same footing as all contracts. See *supra* note 39 and accompanying text.

<sup>115</sup> *Standard Fruit*, 937 F.2d at 475 (quoting 9 U.S.C. § 4 (1982)).

<sup>116</sup> *Id.* (quoting Howard Elec. & Mech. v. Briscoe Co., 754 F.2d 847, 849 (9th Cir. 1985)); accord *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 15 (1983).

<sup>117</sup> *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1989).

<sup>118</sup> *Three Valleys Mun. Water Distr. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1139 (9th Cir. 1991). In Judge Holcomb's dissent, she stated that the majority's decision violated *Prima Paint*'s clear directive that all issues save the arbitration agreement itself are for the arbitrator, not the courts. *Id.* at 1145-46.

*Standard Fruit*.<sup>119</sup> Additionally, in an opinion that came out one month before *Standard Fruit*, *Heinhuis v. Venture Associates, Inc. of Louisiana*, the Eastern District of Louisiana refused to sever an arbitration clause from its container contract.<sup>120</sup>

In *Heinhuis*, the issue concerned the existence of a contractual relationship. The court held that the existence of a contractual relationship was a preliminary question for the courts.<sup>121</sup> Several other courts share *Heinhuis*' reasoning, concluding that if no contractual relationship exists, there is no agreement to arbitrate.<sup>122</sup> Many of these decisions, including *Three Valleys*, limit the nonarbitrability of a contract's existence by concluding that in order for a contract's existence to be resolved by the courts, there must be an unequivocal denial that any agreement between the parties was made.<sup>123</sup>

These decisions do not conflict with *Prima Paint*'s reading of section 4 of the FAA<sup>124</sup> that once a court is satisfied that the agreement to arbitrate is in issue, all other issues must proceed to arbitration. As in *Prima Paint*, these courts look to section 4 of the FAA; however, they hold that a court's preliminary determination as to whether there

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<sup>119</sup> The district court reasoned that an arbitration clause cannot be valid unless the contract containing it is valid. Therefore the district court held that it must first decide whether the contract was valid. In reversing the district court, the Ninth Circuit held that this reasoning violates *Prima Paint*. *Standard Fruit*, 937 F.2d at 476 n.9.

The district court relied to some extent on a Southern District of New York decision which denied arbitration on the ground that a challenge to the entire contract went to "the making" of the arbitration clause. *Pollux Marines Agencies v. Louis Dreyfus Corp.*, 455 F. Supp. 211 (S.D.N.Y. 1978).

In reversing the district court, the Ninth Circuit emphasized that *Pollux* is not the law in the Ninth Circuit, and that it conflicts with Ninth Circuit precedent of following *Prima Paint*.

<sup>120</sup> *Heinhuis*, No. CIV.A.90-2148, 1991 WL 111011 (E.D. La. June 10, 1991).

<sup>121</sup> *Id.* at \*2; *Three Valleys*, 925 F.2d at 1140-41.

<sup>122</sup> See, e.g., *Camping Constr. Co. v. Distr. Council of Iron Workers Local 378*, 915 F.2d 1333, 1340 (9th Cir. 1990) (the court must determine whether a contract ever existed, and unless the court finds that one does, there is no basis for submitting any question to an arbitrator); *Nat'l R.R. Passenger Corp. v. Boston & Maine Corp.*, 850 F.2d 756, 761 (D.C.Cir. 1988) (if parties never agreed to arbitrate, there is no authority to require a party to submit to arbitration); *I.S. Joseph Co. v. Michigan Sugar Co.*, 803 F.2d 396, at 400 (8th Cir. 1986) (when one party denies the existence of a contract with the other, the enforceability of an arbitration clause is an issue for the court).

<sup>123</sup> *Heinhuis*, 1991 WL at \*2; *T & R Enterprises, Inc. v. Continental Grain Co.*, 613 F.2d 1272, 1277 (5th Cir. 1980).

<sup>124</sup> 9 U.S.C. § 4 (1982).

is an arbitration agreement begins with an inquiry as to whether an agreement exists between the parties in the first place.<sup>125</sup>

*Standard Fruit* effectively reconciled these opinions with *Prima Paint* in holding that although section 4 of the FAA requires a court to order arbitration once it is satisfied that a valid arbitration agreement exists, the contract itself must exist in order for the arbitration agreement to exist.<sup>126</sup> Thus, *Standard Fruit* held that the "existence" of a contractual relationship between the parties is a question for the court.<sup>127</sup> All other issues, the court concluded, concern the contract's validity and are for the arbitrators to decide.<sup>128</sup>

In determining that the preliminary issue of whether a contractual relationship existed between SFC and Nicaragua was for the district court to decide,<sup>129</sup> the Ninth Circuit effectively drew the line between the making or validity of a contract, which is arbitrable, and a contract's very existence, which is not. Existence of a contract, the court concluded, is satisfied when both parties admit to entering into a contract with one another.<sup>130</sup> The court noted that the "first principle of arbitration" remains that a party cannot be forced to arbitrate something which it has never agreed to arbitrate.<sup>131</sup> Accordingly,

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<sup>125</sup> See, e.g., *I.S. Joseph Co.*, 803 F.2d at 399 (the FAA provides that the district court's preliminary inquiry as to whether there is an arbitration agreement includes a determination that the parties have made an agreement at all); *Heinhuis*, 1991 WL at \*2-3 (the preliminary question as to a contract's existence which would make the arbitration agreement enforceable is not a question for arbitration).

<sup>126</sup> *Republic of Nicar. v. Standard Fruit Co.*, 937 F.2d at 481.

<sup>127</sup> *Id.* at 480.

<sup>128</sup> *Id.* at 476-77.

<sup>129</sup> *Id.* at 480.

<sup>130</sup> *Id.* at 478.

<sup>131</sup> *Id.*; accord *Three Valleys*, 925 F.2d 1136 at 1142 (9th Cir. 1991); *AT&T Technologies v. Communications Workers of America*, 475 U.S. 643, 648 (1986).

In accordance with this "first principle of arbitration," the Ninth Circuit remanded the issue as to whether a contractual relationship between SFC and Nicaragua existed back to the district court. The Ninth Circuit held that whether SFC was bound when its parent companies signed but SFC itself didn't was a question for the district court. Should the district court decide that SFC was not bound, the parent companies were to go ahead and arbitrate with Nicaragua without SFC being present. *Standard Fruit*, 937 F.2d at 480. See *supra* note 12 for a discussion concerning SFC's reasons for not signing the Memorandum at the outset.

The Ninth Circuit held that the district court's finding that there were no facts on which an inference of agency could be based was erroneous. The court noted that under California law, ostensible or apparent agency "arises as a result of conduct of the principal which causes the third party reasonably to believe that the agent possesses the authority." *Standard Fruit*, 937 F.2d at 480 (quoting *Tomerlin v. Canadian Indem. Co.*, 61 Cal. 2d 638, 643, 394 P.2d 571, 574, 39 Cal. Rptr.

disputes in cases holding that the issue of a contract's existence is nonarbitrable generally center around whether there is an agreement between the parties,<sup>132</sup> whether an unsigned agreement should nevertheless bind a party,<sup>133</sup> whether an agreement binds a third party,<sup>134</sup> and whether certain agents have authority to bind their principals.<sup>135</sup>

Moreover, the Ninth Circuit noted that the Supreme Court in *Prima Paint* made a preliminary ruling that the contract existed;<sup>136</sup> thus, making a preliminary determination that a contract exists is permissible under *Prima Paint*. Even so, such a determination goes beyond the express language of section 4 of the FAA.<sup>137</sup> Section 4 does not specifically permit judicial determination of a contract's existence, but limits the judiciary's role to making a preliminary inquiry into whether a valid arbitration agreement has been made.<sup>138</sup>

*Standard Fruit* mandates that once a contractual relationship is established, and the court has determined that both sides have committed to arbitrate, all other questions are for the arbitrator.<sup>139</sup> Accordingly, once a court determines that the parties are bound by an

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731, 734 (1964)). The court also noted that a party can be bound solely by subsequent conduct whether agency existed or not. *Id.* See *supra* note 18 and accompanying text for a description of SFC's conduct evidencing ratification and a binding agreement.

<sup>132</sup> *I.S. Joseph Co.*, 803 F.2d at 400 (when one party denies the existence of a contract with another, the issue is for the district court).

<sup>133</sup> *American Safety Equip. Corp. v. J.P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968) (district court, not arbitrators, must determine whether an assignee of an arbitration clause can enforce the arbitration agreement against one of the former parties); *McAllister Brothers, Inc. v. A & S Transp.*, 621 F.2d 519, 523-24 (2d Cir. 1980) (whether affiliates of a contracting party are bound by arbitration clause is an issue for the court).

<sup>134</sup> *Heinhuis*, No. CIV.A.90-2148, 1991 WL 111011 at \*3 (holding no arbitration as third party defendants had no contractual relationship with third party plaintiffs).

<sup>135</sup> See, e.g., *Three Valleys Mun. Water Distr. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1140-42 (9th Cir. 1991) (involving dispute over the issue of whether the signatory was without authority to bind his principal, where the court held that the issue of agency is essentially a legal one and must be decided by a court); *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51 (3d Cir. 1980); *N & D Fashions, Inc. v. DHJ Indus.*, 548 F.2d 722 (8th Cir. 1976) (both holding that the question of whether a particular individual has authority to bind a party must be determined by the court, not by an arbitrator); but see *Flender Corp. v. Techna-Quip Co.*, 953 F.2d 273 (7th Cir. 1992) (where an arbitration clause authorized parties to arbitrate disputes as to "relationships created" under the contract, the issue of existence of a contractual relationship was held arbitrable).

<sup>136</sup> *Standard Fruit*, 937 F.2d at 476.

<sup>137</sup> 9 U.S.C. § 4 (1982).

<sup>138</sup> See *supra* note 43, which sets out the relevant portion of 9 U.S.C. § 4 (1982).

<sup>139</sup> *Standard Fruit*, 937 F.2d at 475-76.

arbitration provision, everything else goes to the validity of the contract, and the arbitration provision is severable. Thus, in one fell swoop the Ninth Circuit has managed to clear the traditional confusion concerning "existence" and validity, and to reconcile *Prima Paint* with a long line of seemingly conflicting cases.

*B. Directives for Drafting with Respect to Arbitration*

The Ninth Circuit's decision allows individuals to select their own "decision" system for all issues, restricted only by judicial review of whether the agreement to arbitrate is valid. Thus, whether a dispute will be arbitrated or judicially determined has become a matter of choice. It is therefore imperative that contracting parties planning to include an arbitration clause in the contract fully understand that clause's implications.

In *Standard Fruit*, the Ninth Circuit noted that the FAA is phrased in mandatory terms and leaves no room for discretion. Parties will be directed to arbitrate on issues as to which an arbitration agreement has been made and signed.<sup>140</sup> Although arbitration agreements are to be "rigorously enforce[d],"<sup>141</sup> the policy behind this enforcement is described as a "liberal" means of ensuring private contracting rights.<sup>142</sup>

The Ninth Circuit indicates that intent of the parties is paramount, noting that a court's primary concern is to effectuate the parties' intentions, as in other contracting situations.<sup>143</sup> In observance of the Supreme Court's presumption of arbitrability, the Ninth Circuit warns "that the most minimal indication . . . of intent to arbitrate" will be construed in favor of arbitration.<sup>144</sup> This liberal construction in favor of arbitration relates back to the FAA's underlying purpose of ensuring that arbitration agreements receive guarantees of enforcement equal to all other private contracts.<sup>145</sup> Courts find the

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<sup>140</sup> *Id.* at 475; *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218 (1985).

<sup>141</sup> *Standard Fruit*, 937 F.2d at 475 (quoting *Byrd*, 470 U.S. at 221).

<sup>142</sup> *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985) (describing the liberal federal policy favoring arbitration agreements and noting that in reality it is a policy guaranteeing enforcement of private contracts); *accord Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983).

<sup>143</sup> *Standard Fruit*, 937 F.2d at 475; *Mitsubishi*, 473 U.S. at 626.

<sup>144</sup> *Standard Fruit*, 937 F.2d at 478; *accord Bauhina Corp. v. China Nat'l Machinery & Equip. Import & Export Corp.*, 819 F.2d 247 (9th Cir. 1987) (arbitration ordered even though the contract contained two incomplete and contradictory arbitration clauses); *Mediterranean Enterprises, Inc. v. Ssangyong Corp.*, 708 F.2d 1458, 1462-63 (9th Cir. 1983) (broadly construing scope of arbitration clause under the FAA).

<sup>145</sup> *See* H.R. REP. No. 96, *supra* note 39.

intention to arbitrate in the arbitration clause. In accordance with the emphatic federal policy in favor of arbitration, courts will interpret the scope of the disputes covered by the clause liberally.<sup>146</sup> Finally, courts will resolve any doubts concerning arbitrability in favor of arbitration.<sup>147</sup> This principle applies whether the uncertainty involves the construction of the language of the clause itself or a defense to arbitrability.<sup>148</sup>

Severability of the arbitration clause also turns upon the scope of disputes covered by the arbitration clause. In *Standard Fruit*, the Ninth Circuit determined that *Prima Paint* demands that all arbitration clauses will be severable unless clear intentions to the contrary are evident.<sup>149</sup> Thus, unless the clause fails to cover the dispute in issue, the arbitration clause will be severable and enforceable.

In *Standard Fruit*, the arbitration clause provided that "any and all disputes arising under the arrangements contemplated hereunder" would be referred to arbitration.<sup>150</sup> Accordingly, the court construed the broad language in light of the *Prima Paint* severability rule and the strong presumption favoring arbitration in international disputes, and held that the breach of contract claim was arbitrable.<sup>151</sup> The court found no evidence that the provision was intended to be non-severable and concluded that strict enforcement of the arbitration agreement was warranted.<sup>152</sup>

*Standard Fruit* provides a clear directive for drafting strategy. To ensure that the arbitration clause will be severable from its container

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<sup>146</sup> *Mitsubishi*, 473 U.S. 614, 631 (1985); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974); *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972); *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1989).

<sup>147</sup> *Moses H. Cone Memorial Hospital*, 460 U.S. at 24-25; see also *French v. Merrill Lynch, Pierce, Fenner & Smith*, 784 F.2d 902, 908 (9th Cir. 1986) (an agreement susceptible of an interpretation allowing arbitration should be resolved in favor of arbitration).

<sup>148</sup> See *supra* note 80 for cases illustrating the difficulty of asserting a defense capable of avoiding arbitration.

<sup>149</sup> *Standard Fruit*, 937 F.2d at 476 (declaring that "the unmistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts") (quoting *Prima Paint Corp. v. Flood & Conklin Mfg.*, 388 U.S. 395 at 404).

<sup>150</sup> *Standard Fruit*, 937 F.2d at 473. See also *supra* note 16 for a discussion of circumstances surrounding the drafting of the clause.

<sup>151</sup> *Standard Fruit*, 937 F.2d at 480-81. The court held the clause would be enforced against C & C and Steamship. SFC was not included, as the court remanded the issue of SFC's agency and the existence of a contractual relationship to the district court.

<sup>152</sup> *Id.* at 477.



contract, thereby allowing arbitration of all disputes except for the validity of the arbitration clause itself, parties should draft a broad arbitration clause. For example, a broad arbitration clause would provide for the arbitration of "any and all disputes relating to or arising under this contract."<sup>153</sup> Ultimately, if a broad enough arbitration clause is used, the only issue not arbitrable once the existence of a contractual relationship is determined is the validity of the arbitration clause itself.<sup>154</sup>

Conversely, if a party prefers judicial determination of certain disputes, and only desires certain issues to be arbitrated, a narrow arbitration clause with language expressly limiting arbitration to specific factual disputes must be used. If the clause is too limited to include the dispute in issue, the requisite intent will be lacking and arbitration will accordingly be denied.<sup>155</sup> Regardless of the parties' desires as to the clause's scope, to be effective as well as consistent with the intent of the parties the arbitration agreement should provide for the applicable law to be used, the method of appointing arbitrators, the arbitrators' qualifications, and the place where the arbitration will take place.<sup>156</sup>

Thus, the FAA allows arbitration where the parties desire it, but is not so inflexible as to mandate arbitration where the parties express contrary intent. Provided that a contract contains a broad arbitration clause, and no allegations are made as to the making of the arbitration clause itself, disputes will be sent to arbitration regardless of the validity of the underlying contract.<sup>157</sup> Accordingly, arbitration has become a matter of choice; as long as parties make their intentions clear when drafting the arbitration clause, predictability is ensured.

### C. *Standard Fruit's Impact on International Trade*

Although *Standard Fruit* plainly illustrates the new predictability possible in contracting to arbitrate, the decision is even more sig-

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<sup>153</sup> For examples of clauses held to be broad and narrow arbitration by the courts, see *supra* notes 91-92.

<sup>154</sup> 9 U.S.C. § 4 (1982). See *supra* note 43, which sets out the relevant portion of the section.

<sup>155</sup> *Standard Fruit*, 937 F.2d at 477 (the issue of arbitrability "is to be determined by the contract entered into by the parties.") (quoting *Drake Bakeries v. Local 50, Am. Bakery & Confectionery Workers Int'l.*, 370 U.S. 254, 256 (1962)); accord *AT&T Technologies v. Communication Workers of America*, 475 U.S. 643, 648-49 (1986).

<sup>156</sup> See Lord, *supra* note 109, at 227 (discussing the essential elements in drafting an arbitration agreement).

<sup>157</sup> Parties must not dispute the existence of a contractual relationship, however.

nificant in light of its potential impact on the international business community. It is universally agreed that the "emphatic federal policy in favor of arbitral dispute resolution applies with special force in the field of international commerce."<sup>158</sup> When international companies commit themselves to arbitrate, they are in reality attempting to secure a forum for the resolution of disputes. Thus, the Ninth Circuit noted that agreements to arbitrate warrant great deference as they operate as both choice-of-forum and choice-of-law provisions, offering stability and predictability regardless of the vagaries of local law.<sup>159</sup> Moreover, the Supreme Court has emphasized the importance of this guaranteed stability, declaring that "[t]he elimination of all such uncertainties by agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade, commerce, and contracting."<sup>160</sup>

The recent line of Supreme Court decisions regarding international arbitration reflects a strong concern for the viability of international commerce and a desire to establish a nonparochial judicial stance towards arbitration.<sup>161</sup> The Court observed that "[a] parochial refusal . . . to enforce an international arbitration agreement . . . would invite unseemly and mutually destructive jockeying . . . to secure tactical litigation advantages."<sup>162</sup> The "mutually destructive jockeying" the Court warns of would in effect be a race between the parties to find a forum. As a result, the action might be submitted to a forum hostile to one of the parties' interests or unfamiliar with the issue in dispute.<sup>163</sup> Underlying the pro-arbitration reasoning advanced by the Supreme Court and the Ninth Circuit in *Standard Fruit* lies a realization that the growth of international trade depends upon contracting parties' ability to ensure neutrality and predictability when

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<sup>158</sup> *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985); *Scherk v. Alberto Culver Co.*, 417 U.S. 506 (1974); *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 15 (1972); *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1989).

<sup>159</sup> *Standard Fruit*, 937 F.2d at 478.

<sup>160</sup> *Scherk*, 417 U.S. at 518 (quoting *Bremen*, 407 U.S. at 13-14). The Court also observed that an agreement to arbitrate before a specified tribunal was "in effect a specialized kind of forum-selection clause, selecting not only the location for dispute resolution, but also the procedure to be used in resolving the dispute." 417 U.S. at 519.

<sup>161</sup> *Bremen*, 407 U.S. at 12; *Scherk v. Alberto-Culver Co.*, 417 U.S. at 519.

<sup>162</sup> *Scherk*, 417 U.S. at 516-17.

<sup>163</sup> *Id.* at 519-20.

resolving international disputes through judicial deference to the parties' agreement.<sup>164</sup>

This newfound ability to ensure neutrality and predictability in international commercial arbitration will have an enormous impact on the use of arbitration provisions, and in turn an even more significant impact on the growth of international trade. As modern nations maintain their day-to-day relations largely through commerce, the most significant impact of international commercial arbitration may be its contribution to world peace and stability.<sup>165</sup> Presently, it is increased world trade, and not politics, that is making the largest contribution to world peace, and that growth in trade is being accomplished through international arbitration.<sup>166</sup>

#### IV. CONCLUSION

Specific legislative enactments, international commitments, and broad judicial pronouncements in the United States seem to mandate the honoring of arbitration agreements in commercial contracts, particularly those that are international in scope. The Ninth Circuit affirmed the policy of holding parties to their arbitration agreements and, on a broader scale, held that the arbitral process is capable of deciding all issues save the validity of the arbitration agreement. However, the Ninth Circuit has constricted recent expansive interpretations of *Prima Paint* by insisting that before the arbitration clause is severable, existence of a contractual relationship must first be established.

Although the Ninth Circuit has effectively drawn the long-awaited line between the point where the existence of a contract ends and its validity begins, it has gone beyond the express permission of the FAA in doing so. Accordingly, it is crucial that future courts facing similar issues be careful to leave that line where it is. Should the courts begin pushing that line limiting determination of a contract's existence too far in the direction of contract validity, such an impermissible stretch of the FAA's language could result in a gradual reversal of the trend toward favoring liberal construction of arbitra-

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<sup>164</sup> Pietrowski, *supra* note 51, at 59-61.

<sup>165</sup> Michalle F. Hoellering, *International Commercial Arbitration: A Peaceful Method of Dispute Settlement*, *ARB. J.*, Dec. 1985, at 19, 19-20. The author also noted that "[e]ven between countries with antagonistic policies, trade continues. International commerce may not directly avoid all war, but it certainly creates interdependence and balance."

<sup>166</sup> *Id.* at 19.

tion agreements. The unfortunate result could be judicial refusal to permit arbitration of claims concerning a contract's validity.

*Jennifer Bagwell*