NOTES

THE GROWING ROLE OF CUSTOMIZED CONSENT IN INTERNATIONAL COMMERCIAL ARBITRATION

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I. HOW CHELSEA GOT BITTEN BY THE ARBITRAL SHARK

1996 was an exciting year for James Pitts. He recently had formed a partnership with Kenneth Lazar and Lester Gribetz to import textiles into the United States. The three called their partnership Chelsea Square Textiles (Chelsea), and they experienced immediate success. Simultaneously, Chelsea arranged a lucrative relationship with Bed, Bath, and Beyond (BB&B), a large American retailer. The relationship was an exclusive agreement for which Chelsea would provide BB&B hundreds of thousands of dollars in finished linen textile products. In order to fulfill this agreement, Chelsea contacted several Indian manufacturers, one of which was Bombay Dyeing and Manufacturing Company (BD&MC). A sales relationship was arranged, and BD&MC began shipping.

From the start, BD&MC's relationship with Chelsea experienced difficulties. The textile company was not able to fill the quantity of orders requested by BB&B. Orders that did arrive were often incorrect. After numerous difficulties, BB&B sued Chelsea for breach. Subsequently, Chelsea initiated a U.S. federal court action against BD&MC.

To Chelsea's surprise, BD&MC served Chelsea with a notice to attend an Indian arbitration. BD&MC pointed to a faintly visible clause on the reverse side of their standard invoices that required dispute settlement via Indian arbitration. James Pitts took the dispute regarding the clause to U.S. District Court. The court agreed with Pitts, saying that an incomprehensible arbitration clause is not binding. Upon appeal, the Second Circuit reversed, holding that industry custom dictates arbitration, and, barring objection to the provision, such arbitration is not avoidable. This required Pitts to travel to India and defend his claim before an industry appointed arbitration panel.

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2 See id.
3 See id.
4 See id.
5 See Chelsea Square Textiles, Inc., 189 F.3d at 293.
6 See id.
7 See id. at 294.
8 See id.
9 See Chelsea Square Textiles, Inc., 189 F.3d at 293-94.
10 See id. at 294.
11 See id.
12 See id. at 296 (noting the district court's findings).
13 See id. at 296-97.
The most fundamental tenant of arbitration is the notion of voluntarily entering into a means of dispute settlement. In *Chelsea*, the Second Circuit held that industry custom dictates the use of arbitration, and hence, mutuality amongst industry members is presumed. The court’s fictional mutuality eliminates the notion of voluntary agreement. The absence of agreement makes the method of dispute settlement involuntary and thereby removes the premise of arbitration. In effect, the Second Circuit held that mutuality to contract for arbitration was not necessary: industry custom is enough.14

This note will proceed by discussing the history and likely future of arbitration. Next, it will analyze the role of mutuality in an arbitration clause. However, because mutuality is often difficult to ascertain, the note will then discuss what international norms present as an effective arbitration clause. Finally, the author will contrast the above issues to conclude that a mutual agreement to arbitrate is a necessary component of arbitration.

II. ARBITRAL HISTORY

The world has used arbitration for centuries,15 but the increase in use of arbitration over the past twenty years has been dramatic. European governments and organizations and the United States Supreme Court diligently and consistently encourage expansion.16 A 1989 American study demonstrated that between 1983 and 1988, commercial arbitration rose 84 percent.17 Arbitral expansion is not limited to the traditional commercial world powers. Latin America, Asia, and Africa are other regions, which have turned to international

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14 See id. at 297.
arbitration. The worldwide increase in arbitration is not a one-time phenomenon, and so long as commercial parties are dissatisfied with litigation, arbitration will flourish.

Perhaps because of its long-lived, widespread, and rapidly growing use, definitions of arbitration’s purpose are not always consistent. One well known scholar, for example, describes arbitration as “a process by which parties voluntarily refer their disputes to an impartial third person, an arbitrator, selected by them for a decision based on the evidence and arguments presented before the arbitration tribunal.” Another scholar alternatively describes the process as “a system that is created by the parties themselves. Arbitration is the submission of a disagreement to one or more impartial persons with the understanding that the parties will abide by the arbitrator’s decision.”

Regardless of which definition one uses, the motivation to arbitrate remains the same: dispute resolution outside of litigation often decreases time and expense while providing more beneficial remedies to all involved parties.

Traditionally, U.S. common law did not enforce arbitral agreements until an award was rendered. But, primarily because companies viewed litigation as expensive, time consuming and unreliable, Congress began to look at arbitration as an alternative to traditional dispute resolution. Arbitration was a concept many other countries had already employed, and therefore, it was a natural solution to the heavily burdened U.S. courts. In order to relieve this case load burden, representatives from the American Bar Association proposed


20 ROBERT COULSON, BUSINESS ARBITRATION—WHAT YOU NEED TO KNOW 6 (1980).

21 See Clive M. Schmitthoff, Why Arbitration is the Favored Method of Dispute Resolution, FIN. TIMES LIMITED, Oct. 4, 1985, § II at 29 (demonstrating that in addition to saving time and money, arbitration allows parties to select appropriate judges and enjoy privacy); cf. Wall Street’s Arbitration System: Friend or Foe?, N.Y. TIMES, Dec. 24, 1989, § 3 at 1 (noting differing opinions regarding benefits of securities arbitration).

22 See DOMKE, supra note 19, at 22.


24 See GOLDBERG, supra note 15, at 235.
that Congress model a federal alternative dispute resolution bill after the 1920 New York Arbitration Statute.\textsuperscript{25}

III. THE FEDERAL ARBITRATION ACT AND MODERN UNITED STATES ARBITRATION

In 1924, the Federal Arbitration Act (FAA) passed both the House of Representatives and Senate with little opposition.\textsuperscript{26} In fact, supporters for the FAA remarked on several occasions that agreement concerning the FAA was almost universal.\textsuperscript{27} In 1925, the U.S. Federal Arbitration Act (FAA) was officially enacted.\textsuperscript{28} The far-reaching scope of the FAA became most apparent when, in 1983, the Supreme Court commented, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability."\textsuperscript{29}

Today, arbitration is so popular among U.S. legislators that Congress has enacted several pilot programs, which do not require mutuality of contract in arbitration agreements.\textsuperscript{30} Congressional experiments have required industries as large as local telephone service providers, to resort to arbitration for dispute settlement rather than to utilize the courts. Through the FAA, Congress and the U.S. Supreme Court continuously promote "a national policy favoring arbitration."\textsuperscript{31}

Further, U.S. courts have determined the arbitral bias to be even stronger in international transactions.\textsuperscript{32} In a 1992 benchmark decision, Judge Feinberg of the Court of Appeals for the Second Circuit noted that arbitration reduces

\textsuperscript{25} See Born, supra note 23, at 29-30. See also New York Arbitration Law, 1920 N.Y. Laws 275, §§1-10.
\textsuperscript{26} See Born, supra note 23, at 29-30.
\textsuperscript{27} See id. at 30, n.144.
\textsuperscript{32} See Deloitte Noraudit A/S v. Deloitte Haskins & Sells, 9 F.3d 1060, 1063 (2d Cir. 1993).
costs and delays associated with traditional litigation. Because such costs are often higher when engaged in international disputes, a strong federal policy favoring international arbitration has emerged.

Chelsea Square Textiles, however, was forced into arbitration in an Indian forum. Unfortunately, in modern American jurisdictions, this is not surprising. Because arbitration is becoming such a popular means of dispute settlement, court-imposed arbitration increasingly oversteps its bounds. Especially in international transaction cases, more and more U.S. courts are finding that mutuality of contract is not strictly required to arbitrate.

The rules and regulations regarding international arbitration are by no means identical among foreign governing bodies. The majority of arbitral institutions, however, rely on certain consistent underlying precepts. Because of the diversity of foreign and international code concerning arbitration, this portion of the commentary will center on U.S. arbitration and the international impact of the FAA.

The mainstay of the FAA is Section 2, which provides that all arbitration agreements involving interstate and foreign commerce “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” Section 1 defines commerce as applicable to commercial arbitration. Section 3 requires that arbitrable issues brought before a U.S. court be stayed, pending the results of the arbitration.

The FAA continues by (1) including allowances for failure to partake in an agreed arbitration; (2) giving a court power to appoint an arbitrator; (3) denoting correct arbitral procedures; (4) describing arbitral awards; (5) excluding arbitration agreements made prior to 1926; and (6) defining allowable appeals.


See Deloitte Noraudit A/S, 9 F.3d at 1063.

See id. (expanding international arbitration).


Within the past thirty years, two major amendments to the FAA have been made as a result of international agreements. Chapter 2, drafted in 1970, incorporates the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.\textsuperscript{45} Similarly, Chapter 3, added in 1990, enforces the Inter-American Convention on International Commercial Arbitration.\textsuperscript{46}

Despite the FAA's inclusiveness, the Act fails to give strong guidance on what constitutes mutuality in the arbitration agreement. The only requirement mentioned in Title IX of the U.S. Code is that the agreement to arbitrate must be in writing.\textsuperscript{47} Because arbitration proceedings are not governed by the evolving concepts of common law, Congress' failure to include strong guidance on what constitutes mutuality has led to confusion.

As a solution to this problem, the U.S. Supreme Court takes an actively expansive approach in deciding on the appropriateness of arbitration.\textsuperscript{48} The precepts behind this expansion of arbitration seem sound. Arbitration reduces the federal case load, while presumably saving interested parties the time and money associated with traditional litigation.\textsuperscript{49} Often, arbitration decisions lead to a more efficient resolution as well.\textsuperscript{50}

Unfortunately, the Court has gone too far in expanding arbitration.\textsuperscript{51} For example, former Chief Justice Warren E. Burger, usually viewed as a judicial conservative upholding the limitations of statutes, authored the opinion in \textit{Southland Corp. v. Keating}.\textsuperscript{52} With this opinion, the Court expanded the FAA

\textsuperscript{45} See 9 U.S.C. ch. 2 (1925).
\textsuperscript{46} See 9 U.S.C. ch. 3 (1925).
\textsuperscript{47} See 9 U.S.C. § 3 (1925) (requiring arbitration agreements to be in writing).
\textsuperscript{48} See Moses H. Cone Mem'l Hosp., 460 U.S. at 24.
\textsuperscript{49} See \textit{GOLDBERG, supra} note 15, at 234. \textit{See also} Eva Muller, \textit{Fast-Track Arbitration—Meeting the Demands for the Next Millennium}, 15 J. INT'L ARB. 5, 5-6 (Sept. 1998) (presenting negatives and positives of arbitration).
\textsuperscript{50} See \textit{GOLDBERG, supra} note 15, at 233-Sup.35.
\textsuperscript{51} See Moses H. Cone Mem'l Hosp., 460 U.S. at 24. \textit{See also} Del E. Webb Constr. v. Richardson Hosp. Authority, 823 F.2d 145, 147-48 (5th Cir. 1987) (favoring "related to" contracts test over "substantial" test in order to promote strong policy favoring arbitration); Allied-Bruce Terminix Companies, Inc. v. Dobson, 523 U.S. 265 (1995); \textit{see also} Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979); Brolan v. United States 236 U.S. 216 (1915) (noting that Congress' power to regulate foreign commerce is greater than their power to regulate state commerce); Interstate/Johnson Lane, Corp. v. Gilmer, 500 U.S. 20 (1991) (expanding arbitration to include employment despite 9 U.S.C. § 1); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 628-29 (1985) (allowing arbitration in antitrust suits); Doctor's Assocs. v. Casarotto, 517 U.S. 681 (1996) (stating that a Montana State law requiring notice of arbitration provision be placed on front of a contract is preempted by the FAA).
\textsuperscript{52} See Jeffrey W. Stempel, \textit{Securities Arbitration: A Decade After McMahon: Bootstrapping}
to override all state law. Other traditionally conservative members of the Court have also drastically expanded the FAA. Chief Justice Rehnquist, normally a staunch judicial conservative, has offered little support to stall wholesale arbitral expansion. Similarly, Justice Antonin Scalia, commonly known to defend the original intentions of statute, has said little to limit arbitration.

With the decision in Moses H. Cone Memorial Hospital v. Mercury Construction Corp., the Court strongly supported a “liberal federal policy favoring arbitration agreements.” Although 9 U.S.C. section 1 mandates that only cases involving commerce are subject to the FAA, the Court has gone so far as to require arbitration when there is any doubt at all as to an arbitration agreement in commerce. The difficulty with this rapid expansion is that it benefits large, experienced companies but severely disadvantages consumers and smaller, less experienced companies. Legal commentators have been quick to alarm. One author notes:

[F]rom a practical standpoint, the arbitration clauses are crucial in that they not only bar judicial relief but also may allow companies to select the arbitrators, set the arbitration in a location convenient for the company but not for the little guy, exclude certain recoveries such as punitive damages, shorten the statute of limitations, deny discovery and other procedural protections, and eliminate virtually any right to appeal.


53 See Granny Goose Foods, Inc. v. Brotherhood of Teamsters & Auto Truck Drivers, 415 U.S. 423, 429, 445 (1974) (Rehnquist concurring that 9th Circuit was correct in holding that a federal court could dissolve strike and order arbitration) (Rehnquist, J.).

54 See AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 727 (1999) (noting that 47 U.S.C. § 251(c) makes arbitration regarding use of telephone cable mandatory so long as one party is unsatisfied with previous bargaining results (Scalia, J.)).


56 See id.


58 Jean R. Sternlight, Panacea or Corporate Tool: Debunking the Supreme Court’s
Another scholar, Thomas Carbonneau, concurs:

The Court’s willingness to curtail major constitutional and political interests—such as states’ rights and federalism, civil rights, federal regulatory authority over the marketplace, and generally, due process guarantees—to bolster arbitration benefits neither the legal culture nor, in the long run, the institution of arbitration itself.59 Carbonneau continues his criticism of Supreme Court policies by stating “the quality of the Court’s reasoning in these cases detracts from the credibility of the announced doctrine.”60 Carbonneau argues that the Supreme Court is treating arbitration as an extension of the trial.61 Such an extension has an adverse effect upon the integrity of the U.S. legal system.62 The Court continued to overstep its bounds by severely limiting all state and federal courts to a confining international and domestic arbitration policy.63 One example is antitrust claims. Despite the legal complexity of antitrust claims, the Supreme Court believes that arbitrators, not courts, should decide such disputes.64 By demanding that arbitration always be suitable, the U.S. Supreme Court places burdens in the hands of arbitrators who are not capable of the strict formality of law.65 The inconsistencies that result will only have adverse effects upon the entire legal system.66 Hence, arbitration is not suitable in every situation.

IV. CHELSEA WAS NO SURPRISE

The Second Circuit’s decision in Chelsea was not necessarily unmerited. In fact, some very real reasons prompted the decision to hold Chelsea liable for an arbitration contract. After all, Chelsea did have a makeshift arbitration

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59 Carbonneau, supra note 57, at 1957.
60 See id.
61 See id. at 1954-56.
62 See id.
63 See id. at 1952.
64 See Mitsubishi Motors Corp., 473 U.S. at 636-37.
65 See Carbonneau, supra note 57, at 1957-60.
66 See id.
The Second Circuit noted that although the agreement concerning the articles in question was illegible, a legible agreement could be pieced together from the numerous transactions that Chelsea had previously initiated with BD&MC. In fact, the court used at least thirteen separate receipts to approximate the wording of the single arbitration clause. Realistically, this seems a bit demanding on the time of small business owners. Due to a lack of time and resources, few sole proprietors read the reverse side of each one of their companies’ sales receipts. Fewer have the legal knowledge to decipher any but the most basic legal agreement. By holding that illegible, garbled, conditions on the reverse side of an invoice constitute valid arbitration stipulations, the court places enormous power in the hands of the promisor. Any well-versed lawyer could draft sales conditions incomprehensible to buyers and place them on the reverse side of sales receipts.

In addition to Chelsea, several other U.S. cases indicate that mutuality is not necessary to arbitral proceedings. Furthermore, internationally sanctioned arbitration is rapidly becoming the standard, not the exception. There is a concern about the possibility of industry custom supplanting mutuality in the context of the arbitration agreement.

Arbitration is based on the notion of a mutually agreed upon alternative to litigation. Arbitration is supposed to be a consensual process, not an industry-mandated obligation. As in any other contractual stipulation, the agreement to arbitrate should represent more than a “meeting of the minds.” By continuously expanding the presumption of mutuality in the formation of the agreement, national and foreign courts risk inconsistent approaches to the presumption of a mutual agreement to arbitrate.

In particular, one such opportunity for inconsistency is what the Second Circuit has dubbed “custom.” The court argues that when industries have customary arbitration allowances, contracting parties are presumed to have knowledge of such agreements and are, therefore, subject to compulsory

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67 See Chelsea Square Textiles, Inc., 189 F.3d at 293.
68 See id. at 292-93.
69 See Moses H. Cone Mem'l Hosp., 460 U.S. 1 (demonstrating the Supreme Court's preference of arbitration in cases of questionable arbitration agreements).
71 See E. ALLEN FARNsworth, CONTRACTS § 3.6 (3d ed. 1999) (citing Hotchkiss v. Nat'l City Bank, 200 F. 287, 293 (S.D.N.Y. 1911), aff'd, 201 F. 664 (2d Cir. 1912), aff'd, 231 U.S. 50 (1913) (defining contract as a written obligation, enforceable by law, which accompanies and represents a known intent)).
72 See Chelsea Square Textiles, Inc., 189 F.3d at 296-97.
The U.S. securities industry provides one example of how the Second Circuit intends to define "custom" to determine mutuality in arbitration agreements. This note will proceed by discussing expansion of U.S. arbitration proceedings. The U.S. securities industry will be used to demonstrate the many difficulties that arise when using industry custom as the basis for arbitral agreement. Next, the author will analyze the role of custom from an international perspective. Finally, the author will return to Chelsea and analyze the Second Circuit's discussion of industry custom.

V. THE U.S. SECURITIES INDUSTRIES AND MANDATORY ARBITRATION

With several lenient decisions in the 1980's regarding civil rights and age discrimination, the Supreme Court set the stage for the securities arbitration industry. As a result, the National Association of Securities Dealers (NASD) has published an extensive arbitration procedure manual. The manual is written in legalese and requires a lawyer to decipher, rather than a businessman.

Part one, section one of the manual mandates that claims arising from "connection with the business with any member of the Association . . . (1) between or among members; (2) between or among members and public customers, or others"; and amongst associated registered agencies are subject to arbitration. Similarly, the New York Stock Exchange, in its arbitration manual, states that "[a]ny controversy between parties who are members, allied members or member organizations . . . shall at the instance of any such party, be submitted to arbitration . . ."
The current status of the securities arbitration system leaves little doubt that arbitration does not extend from a consensual agreement to contract, but rather one party's desire to remove a disputed situation from the traditional means of legal dispute: litigation. The Court suggests that the established custom of the industry, i.e., referring disputes to arbitration, is enough to require all securities related disputes to be subject to arbitration. This custom not only conflicts with the Seventh Amendment right to a jury trial, but also undermines the original purpose of arbitration. By allowing the securities industries to proclaim arbitration as industry custom, the Supreme Court places insurmountable power in the hands of the large, wealthy American securities companies and leaves the little man with little recourse.

The arbitration custom in the securities industries places too much power in the hands of large corporations. For example, in *Gilmer v. Interstate/Johnson Lane*, the plaintiff, a broker, was held to agree to arbitration because he registered with several stock exchanges, which had arbitration agreements in their registration applications. Gilmer's suit was based upon termination as a result of unlawful age discrimination. Despite the FAA's restriction of arbitration and employment, the Supreme Court held that the plaintiff's agreement with the exchange compelled arbitration with the corporation being sued. In essence, the Court's decision mandates that any suit by a broker against an exchange member firm is required to go to arbitration. The Supreme Court in essence takes away securities brokers' rights to a jury trial.

In defense of this action, Justice White points toward the plaintiff's experience in the industry. White states, "There is no indication in this case, however, that Gilmer, an experienced business man, was coerced or defrauded into agreeing to the arbitration clause in his registration application... this claim of unequal bargaining power is best left for resolution in specific

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78 See Gilmer, 500 U.S. at 30-35.
79 See U.S. CONST. amend. VII ("In Suits at common law, where the value in controversy shall exceed twenty dollars, the right to trial by jury shall be preserved, and no fact tried by a jury shall be otherwise re-examined in any Court of the United States, than according to the rules of common law."); see also *Beacon Theatres v. Westover*, 359 U.S. 500 (1959) (requiring jury trial of all legal claims before bench trial of equitable claims).
80 See Gilmer, 500 U.S. at 20.
81 See *id.* at 20-21.
82 See 9 U.S.C. § 1 (1994) (stating that Title IX shall not apply to any class of worker engaged in foreign or interstate commerce).
83 See Gilmer, 500 U.S. at 33-35.
84 See *id.*
85 See *id.* at 31.
cases. Justice White forgets that in order to become an associated member of the NASD and therefore, a publicly traded securities broker, the plaintiff, was required to subject himself to compulsory arbitration. In addition, White fails to realize that in order to sustain a claim of unequal bargaining power a plaintiff must first undergo arbitration. Further, White should realize that a federal court could only hear appeals in very specific instances. Perhaps, Justice White knows that few appeals are heard, and fewer are reversed.

In *Gilmer*, Justice White fails to address a key issue: was the claimant aware of the agreement. White implies that industry custom, personal experience, or trade usage dictates that the claimant did know of such an agreement. However, this statement leads to a difficult impasse: experience trading securities does not equate to knowledge of employment related arbitration agreements.

Justice White's decision provokes many interesting questions. Would the scenario be different if the broker had been located half-way around the world? What if the situation arose from a customer complaint (a customer who had experience dealing with stocks and wished to take the industry to court)? Does the *Gilmer* decision mandate arbitration in all security disputes? No good answers exist for these questions. By relying on personal experience and custom to justify the existence of an arbitration agreement, mutuality is destroyed. The best solution coincides with a basic precept of arbitration: two parties must demonstrate arbitrable intent by agreeing in writing.

In addition to adversely affecting industry brokers, the NASD's arbitration policy extends to all customers of NASD members. The NYSE and NASD have effectively eliminated the Seventh Amendment right to a jury trial, and the Supreme Court has supported this action. Additionally, the arbitration customs installed by both groups give the industry unprecedented power. The

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86 See id.

87 See NASD Code of Arbitration Procedure, supra note 75, at 195, § 1. See also NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., NASD MANUAL 1101, ¶ 1121, § 1(a)-(b) (1991) (stating that only registered persons are qualified to be members are associates of members) [hereinafter NASD MANUAL].

88 See NASD Code of Arbitration Procedure, supra note 75, at 195, § 1 (requiring all NASD member related disputes be subject to arbitration). See also 9 U.S.C. § 16 (1925) (allowing appeal only in qualified situations).


91 See NASD Code of Arbitration Procedure, supra note 75, at 195, § 1 (extending compulsory arbitration to all NASD members customers).

92 For examples of the Supreme Court limiting the right to a jury trial within the securities industry, see supra note 74.
NASD arbitration agreement manual includes provision for forum selections, arbitrator selection, and choice of law selections. Forums are chosen for the convenience of the industries; arbitrators chosen are employees of the industry; and, the applicable law was written by the industry. These "agreements" approach the level of unconscionable contracts. Securities arbitration dictates that if one chooses to trade shares of publicly held companies in the United States, one will be subject to the whim of the securities industries.

Even if these fallacies did not exist, there remain compelling reasons as to why the customs of the securities industry should not dictate arbitration. The primary motivation for dispute resolution outside of litigation is that it often decreases time and expense while providing more beneficial remedies to all involved parties. Secondly, such resolutions decrease caseload burdens on courts. By allowing custom to dominate the securities industry, we remove the primary motivation to arbitrate in the first place. To be an effective alternative to litigation, arbitration should save both parties time and expense. Securities arbitration may eliminate the time and court costs that big industry faces in settling legal disputes, but what about the little man? There are few benefits in travelling to a foreign environment and bringing a claim before an arbitrator who is appointed and paid by the competition.

For example, the NASD requires all disputes to be settled, (1) by arbitrators who are paid by the NASD and (2) in forums funded by the NASD. If an individual investor brings action against the NASD for an activity relating to a security transaction, the investor must abide by the NASD arbitration policy. Hence, an individual investor may be required to travel to a distant forum and would be required to bring action before an industry funded arbitrator. The securities industry in the United States, however, is not the only industry to exploit custom and trade usage via arbitration. International arbitration is also teetering toward the customary brink.

93 See NASD Code of Arbitration Procedure, supra note 75, at 205, § 26 (stating that a claimant will be notified of place of arbitration by the Director of Arbitration "at least eight (8) business days prior to the date fixed for the hearing . . ." Id.).
94 See id. at 196, § 3 (requiring arbitration to proceed under director of arbitration appointed by NASD).
95 See id. at 198, § 12 (stating that all disputes will be arbitrable according to code set forth under NASD Code of Arbitration Procedure).
96 See id. at 195, § 1.
97 See GOLDBERG, supra note 15, at 234.
98 See id.
100 See id. at 197, § 8.
VI. UNCITRAL AND TRADE USAGE

The U.S. trend towards using industry custom as the basis for arbitration is slowly expanding throughout the world. In 1985, the United Nations Commission on International Trade Law (UNCITRAL) published its model law on international arbitration, currently accepted by the more than seventy member states. By building on earlier international arbitration agreements, namely, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 and UNCITRAL Arbitration Rules drafted in 1976, the UNCITRAL model law progressively seeks to expand and clarify the use of arbitration.

The main goal of the United Nations in adopting its UNCITRAL Model Arbitration Law was to provide a process of modernization and unification concerning international arbitration practices. The United Nations hoped that by providing such a template, states in need of developed, comprehensive, and appropriate arbitration laws would turn to the Model Law as an example. By encouraging all countries to turn to the Model Law, the UN had ambitions of establishing an international system of dispute resolution.

A large measure of the effectiveness of the Model Law lies in Article 28, defining the applicable dispute rules, and in Article 7, defining the form of an enforceable arbitration agreement. These two articles are often examined together to determine whether or not a valid arbitration agreement exists. While not directly aimed at using custom as a means of determining an arbitration contract, the two articles combine to suggest that custom is in fact a legitimate means of evaluating the existence of an alleged arbitration agreement. Article 7 focuses on the actual form of the agreement:

The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the

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101 See UNCITRAL Model Law on International Commercial Arbitration, supra note 16.
105 See HOLTZMAN & NEUHAUS, supra note 102, at forward.
106 See id.
107 See id.
parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defense in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract.  

On the surface, Article 7, section 2, appears to be straightforward, but the general wording has resulted in numerous commentaries. Foreign courts have been unable to consistently apply Article 7(2) because it leaves too much room for interpretation. For example, Article 7 seems to suggest that virtually any signed commercial transaction (that even hints at arbitration) constitutes an arbitration agreement. International courts have had great difficulty in reconciling the "in writing" requirement with the "signed"

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109 See id., at art. 7(2).


112 See UNCITRAL Model Law on International Commercial Arbitration, supra note 16, at art. 7(2).
requirement. Further, great difficulties arise when courts have examined arbitration agreements contained in a bill of sale, bill of lading, or product order.

Whereas UNCITRAL Model Law often prohibits unsigned sales receipts as valid arbitration agreements, the model law is not so forgiving when it comes to industry custom. While the "in writing" requirement often leads to confusion regarding international and industrial custom, a major problem with Article 7 is the "reference" language. It is often said that Article 7 requires nothing more than a written demonstration that the contracting parties intended to incorporate the arbitration clause into the contract. Surprisingly the model seems lenient in dealing with documents outside of the contract.

In order to incorporate an arbitration clause from a separate written entity into the questioned contract, Article 7 only requires that the questioned contract

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113 See Secretariat Study on the New York Convention, U.N. Doc. A/CN.9/168 (1979). See also Oberster Gerichtshof, 1976 Y.B. COMM’L ARB. 183 (demonstrating that Austria considered an exchange of telex’s as a valid arbitration clause); Israel Chemicals & Phosphates Ltd. v. N.V. Algemene Oliehandel Arrondissementsrechtbank, 1976 Y.B. COMM. ARB. 195 (showing a Dutch court’s decision that an arbitration agreement was valid even though it was not signed by the accepting party because the accepting party had reason to know of the existence and did not object to the clause); cf. Corte di Cassazione, 1979 Y.B. COMM. ARB. 296, 300 (demonstrating Italy’s reluctance to find an arbitration clause where both parties had not demonstrated clear intent to be bound by said clause). Compare Corte di Appello di Firenze, 1979 Y.B. COMM’L ARB. 289 (indicating that not all Italian courts require a clear intent to arbitrate be signed by both parties), with Basler Juristische Mitteilungen, 1979 Y.B. COMM. ARB. 309, 310 (demonstrating that signature of one party can constitute a “written agreement”), and Landgericht Zweibrueckken, 1979 Y.B. COMM’L ARB. 262, 262-63 (demonstrating that if both parties have not signed, an exchange of written communication is all that is required).


116 See Goldberg, supra note 15, at 264.

make reference to that entity.\textsuperscript{119} Foreign courts consistently hold that the questioned contract need not make reference to the outside document as an arbitration agreement.\textsuperscript{120} In other words, no mention of arbitration is required in order to incorporate arbitration language from a separate agreement into the contract in question. In effect, any contract may make reference to any, however obscure, document, and if that document contains an arbitration clause, arbitration will be mandatory. Therefore, in order to create binding arbitration agreements, a company can refer all contracts to extensive and often undecipherable company guidelines that contain arbitration agreements.

Article 28 further supports this concept of trade usage as the basis for valid arbitration agreements. Article 28, paragraph 4 states:

\begin{quote}
In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction.\textsuperscript{121}
\end{quote}

While Article 28 may have been aimed at the enforcement terms of arbitration after the validity of the agreement was decided upon, one effect of Article 28's vague language is to support arbitration agreements when their validity is questionable.

Not all of the United Nations delegates agree with the vagueness of Article 28. In fact, during the drafting of the document, the reference to trade usage was hotly debated.\textsuperscript{122} In the third draft, "usage of trade" was dropped from the Model Law.\textsuperscript{123} The reference was deleted because of "concerns related to the fact that their legal effect and qualification [are] not uniform in all legal

\textsuperscript{119} See *Secretariat Study on the New York Convention*, supra note 114, at para. 25.

\textsuperscript{120} For examples of court decisions holding that a reference to a document containing an arbitration agreement constitutes a valid arbitration agreement, see Bundesgerichtshof, 1977 Y.B. COMM’L ARB. 242, 242; *Ferrara S.p.A. v. United Grain Growers Ltd.*, 441 F. Supp. 778, 780-82 (S.D.N.Y 1977) (holding signors of contract are presumed to have knowledge of an included arbitration clause); *Coastal Trading Inc. v. Zenith Navigation S.A.*, 446 F. Supp. 330, 339 (S.D.N.Y. 1977) (determining arbitration agreement was valid even though plaintiff was not a signatory to the agreement); *Mauritius Sugar Syndicate v. Black Lion Shipping Co. S.A.*, 1 Lloyd’s Law Rep. 545, 549-51(Q.B. 1978) (holding that provision for arbitration contained in arbitral cause was brought into bill of lading).

\textsuperscript{121} See *UNCITRAL Model Law on Commercial Arbitration*, supra note 16, at art. 28, para. 4.

\textsuperscript{122} See *HOLTZMAN & NEUHAUS*, supra note 102, at 764.

However, the United States and Germany expressed strong opinions that one of the principles behind arbitration is the businessmen's desire to have disputes settled within the customs of their respective industries. After this opinion, the Article was edited, and the final draft was created. Trade usage and custom have since been entrenched in international commercial arbitration.

As in the United States, international commercial arbitration agreements offer many benefits. Arbitration reduces courts' case load, while also saving interested parties the time and money associated with traditional litigation. However, difficulties traditionally inherent in national arbitration cases are multiplied in international cases. In drafting UNCITRAL Model Law, the goal of the United Nations was to unify member states in such a way as to provide equitable guidelines for all parties involved in arbitration. Unfortunately, by allowing companies to refer to documentation not included in contracts, UNCITRAL destroyed any opportunity at providing a level playing field. Examples of the ramifications of Articles 7 and 28 in the U.S. include the securities industry and Chelsea Square Textiles. In both situations, the securities industry and the Indian textile manufacturers were able to refer all disputes to inherently biased arbitration simply by including a reference to voluminous industry created code. Such examples are not islands.

VII. ARTICLE 7: HONG KONG'S SHIELD?

Fortunately, foreign courts are slower to expand the use of arbitration than are U.S. courts. This phenomenon is most probably due to the difficulties in obtaining agreement among the diverse members of the United Nations. In light of the constant turmoil surrounding the status of arbitration, foreign businessmen would be wise to identify the hidden arbitration agreement. Foreign courts have not experienced the explosion in arbitration such as U.S. Courts have. But, be wary; the specter looms on the horizon.

One immediate United Nations concern regarding the arbitral process comes from the actual nature of the arbitration agreement. Under UNCITRAL Model Law, one important provision states that the agreement be in a signed

124 See Second Draft, supra note 123, at art. XIX.
127 See Chelsea Square Textiles, Inc., 189 F.3d 289.
writing.\textsuperscript{128} The writing requirement protects parties in interest from illegitimate arbitration claims. Such claims of arbitral contract validity, at least in U.S. Courts, are increasingly being supported by industry custom.

Difficulties in tampering with the writing requirement are apparent in many international jurisdictions,\textsuperscript{129} and Hong Kong provides some excellent examples. In a 1992 decision, the High Court of Hong Kong held that a bill of lading not signed by both parties was not a written agreement to arbitrate and hence, did not fall under UNCITRAL Model Law Article 7.\textsuperscript{130} In this case, the plaintiff, a sub-charterer, filed an action against the defendant, a ship-owner, for loss of cargo due to the vessel's sinking.\textsuperscript{131} The plaintiff filed the claim based on a bill of lading that was subject to Japanese law. The bill incorporated the arbitration clause of a transaction to which neither party was connected.\textsuperscript{132}

In order to justify their claim of a valid arbitration agreement, the defendant pointed to previous correspondence with the plaintiff. The High Court was not impressed.\textsuperscript{133} The court found that mere "party correspondence" is insufficient to constitute an arbitration agreement.\textsuperscript{134} Article 7 requires a signed agreement to arbitrate. In addition, the High Court noted that the boiler plate arbitration clause present in the bill of lading did not represent the true interests of the involved parties.\textsuperscript{135} Therefore, the High Court ruled that it would not manipulate the document to create a valid arbitration clause.\textsuperscript{136} The court dismissed the application to stay the proceedings.\textsuperscript{137}

This decision was not a long-lived precedent. Just one year later, in another bill of lading decision, the High Court of Hong Kong inconsistently held a similar agreement to be valid.\textsuperscript{138} Here, the plaintiff, a sub-charterer, also filed

\begin{footnotesize}
\begin{itemize}
  \item \textsuperscript{128} See UNCITRAL Model Law on International Commercial Arbitration, supra note 16, at art. 7(2).
  \item \textsuperscript{129} For examples of disputes regarding the writing requirement, see supra note 111.
  \item \textsuperscript{131} See id. at 273.
  \item \textsuperscript{132} See id.
  \item \textsuperscript{133} See id.
  \item \textsuperscript{134} See id. at 274.
  \item \textsuperscript{135} See id.
  \item \textsuperscript{136} See id.
  \item \textsuperscript{137} See Hissan Trading, 19 Y.B. COM. ARB. at 274.
\end{itemize}
\end{footnotesize}
a suit for lost ship cargo. The bill of lading contained an arbitration clause providing for arbitration under Chinese law and an exclusive jurisdiction clause favoring Chinese courts; the bill of lading's boiler plate language incorporated an arbitration clause to which neither party was apparently connected. This time, when the defendant sought a stay of proceedings in favor of a Chinese arbitration, the High Court found that the clause constituted a valid agreement to arbitrate.

The High Court's justification relied upon correspondence between the two parties. In spite of having diminished the role of correspondence less than one year prior, the High Court determined that the agreement was valid because the Chinese defendant could provide an unwritten record of the agreement to arbitrate.

Hong Kong legal scholars have not been silent on this apparent discrepancy. In fact, Neil Kaplan, former High Court Judge in Charge of Construction and Arbitration List, has gone so far as to question the need for a signed writing as required in Article 7. Mr. Kaplan erroneously points to a case he decided in 1994, H. Smal, Ltd. v. Goldroyce Garment, Ltd., as representative of the deficiencies in Article 7's writing requirement.

In Smal, the plaintiff claimed to have sent the defendant a purchase order containing an arbitration clause. Upon delivery, the defendant refused the goods. Plaintiff attempted to act upon the arbitration clause, but the defendant rejected the arbitration. The High Court of Hong Kong found that there was no agreement to arbitrate because the plaintiff could not produce a signed agreement containing the alleged arbitration agreement.

This decision was based on simple contract law. The Smal defendant did not have a written obligation that represented the intention to solve disputes via

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139 See id.
140 See id. at 275.
141 See id.
142 See id.
144 See id. at 27.
See Smal, 1994 HKC LEXIS 667, at *4-5
147 See id. at *1.
148 See id. at *1.
149 See id.
150 See id. at *10-11.
Mr. Kaplan, however, is appalled with this decision. He notes that "there was no doubt that the parties entered into a contract that was contained in or evidenced by the written order and B's [the defendant's] conduct." Mr. Kaplan's argument falls short. Indeed, little doubt exists that a contractual relationship existed between Smal and Goldroyce, but there is little indication that the plaintiff was aware of the alleged arbitration clause. Mr. Kaplan proclaims he is not advocating oral agreement to arbitrate, yet he criticizes the High Court's decision in Smal. The High Court rejects the Smal defendant's claim because the alleged arbitration agreement was supported merely by hearsay and conduct, not because a no record of the contract did not exist. The difficulty with Mr. Kaplan's argument for broadening Article 7 is that it would open a Pandora's box concerning what constitutes an arbitration agreement. International courts are experiencing difficulties with the precise signed writing requirement of Article 7. What would happen if we were to broaden the definition of what constitutes an arbitration agreement? One need only look to the United States for an answer. U.S. courts increasingly turn to alternative methods such as trade usage and industry custom to determine the validity of arbitration agreements. And, industry custom only compromises the integrity of arbitration.

VIII. SOME NEGATIVES OF ARBITRAL EXPANSION

The above commentary represents a critique of the international interpretation of various customs regarding what constitutes a valid agreement. However, until now, this commentary has not focused on the potential negative impacts of this unwarranted arbitral expansion. Therefore, the purpose of the following is to analyze several effects that recent arbitral expansion may have. Furthermore, these effects support a conclusion that international business would benefit most by having the international legal powers retain and restore the signed, written arbitration agreement standard.

The declining role of the writing requirement and the increasing role of industry custom in the determination of the validity of arbitration agreements

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151 See FARNSWORTH, supra note 71, at § 3.6.
152 See Kaplan, supra note 143, at 30.
153 Id.
154 See id.
156 See Kaplan, supra note 143, at 45.
157 For examples of disputes regarding the writing requirement, see supra note 111.
do not account for the cultural differences that will always be present in international trade. At the 1991 Geneva Global Arbitration Forum, one legal scholar noted that "we have seen, over the past thirty years, remarkable progress towards an assimilation of views, notions and perceptions" regarding the international procedural treatment of arbitration. Indeed, he is correct. Similar arbitral proceedings are now held throughout the world.

The difficulty with using industry custom as a basis for the formulation of international arbitration agreements is that the customs within and among countries differ. Several authors suggest that the international arbitration system is inherently biased against "non-western" countries.

In addition to creating confusion in regards to diverse cultures, basing arbitration on industry custom severely impairs the rights of the "little guy." This trend is apparent within the U.S. banking industry. Slowly and silently, many major U.S. banks have made arbitration mandatory in loan lender agreements. The agreements specify that rights granted by arbitration include, "either party's right to foreclose on real or personal property, exercise self-help, or maintain a court action for provisional or ancillary remedies." Such remedies work almost exclusively for the banks because borrowers rarely have the opportunity to use them. Furthermore, the banks hide the nature of these agreements by cloaking them in legalese. Additionally, consumers lose the benefit of publicity. Because arbitration proceedings are private, other consumers miss out on the reasoning behind actions against these banks. Also, consumers are forced into these agreements because banks have powerful market share. This phenomenon occurs because of the relative scarcity of lending institutions. All in all, this banking example illustrates the power of industry mandated arbitration. The "little guy" suffers loss of rights, and the industry gains the benefits of power.

Contrary to popular belief, customized arbitration agreements actually may increase judicial caseload burden. Proponents of compulsory arbitration claim

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159 See id. at 82. See also M. Sornarajah, *The Climate of International Arbitration*, 8 J. Int’l Arb. 47 (June 1991), at 51.
160 See id.
161 See Budnitz, supra note 57, at 268. See also *The Use of Arbitration Clauses in the Fields of Banking and Finance*, 15 J. Int’l Arb. 19 (Sept. 1998).
162 See Budnitz, supra note 57, at 272, 274.
163 Id. at 274.
164 See Budnitz, supra note 57, at 276.
165 See id. at 312-13.
166 See id. at 317.
that a major benefit of arbitration includes reduction in the judicial docket; however, between February 8, 1998 and February 8, 2000, there were nearly 800 U.S. securities arbitration cases tried at the federal level. One may argue that the novelty of the system has served to increase the federal docket, but the NASD's Code of Arbitration Procedure was adopted on November 1, 1968. Thirty years after the adoption of arbitration as the standard for dispute resolution among the U.S. securities industry, U.S. federal courts are still adjudicating 400 securities cases per year. Compulsory arbitration does not appear to have diminished the federal docket.

Further, with the globalization of businesses and the rapid expansion of internet commerce, industry customized arbitration agreements represent a threat to electronic commerce. Because a consumer transacting in cyberspace does not necessarily know the customs of a distant provider, arbitration agreements may be severely detrimental to the consumer. For example, E*Trade, the well-known provider of online financial services, is a member of the NASD. As a member firm, all disputes arising between E*Trade and customers are subject to compulsory arbitration. E*Trade fails to mention arbitration anywhere on their web site. Neither is arbitration mentioned in their application procedure. Therefore, E*Trade effectively removes its customers rights to a jury trial without even notifying the customer.

Not all scholars agree that arbitration will lead to difficulties on the internet. Some authors go so far as to suggest that international commercial arbitration is the best answer to internet regulation. There is some merit to this suggestion. Arbitration may be the most cost efficient and globally acceptable method of internet dispute resolution; however, arbitration's future success relies upon mutuality of contract. Internet suppliers seeking arbitral enforcement must make consumers aware of arbitral policy before the purchaser/buyer relationship is commenced.

167 See Goldberg, supra note 15, at 234.
168 See NASD Manual, supra note 87 at 3711.
170 See NASD Code of Arbitration Procedure, supra note 75, at 195, § 1 (stating that all disputes arising between a member firm and public customers are subject to compulsory arbitration).
173 See id. at 1247-49.
As demonstrated above, there are numerous drawbacks to enforcing customized arbitration agreements. Worst of all, these issues combine to form a very serious consequence. In fact, traditional arbitration is an excellent alternative to litigation. However, in order for arbitration to work on a global level, the system must engender feelings of confidence and trust. By imposing arbitration agreements against one party's free will, courts incite animosity, and thereby, destroy society's trust in the arbitration system as a whole.

IX. CONCLUSION: CHelsea Revisited

The Second Circuit's finding that there was a valid arbitration agreement in Chelsea is somewhat troublesome because mutuality was not firmly established. More troublesome, however, is the court's subsequent dicta concerning custom favoring such agreements.

Even if the court was correct in reasoning that Chelsea and BD&MC had a valid arbitration agreement, the Second Circuit's dicta set a dangerous precedent. The court relies on the fact that "Chelsea... was operated by an experienced textile merchant, James Pitts, who had been purchasing textiles from Bombay Dyeing pursuant to the same basic sales Confirmation form for approximately a decade." The Court points to BDMC's extensive experience with arbitration and Mr. Pitts' experience with another Indian textile company. The court fails, however, to point to any experience that indicates Pitts' familiarity with arbitration. Therefore, it is plausible that Pitts has been a textile merchant for twenty years and has never seen nor heard of a single arbitration. This argument becomes more legitimate when one remembers that almost all arbitration proceedings are private.

While Chelsea's case may seem trivial, the decision contributes to a dangerous and growing precedent. Arbitration is an extremely useful alternative to litigation. Unfortunately, by using industry custom to dictate mutuality, U.S. and foreign courts are working against arbitral expansion. The results of compulsory arbitration will include resentment and anger. Because the basis of arbitration is agreement, these emotions will ultimately decrease willingness to enter into arbitration agreements.

174 See Chelsea Square Textiles, Inc., 189 F.3d at 296.
175 See id. at 291.
176 See id.
177 See id. at 291-92.