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AMERICAN BAR ASSOCIATION

ADOPTED BY THE HOUSE OF DELEGATES

AUGUST 3-4, 2009

RECOMMENDATION

RESOLVED, That the American Bar Association supports the use of commercial arbitration to resolve disputes involving international business transactions and supports federal, state and territorial legislation or regulations that recognize and aid in the enforcement of international commercial arbitration agreements and awards.

FURTHER RESOLVED, That the American Bar Association opposes federal, state and territorial legislation or regulations that would reduce or discourage the use of international commercial arbitration to resolve disputes involving international business transactions or that would be inconsistent with established international commercial arbitration standards and practice.

FURTHER RESOLVED, That the American Bar Association opposes federal, state and territorial legislation or regulations that would invalidate pre-dispute agreements to arbitrate international commercial disputes.

FURTHER RESOLVED, That the American Bar Association opposes federal, state and territorial legislation or regulations that would alter the current law as to the allocation of authority between the court and the arbitrators to determine the jurisdiction of the arbitral tribunal in international commercial disputes or that would alter the current law regarding the timing of such determinations.

FURTHER RESOLVED, That the American Bar Association opposes the enactment of any federal legislation intended to protect discrete classes as an amendment to the Federal Arbitration Act, 9 U.S.C. Ch. 1.

REPORT

I. Introduction

This resolution is proposed in order to establish new American Bar Association (ABA) policy with respect to international commercial arbitration. Arbitration is the preferred mechanism for dispute resolution in international business transactions. With the current globalization of the world's economy and the increase in cross border transactions and business affairs, a statement of policy by the ABA on this issue is important.

Many bills have been introduced in Congress in recent years relating to arbitration. Although motivated by a desire to protect individuals in discrete categories of domestic disputes, some of these bills would have unintended consequences that would jeopardize international commercial arbitration in the United States to the detriment of U.S. business and the U.S. economy. The proposed resolution would enable the ABA to identify inadvertent consequences that could result from federal, state, or territorial legislation or regulations and enable the ABA to urge technical corrections that safeguard legislative or regulatory objectives to protect certain classes while at the same time preventing damage to U.S. interests in international commerce. The resolution and discussion in this report are intended to be applicable to congressional proposals that have been or may be introduced in the 111th Congress and beyond, as well as to other similar proposed legislation at the state or territorial levels or to similar regulatory proposals.

Surveys and experience have repeatedly demonstrated that arbitration is the preferred dispute resolution mechanism in international commercial transactions. Arbitration typically resolves disputes flexibly, efficiently, privately and relatively amicably, enabling parties to choose adjudicators with specific, relevant expertise. In international transactions in particular, it permits parties from different countries to choose a neutral forum with an appreciation of cross cultural differences, and it is often the only way in which U.S. parties can avoid having disputes resolved in foreign courts that may be biased against them. Furthermore, the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 ("New York Convention") makes arbitration awards far more enforceable than court judgments.

For purposes of the proposed resolution and this report, the term "international commercial arbitration" is defined relying on the Section 202 of the Federal Arbitration Act¹ ("FAA") which implements the New York Convention as including all arbitrations involving legal relationships considered as commercial excluding disputes arising out of a relationship that is "entirely between citizens of the U.S. unless that relationship involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states." 9 U.S.C. § 202

¹ The Federal Arbitration Act, which comprises Chapter 1 of Title 9, is codified at 9 U.S.C. §§ 1-16 (2000).

This report excludes from the definition of “international commercial arbitration” classes of disputes that are not commercial in character, specifically consumer and employment disputes and civil rights disputes brought by individuals pursuant to U.S. federal or state constitutional or statutory provisions that are intended to afford protection from discrimination based on race, sex, disability, religion, national origin or other invidious basis. Purely domestic U.S. franchise arrangements (i.e., disputes between a U.S. franchisor and a U.S. franchisee) are not “international” unless, pursuant to Section 202 above, “that relationship involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states.” Accordingly, purely domestic franchise disputes are not addressed in the proposed resolution or in this report. In addition, the resolution and the report take no position as to the optimal treatment of disputes concerning consumers, employees, civil rights claims by individuals or purely domestic franchise disputes.

II. Background

A. Arbitration’s Importance and Benefits in International Transactions

The many benefits of arbitration have led to the extensive use of arbitration as the process of choice for dispute resolution in international commercial contracts. These benefits for international commercial disputes include:

- *Flexible Process*- As arbitration is a creature of contract, the parties can design the process to accommodate their respective needs. Hearings may be set at the parties’ convenience and the less formal and adversarial setting minimizes the stress to what are often continuing business relationships.
- *Efficiency*- Arbitration can provide for simpler procedural and evidentiary rules than ordinary litigation and create a mechanism whereby the parties can craft and implement a streamlined procedure.
- *Subject Matter Expertise*- Arbitration permits the parties to choose adjudicators with the necessary expertise to decide complex issues which often require industry specific expertise.
- *Finality*- Judicial review of awards is restricted to a few issues primarily related to the fundamental issues of procedural fairness, jurisdiction, and public policy. The finality of awards is particularly important in business transactions. In many instances, with the cost of capital, the time value of money and the paralysis that indecision can bring to businesses, the most important consideration in a commercial dispute is that it be quickly and definitively decided.
- *Confidentiality*- Arbitral hearings, as opposed to court trials, are generally private and confidentiality can be agreed to by the parties. Most arbitral institutions have specific rules regarding the confidentiality of proceedings and awards. This is an

important feature for many corporations, particularly when dealing with disputes over intellectual property and trade secrets.

- *Cross-border Expertise*- Arbitration permits the parties to choose adjudicators with the necessary expertise to decide their dispute. Such special expertise can include an understanding of more than one legal tradition such as common law, civil law or sharia law, an understanding and ability to harmonize cross-border cultural differences and fluency in more than one language.
- *Neutrality*- In the international context, arbitration provides a neutral forum for dispute resolution and enables the parties to select decision makers of neutral nationalities who are detached from the parties or their respective home state governments and courts, in a setting in which bias is avoided and the rule of law is observed.
- *Enforceability* – In the international context, a critical feature is the existence and effective operation of the New York Convention to which over 140 nations are parties, which enables the enforceability of international arbitration agreements and awards across borders. The grounds for refusing to enforce an arbitration agreement or award are very limited under the New York Convention thus making it possible to enforce an award even in a jurisdiction that might otherwise find ways to favor its domestic party. In contrast, judgments of national courts are much more difficult and often impossible to enforce abroad.

The widespread use of arbitration to resolve international disputes was confirmed in a recent PricewaterhouseCoopers study of international commercial arbitration which concluded that “international arbitration remains companies’ preferred dispute resolution mechanism for cross-border disputes” and that “international arbitration is effective in practice.” See *International Arbitration: Corporate Attitudes and Practices 2008*, p. 1

B. Legal Framework for International Arbitration

1. Legislation and Treaties

In 1925, the U.S. Congress affirmed the importance of arbitration in promoting trade by enacting the FAA, intending to place an arbitration agreement “upon the same footing as other contracts, where it belongs.” H.R. Rep. No. 68-96, at 1 (1924). The terms of the FAA provided for extremely limited judicial review of arbitral awards. Through the FAA, Congress intended “to ensure that private agreements to arbitrate are enforced according to their terms.” *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 53-54 (1995).

As international trade developed and grew in importance in the course of the twentieth century and as it became increasingly evident that the availability of arbitration as an effective dispute resolution mechanism was critical to the development of such commerce, the U.S. entered into a series of international commitments—and Congress passed additional bills—to facilitate and support international arbitration. In 1966, the

United States ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (“ICSID Convention”). The ICSID Convention created a mechanism pursuant to which investors can avail themselves of international arbitration to resolve claims against host states. The ICSID Convention has been ratified by 143 countries. In 1970, the United States became a party to the New York Convention, which creates a right to have international arbitration agreements and arbitral awards recognized and enforced across borders, subject only to limited and defined defenses of procedural fairness and narrow public policy concerns. Congress passed Chapter 2 of the FAA to implement the New York Convention. Currently, 142 countries are parties to this Convention. In 1990, the United States became a party to the Inter-American Convention on International Commercial Arbitration (“Panama Convention”), a regional convention that parallels the New York Convention. Congress implemented the Panama Convention by enacting Chapter 3 of the FAA. Currently, 19 countries are members of the Panama Convention.

2. U.S. Court Decisions

U.S. courts have emphasized repeatedly the importance of arbitration to the conduct of international commercial transactions and recognized a strong federal policy favoring arbitration. *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler Plymouth*, 473 U.S. 614, 629, 631 (1985); *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 217 (1985). Many Supreme Court decisions also have recognized the parties’ need to select their forum for dispute resolution. As the court noted in *Bremen v. Zapata Off-Shore Company*, “agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade, commerce and contracting.” 407 U.S. 1, 13-14 (1972). *See also Scherk v. Alberto-Culver Company*, 417 U.S. 506, 516-517 (1974); *Mitsubishi*, 473 U.S. at 629, 631.

3. Proposed U.S. Legislation

While no legislation has been introduced in the 111th Congress that specifically addresses international commercial arbitration, several arbitration bills dealing with consumer, employment and civil rights arbitration have been introduced that could inadvertently interfere with international commercial arbitration: the Arbitration Fairness Act of 2009, H.R. 1020 (“House Bill”) and the Senate version of the Arbitration Fairness Act of 2009, S. 931 (“Senate Bill”).

The House Bill provides, in relevant part, as amendments to Chapter 1, Section 2 of the FAA:

“(b) No pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of--

- (1) an employment, consumer, or franchise dispute; or
- (2) a dispute arising under any statute intended to protect civil rights.

(c) An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.”

The Senate Bill proposes to create a new Chapter 4 of Title 9, and provides in relevant part in Section 402:

“(a) In General- Notwithstanding any other provision of this title, no pre-dispute arbitration agreement shall be valid or enforceable if it requires arbitration of an employment, consumer, franchise, or civil rights dispute.

(b) Applicability-

(1) In General- An issue as to whether **this chapter** applies to an arbitration agreement shall be determined under Federal law. The applicability of this chapter to an agreement to arbitrate and the validity and enforceability of an agreement to **which this chapter** applies shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.” (*emphasis added*)

The Senate Bill, introduced with the benefit of additional information about international arbitration impacts, avoids many of the unintended consequences that could result from enactment of the House Bill. Unlike the Senate Bill, the House Bill is proposed as an amendment to Chapter 1 of Title 9, i.e., an amendment to the Federal Arbitration Act, rather than as a new chapter, does not define the term “statute intended to protect civil rights,” and does not limit the applicability of section (2)(c) of the legislation to the categories of disputes specified in section 2(b).

III. Technical Corrections to the Leading Bills

This report discusses certain limited technical corrections to the pending legislation that would eliminate unintended consequences without affecting any of the protections that the legislation seeks to provide for certain discrete classes such as consumers, employees, and civil rights claimants. While this report focuses on the House Bill and the Senate Bill, the leading bills in both houses, the discussion in this report is intended to be applicable to similar issues that may raised by other congressional proposals that have been or may be introduced in the 111th Congress and beyond, as well as similar state and territorial legislation and similar regulations.

A. Fundamental Principles of Arbitration – Competence-Competence and Separability

Federal courts have supported arbitration through various decisions. In those decisions, courts have, among other things, developed doctrines concerning arbitration, including the doctrines of “separability” and “competence-competence.” These doctrines are considered to be the conceptual cornerstones of international arbitration as an autonomous and effective form of international dispute resolution and operate together to create the framework for the division of authority between courts and the arbitral tribunal.

The doctrine of separability means that the agreement to arbitrate is “separate” or “separable” from the underlying contract. Accordingly, a contract with an arbitration clause is viewed as containing two distinct agreements: the agreement to arbitrate and the underlying contract. Utilizing this distinction, invalidity of the underlying contract does not invalidate the agreement to arbitrate and does not deprive the arbitrator of jurisdiction to decide on the validity of the underlying contract. The doctrine of separability was enunciated by the Supreme Court over forty years ago in *Prima Paint v. Flood & Conklin*, 388 U.S. 395 (1967) and has been reaffirmed and expanded in several Supreme Court decisions rendered since 1967.

“Competence-competence” is the principle pursuant to which a determination is made as to how the authority to decide challenges to arbitral jurisdiction is allocated between courts and arbitrators. This allocation determines both (1) who rules first on the arbitrator’s jurisdiction (*i.e.*, whether the court determines it at an early stage on a motion to stay or compel arbitration, or does so at a later stage, upon review of the award on a petition to vacate or confirm the award after the arbitrator has already considered the issue) and (2) what standard of review is to be applied to an arbitrator’s ruling on challenges to his or her jurisdiction. Under established U.S. principles of competence-competence, arbitrators have jurisdiction to decide challenges to their own jurisdiction first, if the challenge is not based on an objection to the validity or existence of the agreement to arbitrate itself. In *First Options of Chicago v. Kaplan*, 514 U.S. 938, 943-44 (1995), the Supreme Court clarified the concept of competence-competence. *See also* *Buckeye Check Cashing v. Cardegna*, 546 U.S. 440, 443-49 (2006).

The principles of separability and competence-competence do not preclude all court review for all time. Rather, they establish an effective order for review of the parties’ contentions, which is especially important in international commercial arbitration. Thus the principles of separability and competence-competence are embraced by foreign jurisdictions, and are considered to be the cornerstones of international arbitration. England, France and Switzerland—which along with the United States have been the most frequently designated arbitral jurisdictions—have all codified these principles in their arbitration statutes.² The arbitration rules of premier international

² . *See* English Arbitration Act of 1996, Sections 7, 30; Swiss Private International Law, Sections 178(3), 186; French *Nouveau Code de Procédure Civile*, Article 1458. These principles are also codified in Article 16 of the Model Law on Commercial Arbitration promulgated by the U.N. Commission on International Trade Law (“UNCITRAL”), a body with universal membership specializing in global commercial law reform for over 40 years. Over 50 jurisdictions, including Hong Kong, India, Japan, Mexico, Nigeria, and Russia, have adopted the Model Law in whole or substantial part. The ICSID Convention, to which the United States is a party, also expressly provides in Article 41 that the arbitral tribunal shall determine its own competence and jurisdiction.

arbitration institutions around the world likewise provide for the arbitral tribunal to decide on its own jurisdiction, incorporating the principles of separability and competence-competence.³

As currently drafted, the House Bill could inadvertently overturn this long-standing and widely-recognized principle for all arbitrations, including international commercial arbitrations, a consequence that does not seem to be intended by the drafters. In its current form, the language in the House bill could enable any party to an arbitration agreement to evade arbitration and bring nearly every dispute to court, even if it is not a consumer, employment, or civil rights dispute referenced in section 2(b). This House Bill would thus risk reversing decades of U.S. jurisprudence establishing the internationally-recognized separability and competence-competence doctrines, which are so vital to arbitration and cause U.S. law to be contrary to the law governing international commercial arbitration of virtually all other nations.

As a practical matter, the House Bill could mean that the arbitrator would have to halt the proceedings and await court determination based on a party's simple allegation that the underlying contract was for any reason invalid or unenforceable, even if the challenging party had no specific objection to the arbitration clause itself. Allegations that a contract is void or unenforceable for some reason—lack of consideration, fraud, or other grounds—arise in virtually every contract dispute. Even a basic contract claim that would lie at the heart of the dispute before the arbitrator, such as a claim that the arbitration agreement was invalid because the underlying contract was based on a misrepresentation as to the quality of the goods, could find its way to court as a threshold issue under the House Bill. The House Bill could lead to the very embroilment in court proceedings that the parties sought to avoid by entering into the arbitration agreement in the first place and the parties' expectations of a neutral forum of choice would be defeated.⁴

³ See, e.g., American Arbitration Association International Dispute Resolution Procedures, Article 15; International Chamber of Commerce for the International Court of Arbitration, Rules of Arbitration, Article 6, Section 4; Arbitration Rules of the London Court of International Arbitration, Article 23.1; Arbitration Rules of the Singapore International Arbitration Centre, Article 25.1; Swiss Rules of International Arbitration, Article 21; Arbitration Rules of the Dubai International Arbitration Centre, Article 6.1; Arbitration Rules of the Hong Kong International Arbitration Centre, Article 20; Arbitration Rules of the World Intellectual Property Organization, Article 36.

⁴ The Fairness in Nursing Home Arbitration Act of 2009 (the "Nursing Home Bill"), H. R. 1237, which, as introduced in the 111th Congress contains language which raises similar issues. The bill provides as a proposed amendment to Chapter 1, Section 2 of the FAA:

"(d) A determination as to whether this chapter applies to an arbitration agreement described in subsection (b) shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of such an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting the arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement."

The House Bill could mark the U.S. as a jurisdiction no longer considered a friendly forum for arbitration, as prominent foreign practitioners have already begun to note.⁵ If that were to happen to the U.S., U.S. corporations would be in the anomalous position of desiring that arbitrations be seated outside the U.S., and that foreign law govern the dispute resolution provisions and perhaps the contract as a whole. The U.S.'s reputation as a forum to be avoided by arbitrations would create serious problems for U.S. companies attempting to do business abroad. Foreign parties would avoid U.S. partners, knowing that the potential existed that certain pre-dispute arbitration agreements with those partners would not be honored in the U.S. and that all arbitrations could be subject to lengthy court delays. U.S. court process is often viewed, especially by foreign companies, as much more expensive, burdensome and intrusive of company executive and employee time as the discovery rules in the U.S. are significantly more expansive than those of other jurisdictions. In today's global economy commercial competitiveness in the international arena is critical to the economic success and viability of all nations. The United States is not immune from global forces and faces significant competition. The ability of U.S. businesses to compete should not be hampered by the unintended consequences of arbitration legislation directed at addressing discrete domestic problems relating to concerns about fairness to certain classes of individuals.

It does not appear that the sponsors of the House bill intended this result. In response to these concerns, the sponsors of the similar Senate Bill modified the legislation to call for the creation of a new Chapter 4 of Title 9 for the classes to be protected. In addition, the Senate sponsors also modified the Senate bill to limit the proposed legal changes regarding competence-competence and separability to the classes identified in Chapter 4 rather than to all arbitrations.

B. The Placement of the Proposed Legislation in Chapter 1 of the FAA as in the House Bill Will Lead to Confusion and Unnecessary Litigation

The FAA, contained in Chapter 1 of Title 9, is the bedrock foundation for the arbitration process. It has not been amended in a substantive way since its passage in 1925. Chapter 1 impacts international arbitration as well as domestic arbitration through the enactment of Chapters 2 and 3 of Title 9, which make Chapter 1 applicable in international arbitration to the extent not in conflict with those Chapters or with the New York Convention.

Creating a series of exceptions in the body of Chapter 1 to the general rule that arbitration agreements are to be enforced according to the same terms as contracts

The Nursing Home Bill may be read to limit its reach to disputes relating only to nursing homes, as it states that it applies to "such an agreement." However, the matter is not free from doubt and the phrase could be read to refer to any "arbitration agreement." A party seeking to delay the arbitration proceedings may seize on this ambiguity and argue that the provision is intended to be of broad application and to apply to all arbitration agreements. Like the House Bill, the Nursing Home Bill should be enacted outside Chapter 1 of the FAA. (See discussion in *infra* at pp. 14-15)

⁵ See, e.g., Emmanuel Gaillard, *International Arbitration Law*, NEW YORK LAW JOURNAL, April 4, 2008.

generally, as the House Bill does, would cause considerable confusion and unnecessary litigation. In particular, defendants will seize on this new opportunity to delay resolution and possibly gain a home court advantage. In addition, courts will endeavor to construe the applicability and scope of the new statutory provisions in Chapter 1, which are incorporated by reference into Chapters 2 and 3 where not in conflict. However clearly Congress endeavors to express itself, if the proposed legislation is placed in Chapter 1, creative litigants will find ways to raise issues concerning its interpretation and its applicability to matters unintended by Congress. Such spurious arguments would be particularly disruptive here because they would trigger a separate dispute resolution process derogating from the one agreed by the parties.

Enacting the legislation outside Chapter 1, as the Senate Bill does, would avoid these problems and enable a separate body of law to develop concerning any classes deemed to be in need of protection from mandatory arbitration. This would be consistent with previously enacted legislation that established different rules for arbitration for discrete categories of disputants while emphasizing that it had no broader application.⁶ Such a solution would seem not only to benefit those that would continue to rely on Chapter 1 but also would benefit the protected classes as they would be governed by a new statute pursuant to which law tailored to their issues could be developed.

The proposed ABA resolution advocating that the protection of discrete classes be implemented outside of the FAA is consistent with and builds upon the resolution passed by the ABA House of Delegates in February of 2009 which called for the achievement of legislative “objectives through a method other than amendment to... the Federal Arbitration Act” with respect to pre-dispute arbitration clause involving nursing home disputes.

C. Disputes Arising Under Civil Rights Statutes

The House Bill invalidates pre-dispute arbitration agreements in cases “arising under a statute intended to protect civil rights,” but fails to specify which statutes this language implicates. This omission creates a risk that the statute could be misapplied to commercial disputes, by permitting a litigant to invalidate an arbitration clause merely by asserting a claim under a statute arguably “intended to protect civil rights.” A recent Congressional Research Service report to Congress states that there is an “array of civil rights statutes” under both federal and state law.⁷ Civil rights have been said to include all rights protected by the U.S. Constitution and the right to obtain other benefits set out by law. The extremely broad provision in the House Bill provides no guidance to contracting parties or the courts as to its intended applicability.

Likewise, the House Bill also could be read to include claims arising under foreign law, since the designation of “statutes intended to protect civil rights” is not

⁶ See, e.g., 15 U.S.C. §1226 (arbitration regarding motor vehicle franchises); 7 U.S.C. § 197c (arbitration regarding poultry growers); 10 U.S.C. §987 (arbitration regarding credit for members of armed services).

⁷ CRS Report for Congress, *Federal Civil Rights Statutes: A Primer*, October 2008.

limited to U.S. statutes. As a result, all kinds of claims may be implicated. For example, Chile's Constitution provides for the "right" to protection of one's intellectual property and the "right" to freedom from environmental contamination, and Peru's Constitution provides for the "right" to one's honor and good name and one's own voice and image and the "right" that information services not release information affecting one's privacy. The French Declaration of the Rights of Man and of the Citizen provides for the "inviolable and sacred right" of property and equitable indemnification. In addition, the protections accorded under the European Convention on Human Rights (which is substantively incorporated into the laws of all EU member states) is also increasingly being invoked in commercial cases by corporations and may arguably fall within the language of the House Bill. Such a broad application does not seem to have been the bill proponents' intention, but it could be an unfortunate and unintended consequence.

The Senate Bill seeks to minimize the problems that would be raised by such unnecessarily broad language with respect to civil rights claims by specifically identifying the federal statutes implicated and providing that the arbitration bill will apply only to disputes arising under those federal statutes, under the Constitution of the United States or under the constitution of a state and statutes that prohibit discrimination. Furthermore the Senate Bill's also limits the scope of its provisions on civil rights arbitration agreements to those involving disputes "in which at least one party alleging a violation" of such a provision "is an individual." The practical effect of these reasonable limits would be to reduce the number of cases in which a business dispute would find a way to come within the rubric of this statutory provision.⁸

D. Disputes Relating to Franchise Agreements

The House Bill also would invalidate pre-dispute arbitration agreements in **all** franchise disputes. The effects of this provision are real and extensive. Today, more than 75 industries operate within the franchising format. The International Franchise Association membership and network alone encompass some 1,000 franchisors, 350 suppliers, and over 7,000 franchisee members. Franchise establishments account for a significant percentage of all establishments in many important lines of business: 56.3% in quick service restaurants, 18.2% in lodging, 14.2% in retail food, and 13.1% in table/full service restaurants.

⁸ The Senate Bill provides: "(1) the term 'civil rights dispute' means a dispute

(A) arising under

(i) the Constitution of the United States or the constitution of a State; or

(ii) a Federal or State statute that prohibits discrimination on the basis of race, sex, disability, religion, national origin, or any invidious basis in education, employment, credit, housing, public accommodations and facilities, voting, or program funded or conducted by the Federal Government or State government, including any statute enforced by the Civil Rights Division of the Department of Justice and any statute enumerated in section 62(e) of the Internal Revenue Code of 1986 (relating to unlawful

discrimination); and "(B) in which at least 1 party alleging a violation of the Constitution of the United States, a State constitution, or a statute prohibiting discrimination is an individual;

'(B) in which at least 1 party alleging a violation of the Constitution of the United States, a State constitution, or a statute prohibiting discrimination is an individual'"

Many of these franchising relationships are both international in scope and substantial in size. Illustrative of global franchise operations are McDonalds, Burger King, Hilton, Intercontinental, Athlete's Foot and UPS Stores. Disputes between franchising enterprises and their franchisees are often cross-border disputes between sophisticated parties and do not present the kind of circumstance in which pre-dispute arbitration agreements should be *per se* invalid. To the contrary, arbitration in the international arena is essential to many franchisors' ability to ensure franchisees' performance, maintain the quality and service of the brand for the benefit of the franchisor and the franchisee and enable the franchisor to address any necessary corrective action with some measure of urgency. The House Bill would make it difficult for U.S. franchisors to protect their interests abroad and force them to rely on foreign courts with which they are not familiar and which may favor their domestic party.

The narrower definition of a franchise dispute in the Senate Bill is a notable improvement as it limits applicability to franchisees "with a principal place of business in the U.S." and thus allows U.S. franchisors to pursue arbitration remedies in their relationships with franchisees located outside the U.S. Congress may wish to consider, however, whether the Senate Bill's invalidation of pre-dispute agreements between foreign franchisors and domestic franchisees would dissuade foreign franchisors from opening, expanding or continuing franchise operations in the U.S., a result which would be contrary to U.S. economic interests. Moreover, this invalidation of arbitration agreements that fall within the definition of Chapter 2 of Title 9 would likely mean a breach by the U.S. of the terms or the spirit of U.S. treaty obligations under the New York Convention as the courts apply the legislation. See *infra* at 12-13. This gap could be easily corrected if the definition of franchise disputes were to require that both the franchisee and franchisor be citizens of the United States and provide that a corporation shall be deemed to be a citizen of any State by which it has been incorporated and of the State where it has its principal place of business.⁹

E. U.S. Treaty Obligations

Both the substantive changes effected by voiding certain international commercial pre-dispute arbitration agreements and the procedural changes wrought by overruling decades of law on competence-competence and separability would put the U.S. at risk of breaching if not the terms, at least the spirit, of its treaty obligations relating to arbitration. The goal of the New York Convention was not only to foster the recognition and enforcement of commercial arbitration agreements in international contracts but also, as noted by the Supreme Court, "to unify the standards by which agreements to arbitrate are observed and arbitral awards enforced in the signatory countries." *Scherk v. Alberto-Culver, supra*, 417 U.S. 506, 520 (1974). Recognizing that the benefits of the New York Convention would be undone if national courts allowed national "parochial" views to prevail in enforcement proceedings, the court in *Mitsubishi* stated that "the utility of the

⁹ Many popular franchise operations in the United States are offered by franchisors that are incorporated and have their principal place of business in the United States, e.g. McDonalds, Wendy's, Burger King, Midas Mufflers and Aamco Transmissions; the protections offered to them and to many other franchisees under the legislation should not be affected by this change in the legislative language.

convention in promoting the process of international arbitration depends upon the willingness of national courts to let go of matters they normally think of as their own.” *Mitsubishi*, 473 U.S. at 639.

Serious consideration should be given to assuring that legislation enacted does not lead to a contravention of U.S. treaty obligations. For example, courts may refuse to refer a matter to arbitration finding that it falls within the “null and void exception” of Article II of the Convention. Courts may deny enforcement of an arbitral award finding that the agreement “was not valid” under Article V §1(a) or that “the subject matter of the difference is not capable of settlement by arbitration under the law of that country” or against “public policy” under Article V §2 of the New York Convention. Courts might apply the new procedural rules on separability and competence-competence to international awards under Section III of the Convention and refuse to enforce a foreign award. Such contravention of U.S. treaty obligations must be reviewed with care.

F. Overriding Chapters 2 and 3

The Senate Bill raises concerns by providing that Chapter 2 and Chapter 3 of Title 9 apply only to the extent that they are not in conflict with Chapter 4 of Title 9. This is contrary to the treatment of Chapter 1 in Chapters 2 and 3; Sections 208 and 307 of Title 9 provide that Chapter 1 applies only to the extent it is not in conflict with Chapter 2 and 3. The Senate Bill’s provision would allow courts to reject the applicability of Chapter 2 and Chapter 3 solely based on the existence of a conflict with Chapter 4. This rejection could set an unfortunate precedent for the enactment of domestic laws that provide that they trump treaty obligations and damage perceptions as to the U.S.’s commitment to international obligations.

This provision in the Senate bill is not necessary to accomplish Congressional objectives with respect to consumers, employees, and civil rights claims by individuals and should be omitted. The United States entered a reservation to the New York Convention, which provides that the U.S. will only apply the Convention “to differences arising out of relationships . . . that are considered commercial under the national law.” Such claims should not be viewed as commercial. If Congress wishes to assure itself of this result, it could specifically so state in the legislation.

IV. Other Arbitration Bills

In addition to the House and Senate Bills, many other arbitration bills have been introduced in Congress. A full discussion of each bill is beyond the scope of this report. Many of these bills attempt to impose specific procedural requirements on arbitration as an alternative to invalidating the arbitration agreements outright. If Congress were to consider due process and other limitations and standards for designated classes of arbitration parties, care must be taken to ensure that such legislation is consistent with established international practice.

For example, the Fair Arbitration Act of 2007, introduced in the 110th Congress as S. 1135, would, *inter alia*, ban *ad hoc* arbitration and require that the arbitrator be a

member of the bar of the court in the U.S. state where the hearing is conducted. These features conflict directly with international commercial arbitration standards and practice and would make it virtually impossible to have international arbitrations in the U.S. Foreign parties would be highly unlikely to accept purely local arbitrators, and international commercial arbitrations are frequently—and successfully—conducted without an administering institution. Requiring administered arbitrations can increase the costs of arbitration in the international setting.

Conclusion

If legislation is passed without careful attention to its international impacts, the unintended consequences of arbitration legislation and regulation could materially alter the established legal landscape for international arbitration with respect to the validity of pre-dispute arbitration agreements in a broad range of cases and to the division of authority between the courts and the arbitrators. These changes will have major ramifications for international commercial arbitration in the U.S. and for U.S. businesses in the global marketplace.

The Senate Bill, introduced after the House Bill and with the advantage of greater input regarding the impact on international commercial arbitration, provides great encouragement that carefully crafted legislation can both protect needful individuals and preserve international commercial arbitration. Further improvements consistent with this report and developed as a result of further Congressional hearings can accomplish this desirable goal. Accordingly it is recommended that the American Bar Association give its strong support to the proposed resolution.

In light of the importance of arbitration for the operation of international business and U.S. business' multi-national operations, the following two paragraphs of the resolution are proposed to provide general ABA policy in support of international commercial arbitration:

RESOLVED, that the American Bar Association supports the use of commercial arbitration to resolve disputes involving international business and supports federal or state legislation or regulations that recognize and aid in the enforcement of international commercial arbitration agreements and awards.

FURTHER RESOLVED, that the American Bar Association opposes federal or state legislation or regulations that would invalidate pre-dispute agreements to arbitrate international commercial disputes.

In order to assure that competence-competence and separability, cornerstones of international arbitration, are not subverted in the U.S. by the unintended consequences of U.S. legislation the following resolution paragraph is proposed:

FURTHER RESOLVED, that the American Bar Association opposes federal or state legislation or regulations that would alter the current law as to the allocation of authority between the court and the arbitrators to determine the jurisdiction of the arbitral tribunal

in international commercial disputes or that would alter the current law regarding the timing of such determinations.

To protect the jurisprudence relating to international commercial arbitration it is proposed that any legislation to protect discrete classes be placed outside Chapter 1 of Title 9, i.e., the FAA. This resolution paragraph is consistent with and builds upon the resolution passed by the ABA House of Delegates in February of 2009 which called for the achievement of legislative “objectives through a method other than amendment to... the Federal Arbitration Act” with respect to pre-dispute arbitration clause involving nursing home disputes.

FURTHER RESOLVED, that the American Bar Association opposes the enactment of any federal legislation intended to protect discrete classes as an amendment to the Federal Arbitration Act, 9 U.S.C. Ch. 1.

Finally in order to address legislation that may be proposed that would conflict with established international commercial arbitration standards and practices the following resolution paragraph is proposed:

FURTHER RESOLVED, that the American Bar Association opposes federal or state legislation or regulations that would reduce or discourage the use of international commercial arbitration to resolve disputes involving international business transactions or that would be inconsistent with established international commercial arbitration standards and practice.

Respectfully submitted,

Aaron Schildhaus,

Chair, Section of International Law

August 2009

GENERAL INFORMATION FORM

Submitting Entities: Section of International Law

Submitted by: Aaron Schildhaus, Chair, Section of International Law

Summary of recommendation

The American Bar Association should support the use of international commercial arbitration and legislation or regulation that recognizes and aids in the enforcement of international commercial arbitration agreements and awards, oppose the passage of any legislation or regulation that would discourage such arbitration, or that would invalidate pre-dispute arbitration agreements in international commercial transactions, or that would alter the current law as to the allocation of authority between the court and the arbitrators to determine the jurisdiction of the arbitral tribunal in international commercial disputes or that would alter the timing of such determinations, or that would protect discrete classes as an amendment to Chapter 1 of Title 9, i.e., the Federal Arbitration Act (“FAA”). The resolution and the report take no position as to the optimal treatment of disputes concerning consumers, employees, civil rights claims by individuals or purely domestic franchise disputes.

1. Approval of submitting entities

The Council of the Section of International Law approved the recommendation at the April 2009 Council meeting

2. Has this or a similar recommendation been submitted to the House or Board previously?

No.

3. What existing policies are relevant to this recommendation and how would they be affected by its adoption?

The American Bar Association has consistently promoted the use of alternative dispute resolution and the facilitation of the parties’ choice of forum for dispute resolution, including arbitration, especially in the context of international matters. The proposed resolution is generally consistent with and would build upon the following existing ABA resolutions:

- 1974 - urging ratification by all countries of the New York Convention.
- 1974 - recognizing the need for prompt development of a uniform set of international rules of procedure to supplement the Arbitration Rules of the U.N. Economic Commission for Europe.

- 1978 - supporting the ratification by the United States of the Panama Convention, provided that implementing legislation, or an appropriate resolution of advice and consent, or both, are prepared which are designed (a) to avoid conflicts with the New York Convention; and (b) to provide appropriate safeguards with respect to future amendments in the IACAC Arbitration Rules.
- 1989 - favoring recognition of the freedom of parties in international commercial arbitration proceedings to use lawyers who need not be admitted to practice in the jurisdiction where the proceeding takes place.
- 1990 - urging the United States to start negotiations with other governments in order to implement the principles contained in the Draft General Treaty on the Peaceful Settlement of Disputes to accept arbitration for the resolution of international disputes.
- 2006 - urging the United States government promptly to sign, ratify and implement the Hague Convention on Choice of Court Agreements.
- 2009- urging that Congressional objectives with respect to legislation voiding pre-dispute arbitration clauses involving nursing homes be accomplished through a method other than amendment to Chapter 1 of the Federal Arbitration Act.

4. What urgency exists which requires action at this meeting of the House?

Many arbitration bills were introduced in Congress. Several of the proposals are gaining momentum and there is an expectation that they may be passed in the 111th Congress. Unintended consequences of these bills could severely damage international commercial arbitration. Technical corrections could prevent such damage to international commercial arbitration and U.S. interests in international commerce without interfering with legislative or regulatory objectives to protect consumers, employees, individual civil rights claimants and domestic franchisees.

5. Status of legislation

The Arbitration Fairness Act of 2009 H.R. 1020 was introduced in the House of Representatives in the 111th Congress in February 2009 by Representative Hank Johnson (D-GA) and has gathered 57 cosponsors. Senator Russell Feingold (D-WI) introduced the Senate Bill in April 2009, as the Arbitration Fairness Act of 2009, S. 931. Seven leading senators are cosponsoring the bill. Hearings on earlier versions of these bills were held in prior sessions of Congress and it is anticipated that hearings will be held shortly in the 111th Congress. The bills are currently in committee. The Nursing Home Bill was approved by the House and Senate Judiciary Committees in 2008 but died at the end of the 110th Congress. Similar legislation was recently reintroduced in the 111th Congress by Senator Mel Martinez (R-FL) as S. 512 and by Representative Linda Sanchez (D-CA) as H.R. 1237.

6. Cost to Association?

None.

7. Disclosure of interest?

None

8. Referrals

Simultaneous with this submission, referral is being made to all other ABA Sections and Divisions.

9. Contact persons

Michael H. Byowitz

Joshua Markus

10. Contact persons (who will present the report to the House)

Michael H. Byowitz
Wachtell Lipton Rosen & Katz
51 W. 52nd Street
New York, NY 10019-6119
212/403-1268 - phone
<mailto:mhbyowitz@wlrk.com>mhbyowitz@wlrk.com

Joshua Markus
Carlton Fields PA
Suite 4000
100 SE 2nd Street
Miami, FL 33131-2114
305/539-7433 – phone
<mailto:jmarkus@carltonfields.com>jmarkus@carltonfields.com

EXECUTIVE SUMMARY

- (a) Summary of Recommendation: The American Bar Association should support the use of international commercial arbitration and legislation or regulation that recognizes and aids in the enforcement of international commercial arbitration agreements and awards, oppose the passage of any legislation or regulation that would discourage such arbitration, or that would invalidate pre-dispute arbitration agreements in international commercial transactions, or that would alter the current law as to the allocation of authority between the court and the arbitrators to determine the jurisdiction of the arbitral tribunal in international commercial disputes or that would alter the timing of such determinations, or that would protect discrete classes as an amendment to Chapter 1 of Title 9, i.e., the Federal Arbitration Act (“FAA”). The resolution and the report take no position as to the optimal treatment of disputes concerning consumers, employees, civil rights claims by individuals or purely domestic franchise disputes.
- (b) Summary of the Issues: International arbitration is a preferred dispute resolution mechanism in many international business transactions. Unintended consequences of arbitration legislation pending in Congress, particularly a bill currently pending in the House of Representatives, threaten to cause significant damage to international arbitration and to U.S. participation in global commerce. While apparently not intended to do so, the House Bill would reverse fundamental principles of international arbitration and decades of Supreme Court jurisprudence with respect to **all** arbitrations and could thus enable parties to bring virtually every arbitration to court. The House Bill would invalidate pre-dispute arbitration clauses in international franchise relationships, an area of significant international commerce. The House Bill would enable parties to raise a host of domestic and foreign statutory claims asserting that they fall within the undefined statutory provision for civil rights claims and thus derail international commercial arbitrations into court. The House Bill seeks to provide protections for discrete classes by amending the FAA, which could lead to confusion and unnecessary litigation. All of these unintended consequences can be corrected by limited technical amendments.
- (c) How proposed policy would address the issue: The proposed resolution would enable the ABA to identify the inadvertent consequences that could result from federal, state, or territorial legislation or regulations that impact international commercial arbitration and enable the ABA to urge technical corrections that would not interfere with legislative or regulatory objectives to protect certain classes while at the same time preventing serious damage to U.S. interests in international commerce.
- (d) No minority views have been identified in opposition.