

INTERNATIONAL ARBITRATION

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This paper addresses the relationship among the Federal Arbitration Act (FAA), the Foreign Sovereign Immunities Act (FSIA) and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "Convention").

I. INTRODUCTION

International arbitration issues are important to the topic of the program--defending arbitration against unnecessary litigation-- for several reasons:

- the substantial increase of multinational commercial disputes arising out of globalization of business activities;
- a significant portion of commercial activity is carried out by sovereign states directly or through governmental entities;
- international arbitration disputes by their very nature ordinarily entail unique difficulties that add to the complexity, length and costs of the proceedings.

II. THE FAA

The FAA, 9 U.S.C. § 1 et seq., evinces a strong federal policy to encourage arbitration giving effect to private agreements to resolve commercial disputes by arbitration and enforcing the awards resulting from arbitration proceedings. This bias in favor of arbitration is even stronger in the context of international business transactions. David L. Threlkeld & Co. v. Metallgesellschaft Ltd., 923 F.2d 245, 248 (2d Cir. 1991).

Chapter I of the FAA applies to written agreements to arbitrate in any "maritime

transaction" or a contract for a "transaction involving commerce." 9 U.S.C. § 2. "Commerce" is defined in § 1 to embrace interstate and foreign transaction. See 9 U.S.C. § 1.

To recognize and enforce arbitration agreements within reach of the statute, the FAA authorizes courts to: stay litigation that contravenes the parties' contractual obligation to arbitrate (§ 3); direct the parties to arbitrate covered disputes in accordance with the terms of their agreement (§ 4); and confirms awards rendered pursuant to arbitration (§ 9).

Though the FAA statute established a distinct area of federal law fostering arbitration and enforcing the contractual commitment to do so, it did not create an independent source of federal jurisdiction for this purpose. See Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 26 n.34 (1983). Hence, a litigant who seeks to invoke the statute to aid arbitration must satisfy the requirements of jurisdictional amount and diversity of citizenship, or demonstrate the existence of some other independent basis of subject matter jurisdiction, before the court may validly entertain an application for any remedy authorized by the statute. See id. While federal courts may stay litigation instituted in violation of an arbitration clause, this relief is available only in the court in which the particular suit has been instituted. See 9. U.S.C. § 3; Provident Bank v. Kabas, 141 F. Supp. 2d 310, 315 (E.D.N.Y. 2001); Couleur Int'l., Ltd. v. Saint-Tropez West, 547 F. Supp. 176, 177-78 (S.D.N.Y. 1982). Additionally, the statute confines the federal courts' authority to recognize arbitration agreements and confirm arbitral awards only when such proceedings are to occur, or the awards have been rendered, within the bounds of their own districts. See 9 U.S.C. § 4; Snyder v. Smith, 736 F.2d 409, 418 (7th Cir. 1984), overruled on other grounds, Felzen v. Andreas, 134 F.3d 873, 877 (7th Cir. 1998);

Provident Bank, 141 F. Supp. 2d at 315; Couleur Int'l, 547 F. Supp. at 177-78.

Prior to Congress's ratification of and the Convention passage of enabling legislation in 1970 to enforce it, these jurisdictional and venue constraints worked to narrow the scope of the federal courts' authority to recognize and enforce arbitration agreements covering international transactions, in particular those calling for arbitration to be held abroad or seeking enforcement of an arbitration agreement entered into, or confirmation of an arbitral award rendered, in a foreign state. The federal courts' competence to recognize and give effect to such arbitration agreements and awards, absent individual bilateral treaties with particular nations, was often lacking.

Nonetheless, federal jurisdiction over some actions brought to adjudicate controversies arising from international transactions covered by arbitration agreements existed under FAA Chapter 1, though limited in scope and hindered by the constraints described above. Absent some independent basis, federal courts lacked subject matter jurisdiction over cases involving foreign parties on both sides of the dispute. However, if original jurisdiction was properly invoked through the pleading of a federal question or the prerequisites of diversity, the Court, absent a bilateral treaty permitting otherwise, lacked authority, as circumscribed by 9 U.S.C. § 4, to direct arbitration abroad, or indeed beyond the bounds of the court's own district, even if the arbitration agreement's forum selection clause so specified. See Batson Yarn and Fabrics Machinery Group, Inc. v. Saurer-Allma GmbH-Allgauer Machinebau, 311 F. Supp. 68, 70 (D.S.C. 1970).

In such cases, litigation instituted with regard to issues subject to arbitration in a foreign state generally prompted either dismissal -- if the only relief sought was arbitration and all of the issues in dispute were arbitrable -- or more commonly, a stay of judicial

proceedings pending foreign arbitration.

III. THE CONVENTION

The Convention and the accompanying Enabling Act adopted by Congress in 1970 were intended by Congress to cure the limitations described above. The Convention addressed the prevalent flaws in international arbitration practice by authorizing the recognition and enforcement of qualifying arbitration agreements in courts of signatory states, without jurisdictional restrictions as to the citizenship of the parties to the contract or distinctions concerning the location of the matter in dispute. See Smith/Enron Cogeneration Ltd. Part., Inc. v. Smith Cogeneration Int'l, Inc., 198 F.3d 88, 93 (2d Cir. 1999); Bergesen v. Joseph Mullen Corp., 710 F.2d 928, 931 (2d Cir. (1983)).

The Convention, commonly referred to as the New York Convention, is codified as Chapter 2 of the FAA, 9 U.S.C. § 201 et seq. Article II of the Convention provides:

1. Each Contracting State shall recognize an agreement in writing under which the parties undertake to submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning a subject matter capable of settlement by arbitration.
2. The term "agreement in writing" shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.
3. The Court of a Contracting State, when seized of an action in a matter in respect to which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the same agreement is null and void, inoperative or incapable of being performed.

9 U.S.C. § 201.

In § 202, the Enabling Act describes the types of arbitration agreements and awards enforceable by federal courts under the Convention. It provides:

An arbitration agreement or arbitral award arising out of a legal relationship, whether contractual or not, which is considered as commercial, including a transaction, contract, or agreement described in section 2 of this title, falls under the Convention. An agreement or award arising out of such a relationship which is entirely between citizens of the United States shall be deemed not to fall under the Convention 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; Yusef Ahmed Alghanim & Sons, W.L.L. v. Toys "R" Us, Inc., 126 F.3d 15, 20 (2d Cir. 1997); Smith/Enron, 198 F.3d at 92.

The Convention has been uniformly applied to actions between foreign entities and United States parties concerning disputes that principally involve conduct and performance abroad with respect to contracts entered into in the United States. See U.S. Titan, Inc. v. Guangzhou Zhen Hua Shipping Co., Ltd., 241 F.3d 135, 146 (2d Cir. 2001); Chelsea Square, 189 F.3d at 294; Toys "R" Us, 126 F.3d at 19; In Toys "R" Us, the Second Circuit, interpreting § 202, concurred with the Seventh Circuit in declaring the provision to mean that "any commercial arbitral agreement, unless it is between two United States citizens, involves property located in the United States, and has no reasonable relationship with one or more foreign states, falls under the Convention." 126 F.3d at 19 (quoting Jain v. de Mere, 51 F.3d 686, 689 (7th Cir.), cert. denied, 516 U.S. 914 (1995)).

However, not every arbitration agreement that satisfies this definition is necessarily enforceable under the Convention and the Enabling Act.¹ In U.S. Titan, the Second

¹ The scope of the Enabling Act is not entirely coextensive with the permissible coverage of the Convention. For instance, the Convention contains no explicit limitation to commercial disputes, but allows each contracting state to define in its national law the non-domestic matters to which the Convention would apply. See Convention, Art. I(3), 9 U.S.C. § 201. The Convention also permits reservations enabling signatories, on the basis of reciprocity, to confine recognition and enforcement of awards made in other contracting states. See Convention, Art. I(3). The effect of these reservations, adopted by the United States when it acceded to the Convention, is to preclude application of the Convention and the Enabling Act to recognition of agreements

Circuit further elaborated the standards by which "an agreement to arbitrate exists within the meaning of the [Convention] and the [FAA]," requiring four preliminary findings: "(1) there is a written agreement; (2) the writing provides for arbitration in the territory of a signatory of the convention; (3) the subject matter is commercial; and (4) the subject matter is not entirely domestic in scope." 241 F.3d at 146 (citing 9 U.S.C. § 201 and Smith/Enron, 198 F.3d at 92) (emphasis added). If an agreement to arbitrate satisfies these criteria, a court petitioned to recognize the contract must enforce its arbitration terms. See id. ("Arbitration agreements subject to the Convention are enforced in accordance with Chapter 2 of the FAA [U]pon finding that such an agreement exists, a federal court must compel arbitration of any dispute falling within the scope of the agreement pursuant to the terms of the agreement."); Ledee v. Ceramiche Ragno, 684 F.2d 184, 187 (1st Cir. 1982).

providing for arbitration in a non-contracting state or to enforcement of awards made in such countries.

Enforcement of an arbitration agreement requires a court properly "seized of an action," at the request of a party to the agreement, to issue an order directing the parties to honor their contractual obligation and proceed to arbitrate the matter in dispute. Convention, Article II(3), 9 U.S.C. § 201. Although the Convention contains no express provision concerning a stay of the underlying litigation, such authority exists both implicitly, as well as by incorporation of Chapter 1 into Chapter 2 and the Convention through 9 U.S.C. § 208. See Andros Compania Maritima, S.A. v. Andre & Cie, S.A., 430 F. Supp. 88, 92 (S.D.N.Y. 1977).² To this extent, the provisions of Chapters 1 and 2 of the FAA contain "overlapping coverage" and may both apply in a given case insofar as they do not conflict. Bergesen, 710 F.2d at 934 ("There is no reason to assume that Congress did not intend to provide overlapping coverage between the Convention and the Federal Arbitration Act.").

The court's authority to compel arbitration of a dispute covered by an agreement

² Such competence would exist implicitly, in particular, because not all issues presented in disputes subject to the Convention are necessarily arbitrable; some matters may fall within the terms of the arbitration agreement while others may not. The court in which the underlying action is pending, assuming it otherwise has jurisdiction over the matter and the parties, may thus stay the litigation solely with respect to the arbitrable aspects of the dispute. In fact, Article II(1) of the Convention clearly recognizes that an arbitration agreement may provide for arbitration of "all or any differences" which arise between the parties. 9 U.S.C. § 201.

Otherwise, the power to stay an action related to an arbitration agreement encompassed by the Convention could derive from incorporation of § 3 into Chapter 2 and the Convention to the extent application of § 3's provisions in a given case is not incompatible with the requirements of the Convention. See 9 U.S.C. § 208.

subject to the Convention is set forth in Chapter 2 under § 206, which states in pertinent part that: "A court having jurisdiction under this chapter may direct that arbitration be held in accordance with the agreement at any place therein provided for, whether that place is within or without the United States." 9 U.S.C. § 206.

However, as discussed above, arbitration of a dispute involving an international commercial transaction may not be compelled under an agreement calling for arbitration to occur in a country that is not a contracting party to the Convention. See National Iranian Oil Co. v. Ashland Oil, Inc., 817 F.2d 326, 331 (5th Cir.), cert. denied, 484 U.S. 943 (1987) (noting that under the Convention federal courts were granted power to compel arbitration only in signatory countries). The Second Circuit has recognized such a prerequisite in its articulation of the four standards that determine whether an arbitration agreement enforceable under the Convention and the FAA exists. See U.S. Titan, 241 F.3d at 146; Smith/Enron, 198 F.3d at 92.

In sum, an arbitration agreement relating to an international transaction that falls within the definition of § 202, but that designates a non-signatory state as the forum for arbitration, does not qualify as an "agreement within the meaning of [the Convention]" and the Enabling Act, and is thus not enforceable in federal courts in accordance with its terms. Nonetheless under some circumstances, in particular where the underlying action is instituted pursuant to the court's diversity jurisdiction such an agreement may fall within the reach of FAA Chapter 1 in other respects and for other purposes.

In this connection, it bears highlighting that the Convention and the Enabling Act do not encompass the entire field of arbitration agreements involving international commercial transactions, and that where an arbitration clause designates a forum in a country that is a

non-contracting party to the Convention, the Court may still possess jurisdiction to grant appropriate relief solely under the provisions of Chapter 1, insofar as the Court's exercise of jurisdiction to do so would not conflict with any provision of the Convention or Chapter 2. A further constraint in this regard is found in § 4. That provision states that a party to an arbitration agreement allegedly breached by another party may bring an action in a federal court having jurisdiction over the matter:

for an order directing that such arbitration proceed in the manner provided for in such agreement.... The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed.

9 U.S.C. § 4.

Thus, § 4 embodies a mandate that in some cases may engender an internal conflict: it directs both that the court enforce an arbitration agreement in accordance with its terms and that it may direct arbitration only if it is to occur within the court's own district. See Jain, 51 F.3d at 690; National Iranian Oil, 817 F.2d at 330; Snyder, 736 F.2d at 419-20. Consequently, in reviewing a petition to enforce an agreement within the scope of Chapter 1, "[a] district court compelling arbitration under § 4 lacks the power to order arbitration to proceed outside its district." Jain, 51 F.3d at 690.³

³ In some cases to which the Convention and Chapter 2 do apply, a potential conflict may arise between the provisions of Chapter 1 and those of Chapter 2. In endeavoring to harmonize the overlap between § 4 of

Chapter 1 and § 206 of Chapter 2, the Seventh Circuit explained:

Without question, chapter 2 incorporates § 4 to some degree. Where an arbitration agreement specifies an arbitration site, § 4 is admittedly incompatible with chapter 2. If the agreement calls for arbitration within the district in which the action is brought, both § 4 and § 206 permit the court to compel arbitration there; section 4 is at most redundant. If the agreement calls for arbitration outside of the district in which the action is brought, the limits of § 4 directly conflict with the district court's powers under § 206, and § 208 would render § 4 inapplicable.

Id.

The interrelationships among these provisions and an application of the underlying principles are discussed in DaPuzzo v. Globalvest Mgmt. Co., L.P., 263 F. Supp. 2d 714 (S.D.N.Y. 2003). There, the parties entered into a partnership agreement which contained a provision calling for arbitration of any disputes under the agreement in the Bahamas, a non-signatory to the Convention. Related partnership documents also made reference to settlement of disputes through binding arbitration according to the rules of the American Arbitration Association, which, if applicable, would have located venue for the proceedings in New York. Plaintiff contended that the arbitration clause was not enforceable to compel arbitration in the Bahamas and sought an order directing arbitration in New York. Defendants moved for a stay of further litigation pending the parties' arbitration in the Bahamas.

The Court determined that the Bahamas arbitration clause applied and recognized the limitations of FAA Chapter 2 and the Convention that precluded compelling arbitration in the Bahamas. Nonetheless, the Court also gave expression to the FAA's strong policy favoring arbitration and ordered a stay of the plaintiff's action either under an interpretation of Chapters 1 and 2, or, alternatively, under an exercise of the court's inherent discretion to stay litigation.

IV. THE FSIA

The FSIA recognizes that foreign states and their agencies and instrumentalities possess sovereign immunity from the exercise of judicial authority as regards official acts and functions, and confers court jurisdiction over them only with respect to cases involving certain specified matters. See 28 U.S.C. §§ 1330, 1605. In one of the exceptions to this official immunity, the FSIA authorizes jurisdiction over foreign states that have agreed to

submit to arbitration of their disputes with private parties where the agreement or award may be "governed by a treaty or other international agreement in force for the United States calling for the recognition and enforcement of arbitral awards." 28 U.S.C. § 1605(a)(6)(B). The Convention qualifies as such a treaty. See Monegasque de Reassurances S.A.M. v. Nak Naftogaz of Ukraine, 311 F.3d 488, 494 (2d Cir. 2002).

The FAA, the Convention and the FSIA all embody expression of national policy favoring the recognition and enforcement of foreign arbitration agreements and awards. To this end, the Convention mandates that each contracting state "shall" recognize and enforce arbitral awards "in accordance with the rules of procedure" of the territory where the award is relied upon." Convention art. III. Consistent with the encouragement of arbitration, the Convention specifies that denial of enforcement of an award may be authorized upon proof supporting seven grounds:

1. the parties to the arbitration agreement lacked capacity or the agreement was not legally valid;
2. proper notice of the appointment of the arbitrator or of the arbitration proceedings was not given;
3. the award deals with a matter not submitted to arbitration or beyond the scope of the submission;
4. the arbitral authority or procedure was not agreed to by the parties;
5. the award was not yet binding or had been set aside or suspended in the enforcement forum;
6. the subject matter of the dispute was not capable of settlement by arbitration;
7. recognition or enforcement of the award would be contrary to the public policy of the signatory nation where enforcement is sought.

Id. art. V(1), V(2); Monegasque, 311 F.3d at 494

These specified grounds for denial of recognition or enforcement of an arbitration award subject to the Convention are exclusive. See Monegasque, 311 F.3d at 494; FAA, 9 U.S.C. § 207 ("The court shall confirm the award unless it finds one of the grounds for refusal or deferral of recognition of the enforcement of the award specified in the said Convention."); Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc., 126 F.3d 15, 23 (2d Cir. 1997); see also, Restatement (Third) of foreign Relations, § 488, cmt. a (1987) ("The defenses to enforcement of a foreign arbitral award set forth in [Article V of the Convention] are exclusive.")"

Nonetheless, a number of limitations on recognition and enforcement have developed as a result of judicial rulings, particularly reflecting the condition in the Convention that refers to the "rules of procedure" of the state where recognition or enforcement is sought.

A. PERSONAL JURISDICTION AND "MINIMAL CONTACTS"

Some Courts have ruled that personal jurisdiction over the defendant is a prerequisite to maintain an action for recognition or enforcement of an arbitral award under the Convention. See Glencore Grain Rotterdam BV. Shivnath Rai Harnarain, 284 F.3d 1114, 1121 (9th Cir. 2002). In Glencore Grain the Ninth Circuit rejected the defendant's argument that lack of personal jurisdiction over the defendant is not among the seven defenses the Convention expressly specified, and held that "neither the Convention nor its implementing legislation removed the district courts' obligation to find jurisdiction over the defendant in suits to confirm arbitration awards." Id. In so deciding, the Circuit Court indicated that due process principles circumscribe the application of the Convention.

B. LOCATION OF PROPERTY IN THE FORUM

Other courts have limited the application of the convention by declining to enforce arbitral awards in cases involving seizure of property as a basis for personal jurisdiction where the location of the property within the forum state "provided no basis for asserting jurisdiction when there is no relationship between the property and the action." Base Metal Trading, Ltd. v. OJKS, 283 F.3d 208, 211 (4th Cir. 2002).

C. FORUM NON CONVENIENS

Another limitation in the application of the Convention to recognize and enforce arbitral awards in the United States is the doctrine of forum non conveniens, as the Second Circuit ruled in Monegasque. There, the Circuit Court held that although the seven grounds that the Convention specifies as defenses to recognition and enforcement of foreign arbitration awards are exclusive, those considerations all pertain to substantive matters. See 311 F.3d at 494. However, the Convention also provides that proceedings for enforcement of arbitral awards are subject to the rules of procedures of the forum where enforcement is sought, and because the doctrine of forum non conveniens is procedural rather than substantive it applies to authorize dismissal of actions where the underlying standards are satisfied. See id. at 495.