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# The Enforcement of International Arbitration Agreements in U.S. Courts

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## Introduction

Parties contemplating the arbitration of international disputes in the U.S. need to be cognisant of the attitudinal differences between the state and federal courts toward the enforcement of pre-dispute arbitration agreements. In broad terms, the federal courts in the U.S. are more likely to enforce pre-dispute arbitration agreements, while the state courts, particularly in cases involving employment or consumer disputes, often tend to go the other way.

This disparity is rooted in two parallel but overlapping sets of rules. In federal court the enforcement of private arbitration agreements is governed by a federal statute, the Federal Arbitration Act (“the FAA”), which is found at 9 U.S.C. §§ 1 *et seq.* The FAA embodies a “liberal federal policy favoring arbitration agreements notwithstanding any state substantive or procedural policies to the contrary”. *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 US 1, 24 (1983).

By contrast, state court judges – in determining whether to enforce an agreement to arbitrate a dispute – frequently apply doctrines such as unconscionability or public policy to invalidate pre-dispute arbitration agreements. See, e.g., *Cohen v. DirecTV, Inc.*, 142 Cal. App.4th 1442, 1451-1453 (2006); *Klussman v. Cross Country Bank*, 134 Cal.App.4th 1283, 1297 (2005); *Aral v. Earthlink, Inc.*, 134 Cal.App.4th 544, 556-557 (2005). In addition, many states have their own procedural rules governing the enforcement of pre-dispute arbitration agreements. As these rules are sometimes inconsistent with the FAA, their application in particular cases may yield fundamentally different outcomes than what might have resulted from application of the FAA.

Given this environment, parties contemplating the arbitration of international disputes in the U.S. should give consideration to including certain key provisions in their underlying agreement which can serve to mitigate the risk that a U.S. court will decline to enforce their agreement to arbitrate. In addition, parties seeking to enforce their agreement to arbitrate should also try to secure a federal court forum.

## A. The Typical Context

The core problem addressed in this article typically arises in the following context:

Parties A and B enter into a commercial agreement containing a dispute-resolution provision that specifies that the parties are to arbitrate any future dispute between them. This dispute resolution provision also specifies that the arbitration will take place in

a particular U.S. state, under the auspices of a particular arbitral organisation and that the merits of the controversy will be governed by the law of that state.

After a dispute arises, one of the parties (Party B) files a preemptive lawsuit in state court. In addition to seeking relief concerning the merits of the dispute, Party B’s lawsuit also challenges the validity and enforceability of the dispute-resolution provision. Among other things, Party B alleges that the provision respecting arbitration is unconscionable or that because the underlying agreement was procured by fraud the dispute-resolution provision is unenforceable. Put simply, Party B wants his proverbial day in Court with a jury as the fact-finder.

Because an agreement to arbitrate a future dispute is not self-executing, Party A must now compel Party B to submit to arbitration. In this regard, Party A files a petition to compel arbitration in the lawsuit that was preemptively filed by Party B. The state court judge hearing Party B’s lawsuit must now rule on Party A’s petition to compel arbitration and in so doing must resolve Party B’s challenges to the enforceability of the arbitration agreement.

## B. The Federal Court Forum

The forum in which Party A’s petition to compel arbitration will be determined matters greatly to its outcome. In this regard, petitions to compel arbitration which are filed in federal court are governed by the FAA, which is highly arbitration-friendly.

Thus, in *Doctor’s Assocs. v. Casarotto* 517 U.S. 681 (1996), the U.S. Supreme Court invalidated a Montana statute which required notice that a contract is subject to arbitration be typed in underlined capital letters on the first page of the contract. *Doctor’s Assocs.* held that any state statute which imposes special requirements for the enforceability of arbitration provisions will be struck down on the ground that such requirements are inconsistent with § 2 of the FAA.

The Court reiterated that state law principles such as fraud, duress or unconscionability may be applied to invalidate contracts containing arbitration provisions if that law arose to govern issues concerning the validity, revocability and enforceability of contracts in general. But state courts “may not, however, invalidate arbitration agreements under state laws applicable only to arbitration provisions”. *Doctors’ Assocs.*, 517 U.S. at 687.

Recent cases have taken the holding in *Doctor’s Assocs.* several steps further. For example, in *AT&T Mobility v. Concepcion*, 131 S.Ct. 1740 (2011), the pertinent contract provided for arbitration of all disputes between the parties, but required that claims be brought in the parties’ individual capacity, and not as plaintiff or class member in any purported class or representative proceeding. The

plaintiff-consumers opposed AT & T's petition to compel arbitration on the ground that the arbitration agreement was unconscionable because it disallowed classwide procedures. The District Court and the Ninth Circuit agreed, but the U.S. Supreme Court reversed.

In so doing, the Court framed the key question as follows:

...the inquiry becomes more complex when a doctrine normally thought to be generally applicable, such as duress or, as relevant here, unconscionability, is alleged to have been applied in a fashion that disfavors arbitration. In *Perry v. Thomas*, 482 U.S. 483 [] (1987), for example, we noted that the FAA's preemptive effect might extend even to grounds traditionally thought to exist "at law or in equity for the revocation of any contract" [Citation omitted] We said that a court may not "rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what...the state legislature cannot. *AT&T v. Concepcion*, *supra*, 131 S.Ct. at 1747.

This means that federal courts applying the FAA will disregard state law: (1) where, as in *Doctor's Assocs.*, a state statute conditions the enforceability of an agreement to arbitrate on the contract's compliance with special or unique requirements; (2) where, as in *Concepcion*, state law contract principles such as unconscionability are applied with particular strictness in respect to an agreement that provides for arbitration; and (3) where, as in *Ferguson v. Corinthian Colleges*, 733 F.3d 928 (9th Cir. 2013), state law prohibits outright the arbitration of a particular type of claim.

In *Ferguson*, former students at defendants' for-profit schools brought a putative class action alleging that defendants engaged in a deceptive scheme to entice the enrollment of prospective students in violation of California law. Pursuant to arbitration clauses in plaintiffs' enrollment agreements, defendants moved to compel arbitration. The U.S. District Court denied the motion as to plaintiffs' claims for injunctive relief under California's unfair competition law, false advertising law and Consumer Legal Remedies Act. In so doing, the District Court relied on decisions by the California Supreme Court establishing the so-called Broughton-Cruz rule, which exempts claims for "public injunctive relief" from arbitration.

The Ninth Circuit reversed, holding that California's *Broughton-Cruz* rule was preempted by the FAA. In this regard, the Court cited language from the Supreme Court's decision in *AT&T Mobility v. Concepcion* to the effect that "[w]hen state law prohibits outright the arbitration of a particular type of claim, the analysis is straightforward: The conflicting rule is displaced by the FAA". *Ferguson, supra*, 733 F.3d at 934.

In similar fashion, federal courts in California have also rejected the decision in *Iskanian* insofar as that decision exempts from arbitration claims under California's Private Attorney General Act. See *Lucero v. Sears Holdings Management Corp.* (S.D. Cal. November 3, 2014) 2014 WL 6984220; *Mill v. Kmart Corp.* (N.D. Cal. November 26, 2014) 2014 WL 6706017; *Langston v. 20/20 Cos.* (C.D. Cal. October 7, 2014) 2014 WL 5088240; and *Fardig v. Hobby Lobby Stores, Inc.* (C.D. Cal. August 11, 2014) 2014 WL 4782618.

## C. The State Court Forum

From the standpoint of both substantive law and also procedure, state court is often a decidedly more hostile forum for the enforcement of pre-dispute arbitration agreements than federal court. See, e.g.: *Columbus Anesthesia Group v. Kutzner*, 218 Ga. App. 51, 459 S.E.2d 422 (1995) (court declined to enforce arbitration provision in agreement to join medical practice group because services

provided did not constitute interstate commerce, invoking the FAA, and contract did not conform to state's procedural requirements for arbitration of employment contracts); and *Barter Exch., Inc. of Chicago v. Barter Exch., Inc.*, 238 Ill. App. 3d 187, 606 N.E.2d 186 (1992) (court declined to enforce arbitration provision in franchise agreement due to franchisor's failure to comply with state franchise regulations).

In California, for example, certain substantive claims have been exempted outright from arbitration by judicial fiat. These include claims by employees against their employers under the Private Attorneys General Act ("PAGA") for violation of California's Labor Code (*Iskanian v. CLS Transportation Los Angeles, LLC*, 59 Cal.4th 348 (2014)) and claims for injunctive relief under California's Unfair Competition Law (*Broughton v. Cigna Healthplans of California*, 21 Cal.4th 1066 (1999); and *Cruz v. Pacific Care Health Systems, Inc.*, 30 Cal.4th 1157 (2003)). Furthermore, California courts have declined to enforce pre-dispute arbitration provisions where those provisions are contained in an agreement found to be unconscionable as a whole or where the arbitration provisions themselves are found to be unconscionable or violative of the state's public policy. *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005).

However, in addition to exempting certain categories of claims from arbitration, California law also provides its own procedural rules for the enforcement of pre-dispute agreements to arbitrate. These rules are embodied in the California Arbitration Act ("the CAA"). Among other things, the CAA allows the Court to deny a petition to compel arbitration on the ground that "[a] party to the arbitration agreement is also party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is the possibility of conflicting rulings on a common issue of law or fact". California Code of Civil Procedure ("C.C.P.") § 1281.2(c). Put differently, California courts are authorized by statute to stay arbitration pending resolution of litigation, or to refuse to enforce a valid arbitration provision in order to avoid duplicative proceedings or conflicting rulings.

Where an arbitration involves "international commercial disputes", there is a California statute that provides some relief from the prospect that a valid arbitration agreement will not be enforced. C.C.P. §§ 1297.11, *et seq.* governs the arbitration and conciliation of "international commercial disputes" where the arbitration or conciliation is to take place in California.

This statute is relatively new, appears not to have been widely used and there is little commentary or judicial construction of its provisions. Moreover, while the statute recites that insofar as the arbitration or conciliation of international commercial disputes is concerned it supersedes those parts of the CAA that give California judges the discretion not to enforce a valid arbitration agreement, the statute does not purport to displace the limitations that have been placed on arbitration in California as a result of judicial decision-making.

## D. Different Outcomes if the FAA or State Law Rules are Applied

Although Party A's petition to compel arbitration has been filed in Party B's state court lawsuit, state courts must apply the FAA in cases involving interstate commerce or where the FAA would otherwise preempt state procedural rules. See *Southland Corp. v. Keating*, 465 U.S. 1 (1984). For this reason, the threshold question for the state court judge in ruling on Party A's petition is whether the FAA or state court rules apply.

This is a consequential question, as the application of the FAA or state court rules can be outcome-determination. Consider the following possible outcomes:

- The Court determines that the FAA applies. Under section 3 of the FAA, the Court is required to enforce the contracting parties' arbitration provision even if there is litigation pending that is arising out of or relating to the controversy embraced by the parties' arbitration agreement. Thus, this statute provides that a Court "shall on application [of a contracting party] stay the trial of the action until such arbitration has been had..." 9 USC § 3. This language has been interpreted to mean that the Court has *no discretion* to refrain from enforcing an arbitration provision, even if there is a litigation already pending involving some of the same issues of law or fact. See, e.g., *Itoh & Co., Inc. v. Jordan International*, 552 F.2d 1228, 1231-32 (7th Cir. 1977).
- The Court determines that state law applies. An entirely different outcome may arise under state law. Thus, for example, the CAA provides that a court may decline to enforce an arbitration provision if a contracting party is involved in related litigation with a third party that creates the risk of conflicting rulings on a common issue of law or fact. C.C.P. § 1281.2(c). The CAA also provides that a court may decline to enforce an arbitration provision if "there are other issues between [the contracting parties] which are not subject to arbitration..." *Id.*

Put simply, if an arbitration provision is governed by the FAA, it will more likely be enforced according to its terms, even if there is related litigation pending. By contrast, if the arbitration provision is deemed governed by state law, the Court has discretion to stay any arbitration in favour of pending or prospective litigation.

These differences in outcome could be quite consequential for a contracting party about to enter into a commercial agreement with another party. As pre-dispute jury waivers may be unenforceable in certain jurisdictions (*Grafton Partners v. Superior Court*, 36 Cal.4th 944 (2005)), the only way to insure that a dispute is resolved without a jury may be through arbitration. Further, arbitration allows parties to a dispute to avoid the virtually unlimited pre-trial discovery that is common in ordinary civil litigation.

## E. Strategies for Enhancing the Prospects for Enforcement

There are two principal strategies for enhancing the prospects for the enforcement of an agreement to arbitrate future disputes: first, certain key provisions should be included in the parties' underlying agreement; and second, the party seeking to enforce the arbitration provision should try to secure a federal court forum for the determination of its petition to compel arbitration.

In terms of the first approach, commercial parties wishing to achieve certainty in connection with their dispute-resolution arrangements ought to consider including the following provisions in their agreement:

### 1. **Separate choice of law provision governing arbitration provision.**

Parties to an arbitration agreement may expressly designate that any arbitration proceeding should move forward under the FAA's procedural provisions rather than under state procedural law. See, e.g., *Cronus Investments v. Concierge Services*, 35 Cal. 4th 376, 394 (2005); see also *Gloster v. Sonic Automotive, Inc.*, 226 Cal. App. 4th 438, 447 (2014) (parties can provide that the arbitration proceeding contemplated in their agreement will be conducted under the FAA).

In this regard, the global choice of law provision in the parties' agreement should "carve out" the arbitration provision contained therein. For example, the parties' agreement may specify that California law will apply in connection with the determination of the parties' respective claims, but the arbitration provision should be governed by a separate choice of law provision.

### 2. **Express waiver of state procedural rules.**

As noted above, the CAA allows the Court to deny a petition to compel arbitration where a complaint contains both arbitrable and non-arbitrable claims arising out of the same transaction. In that instance, the Court has discretion to stay either the arbitration or the court proceeding, or to deny a petition to compel arbitration and order the arbitrable claims to proceed in court. See C.C.P. § 1281.2(c). In *Gloster, supra*, the Court confirmed the efficacy of a contract provision whereby the parties expressly waived all rights granted under that statute.

### 3. **Delegation clause.**

While ordinarily it is the Court, and not the arbitrator, that determines the threshold question of arbitrability (*Mobile Comm 'ns AS v. Storm, LLC*, 584 F.3d 396 406 (2nd Cir. 2009)), the parties can expressly provide in their arbitration provision that the question of arbitrability will be determined by the arbitrator. Such provisions are fully enforceable absent a showing of unconscionability as to the delegation clause itself. See *Rent-a-Center, Inc. v. Jackson*, 130 S. Ct. 2772 (2010) (parties may agree to have arbitrator decide "threshold issues" regarding the arbitration of their dispute); and *Malone v. Superior Court*, 226 Cal.App.4th 1551, 1564-71 (2014); *Tiri v. Lucky Chances, Inc.*, 226 Cal.App.4th 231, 241-49 (2014).

### 4. **Reservation to make unilateral changes in arbitration provision.**

Even where these key provisions may not already be included in the parties' underlying agreement, a party may reserve the right to make unilateral changes to the agreement's arbitration provision. In this regard, courts have permitted parties to make such unilateral changes so long as notice is provided and the modification does not affect any claims that arose before the date of the modification. *Casas v. CarMax Auto Superstores California LLC*, 224 Cal. App.4th 1233 (2014); and *Davis v. Nordstrom, Inc.*, 753 F.3d 1089 (9th Cir. 2014). Thus, a contracting party at the drafting stage may wish to include language in the arbitration provision which reserves that party's right to make unilateral changes in the future.

Beyond seeking to include these key provisions in the parties' underlying agreement, the party seeking to enforce the arbitration provision should try to secure a federal court forum for the determination of its petition to compel arbitration.

Absent a forum selection clause in the parties' agreement, Party A can either bring the enforcement action in the first instance in federal court, or, if Party B has already filed an action in state court challenging the parties' arbitration provision, Party A can seek to have that action removed to federal court under 28 U.S.C. § 1446.

In either case, however, Party A must establish subject matter jurisdiction in the federal court. This is because the FAA provides no independent basis for federal subject matter jurisdiction. *Scandinavian Reinsurance Co. Ltd. vs. Saint Paul Fire & Marine Ins. Co.*, 668 F.3d 60, 71 (2nd Cir. 2012); *Robert Lawrence Co. vs. Devonshire Fabrics, Inc.*, 271 F.2d 402, 408 (2nd Cir. 1959).

For parties involved in the arbitration of international disputes, there are two principal paths to establishing subject matter jurisdiction in federal court.

First, if a dispute is between a U.S. party and a non-U.S. party, there will be complete diversity of citizenship such that federal subject matter jurisdiction under 28 U.S.C. § 1332(a)(2) will be satisfied. In that circumstance, Party A may commence an original proceeding in US District Court to compel arbitration or, if Party B has already commenced an action in state court, Party A may remove that action to federal court.

Second, Chapter 2 of the FAA (9 U.S.C. §§ 201-208) provides both removal and subject matter jurisdiction in federal court where the dispute “relates to” an arbitration or arbitral award under the New York Convention of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517 (“the New York Convention”).

While a full discussion of this section of the FAA is beyond the scope of this article, it bears noting that this section only applies if the arbitration agreement or award “falls under” the New York Convention. 9 U.S.C. § 202. In this regard, a key requirement for coverage under the New York Convention is that the underlying agreement must concern a “foreign” or “non-domestic” award. Key to meeting this threshold requirement is demonstrating that the award was made within the legal framework of another county, i.e.,

that it was pronounced in accordance with foreign law or involved parties domiciled or having their principal place of business outside the enforcing jurisdiction. *Bergeses v. Joseph Mullen Corp.*, 710 F.2d 928 (2nd Cir. 1983).

### Conclusion

In March of this year, the U.S. Supreme Court granted *certiorari* in *DIRECTV, Inc. vs. Imburgia*, an April, 2014 decision from California’s intermediate appellate court which purported to apply California rules limiting the enforcement of a pre-dispute agreement to arbitrate even where that agreement was expressly governed by the FAA.

Given the apparent hostility of the California courts toward pre-dispute arbitration agreements, parties contemplating the resolution of future disputes through arbitration should consider including the provisions discussed above in their agreement. Further, and in the event that the parties’ arbitration provision must be enforced, the parties also ought to seek a federal forum for that enforcement proceeding. By employing these techniques, contracting parties can mitigate the risk that a court may for some reason decline to enforce a valid arbitration provision.



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