Enforcing International Arbitration Agreements - Marchetto v. DeKalb Genetics Corp.

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ENFORCING INTERNATIONAL ARBITRATION AGREEMENTS

Marchetto v. DeKalb Genetics Corp.¹

I. INTRODUCTION

The importance, magnitude and frequency of international business transactions have necessitated finding an acceptable method of resolving disputes arising from such transactions. Parties to international commercial transactions often come from nations with cultures and legal systems which are greatly diverse.² Arbitration agreements in international commercial contracts are a preferred manner of resolving disputes.³ Arbitration is a method of providing orderliness and predictability in an area in which it is necessary, but often difficult to achieve.⁴ In order for the arbitration system to work, courts of law must be willing to relinquish their jurisdiction and allow the arbitration system to resolve the dispute. Marchetto v. DeKalb Genetics Corp. is an example of a United States court's referral of a dispute to an arbitration panel.

II. THE MARCHETTO DISPUTE

The dispute arose from a shareholders' agreement of DeKalb Italiana.⁵ The agreement was between the Marchetto Group⁶ and DeKalb Agricultural Association, joint venturers in DeKalb Italiana.⁷ Before the parties could transfer shares of DeKalb Italiana, the shareholders' agreement required that they first obtain consent from the other shareholders and offer them the right of first refusal. The shareholders further agreed to submit any disputes among themselves to a panel of arbitrators in Rome, Italy.⁸

⁵ Marchetto, 711 F. Supp. at 937.
⁶ The Marchetto Group consisted of Antonio Marchetto and Sergio Marchetto, both of whom were Italian citizens. Id.
⁷ Id. Each of the parties owned one half of the outstanding shares of DeKalb Italiana Stock. DeKalb Italiana is an Italian corporation. Id.
⁸ Id.
Nineteen years after the formation of DeKalb Italiana, DeKalb Agricultural sold its shares of DeKalb Italiana to DeKalb-Pfizer Genetics. The Marchetto Group neither knew of nor acquiesced to the transfer. DeKalb did not offer the shares to the Marchetto Group before the sale.

As a result of the sale, the Marchetto group brought suits for breach of contract and tortious interference with the shareholders agreement against DeKalb in the United States Federal Court for the Eastern District of Illinois. Defendants moved for dismissal, claiming that the arbitration agreement controlled and the dispute should be submitted to an arbitration panel in Rome, Italy.

Defendants based their motion for dismissal on the United States’ membership in the Convention on the Recognition and Enforcement of Foreign Arbitral Awards [hereinafter the 1958 Convention]. By entering into the 1958 Convention, Defendants claimed that the United States agreed to abide by international arbitration agreements when the standards set forth in the 1958 Convention are met. Defendants contended that all standards were fulfilled and thus, the Italian arbitration panel, rather than the United States Courts, should assert jurisdiction over and decide the dispute.

Plaintiffs also relied upon the 1958 Convention. They contended that because only one of the defendants was a party to the agreement, it was not enforceable against non-party defendants under Italian law. Therefore, the Italian arbitration panel would not assert jurisdiction. Because arbitration was not performable,

9. DeKalb Agricultural Association had since changed its name to DeKalb Corporation. Id.
10. DeKalb-Pfizer Genetics was a joint venture of DeKalb Corporation and Pfizer-Genetics, Inc. Id. at 937-38.
11. Id. at 938. In 1988, six years after the sale of DeKalb's shares to DeKalb-Pfizer Genetics, DeKalb Corporation reorganized into three separate corporations. The newly formed corporations were DeKalb Energy, DeKalb Genetics and Pride Petroleum Services. DeKalb Energy was the successor corporation to DeKalb Corporation. DeKalb Genetics replaced DeKalb Corporation in DeKalb-Pfizer Genetics. Id. All defendants, referred to jointly, will hereinafter be called Defendants.
12. Id. at 937-38.
17. These standards are "whether (1) there is a written arbitration agreement; (2) the agreement provides for arbitration in a signatory country; (3) the agreement arises out of a commercial legal relationship; and (4) the commercial transaction has a reasonable relationship to a foreign state." Id. at 939 (citing Sedco Inc. v. Petroleos Mexicanos Mexican Nat'l Oil Co., 767 F.2d 1140, 1144-45 (5th Cir. 1985); Ledee v. Ceramiche Ragno, 684 F.2d 184, 186-87 (1st Cir. 1982)).
19. DeKalb Energy as the successor to DeKalb Corporation. Id.
Plaintiffs asserted, the 1958 Convention did not require arbitration. Plaintiffs also argued that the tortious interference allegation was not within the scope of the agreement, and thus was not subject to arbitration.

The federal district court, following the standards set forth in the 1958 Convention, held that the dispute was arbitrable. These standards dictate that when an arbitration clause arising from a commercial relationship provides for arbitration in a signatory country and has a reasonable relationship to that country, arbitration is mandatory. Further, when a dispute arises as to the jurisdiction of the arbitration panel, the issue of jurisdiction is to be decided by that panel.

### III. BACKGROUND

Arbitration has long been an alternative to courts of law. The legal basis of arbitration is found in ancient Roman law and has continued to evolve throughout the centuries to its present form.

#### A. Arbitration in the United States

The United States once had a deep rooted hostility toward arbitration. This hostility was a carry-over from the English common law courts which refused to honor arbitration agreements because they were an attempt to oust the courts of their jurisdiction. The hostility seems to have magnified because the early English courts received fees for each case heard and the judges lost a part of their salary with each case that was arbitrated; thus, judges were unwilling to refer a case to arbitration.

Gradually, arbitration became accepted in England and, in 1889, the English Arbitration Act was passed. This act made arbitration agreements irrevocable. The common law of England at this time still allowed certain arbitration

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20. Id. at 939. Plaintiffs relied on Art. II para. 3 of the 1958 Convention, which states, "The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of the Article, shall at the request of one of the parties, refer the parties to arbitration, unless it finds that said agreement is null and void, inoperative or incapable of being performed."


22. Id. at 939.

23. Id. at 939, 940-41.

24. Id. at 940.


26. See generally id. at 83-130.


28. Id. at 983-85.

29. Id. at 983-84. See also Bedell, Harrison & Grant, Arbitrability: Current Developments in the Interpretation and Enforceability of Arbitration Agreements, 13 J. Contemp. L. 1 (1987).

agreements to be revoked until the arbitrator's final decision was made.\textsuperscript{31} The United States adopted the English common law and allowed revocation of arbitration agreements.

American courts have acknowledged arbitration for well over a century and stated that arbitration, "[a]s a mode of settling disputes should receive every encouragement from courts."\textsuperscript{32} However, while criticizing the common law for allowing revocation of arbitration agreements, the courts refused to overturn the common law without statutory support.\textsuperscript{33} Thus arbitration agreements remained revocable until the final decision.

The Federal Arbitration Act of 1925\textsuperscript{34} was the first United States statute which favored arbitration as a federal policy.\textsuperscript{35} The Act provided that arbitration agreements which were in writing and involved foreign or interstate commerce were valid and irrevocable.\textsuperscript{36} The Act also allowed a court to stay proceedings when there was a controlling arbitration agreement;\textsuperscript{37} one party to petition the courts to force compliance with the agreement;\textsuperscript{38} the court to appoint an arbitrator, if necessary;\textsuperscript{39} for entry of an arbitration award;\textsuperscript{40} and to vacate an award in case of fraud, corruption or misconduct of an arbitrator.\textsuperscript{41} The purpose of the Act was to enforce arbitration agreements as a means to encourage efficient and speedy dispute resolution in a non-judicial setting\textsuperscript{42} at a time when substantial delays and costs were compiling in litigation. Arbitration was seen as a method of dealing with crowded court dockets.\textsuperscript{43}

B. International Arbitration

The first steps toward an international law of arbitration for commercial transactions were taken at the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927 and the Geneva Protocol on Arbitration Clauses in

\textsuperscript{31} R. David, supra note 25, at 114-17. See also Sayre, Development of Commercial Arbitration Law, 37 Yale L. J. 595, 607 (1928).
\textsuperscript{32} Burchell v. Marsh, 58 U.S. (17 How.) 344, 349 (1855).
\textsuperscript{36} 9 U.S.C. §§ 1, 2 (1982).
\textsuperscript{37} 9 U.S.C. § 3 (1982).
\textsuperscript{40} 9 U.S.C. § 9 (1982).
\textsuperscript{41} 9 U.S.C. § 10 (1982).
\textsuperscript{42} Byrd, 470 U.S. at 220.
The agreements which arose affected recognition and enforcement of foreign arbitration agreements and awards. These first agreements were adopted by few nations outside of Europe and have been called unsatisfactory for international commerce.

After World War II, there was another push to conceive an international arbitration law. Two reasons have been offered for this movement. First, there was fear that anarchy in the world economic order could threaten the new found peace. Second, arbitration was gaining acknowledgement as an important part of international trade disputes. The first step in this movement was made by the International Chamber of Commerce which drafted its own revised Convention in 1953.

The International Chamber of Commerce referred the matter to the United Nations who had its Economic and Social Counsel set up a committee to study international arbitration. In 1955, the committee recommended a new Convention which was reviewed and revised by a 1958 conference of forty-eight nations and thirteen organizations. The final result was a new Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The United States did not adopt the 1958 Convention until 1970. Although present at the 1958 negotiations, the United States did not adopt the Convention due to conflicts in domestic law. One such conflict was that only seventeen states had enacted legislation declaring arbitration agreements irrevocable, while Article II of the 1958 Convention required contracting parties to recognize arbitration agreements as irrevocable. There were also other obligations in the 1958 Convention which might have been inconsistent with state law and procedure. The United States finally adopted the 1958 Convention due to increased pressure from governmental, commercial and private groups which favored international arbitration.

By becoming a signatory nation to the 1958 Convention, the United States showed its willingness to enforce arbitration agreements in international commercial transactions. The federal policy favoring arbitration was given

44. R. DAVID, supra note 25, at 145.
46. Id. See also R. DAVID, supra note 25, at 145.
47. R. DAVID, supra note 25, at 145.
48. Id.
49. Id.
50. 1958 Convention, supra note 16; R. DAVID, supra note 25, at 145.
51. Comment, supra note 35, at 63 n.34.
52. Czyzak & Sullivan, supra note 45, at 202-03.
53. Id.
added consideration in the area of international commercial transaction, resulting in a strong presumption favoring such arbitration agreements.

IV. THE MARCHETT Decision

The 1958 Convention required the Marchetto court to determine whether there existed a written arbitration agreement which arose out of a commercial relationship and required arbitration in a signatory country for disputes with a reasonable relationship to that forum state. If these factors were met, the court was required to submit the dispute to arbitration. The court found all factors present. In addition to finding these factors, the court addressed two other issues to determine the validity of the arbitration clause. The issues, raised by Plaintiffs, were whether the arbitration clause was incapable of performance and whether the tort claim was within the scope of the clause. According to Article II(3) of the 1958 Convention, arbitration is not mandatory if the arbitration agreement is "incapable of being performed." Plaintiffs argued that the arbitration clause would not be enforced under Italian law because only one of the defendants was a party to the arbitration agreement. Thus, the agreement could not be performed and the court had no duty to refer the dispute to the Italian arbitration panel.

The court rejected Plaintiffs' incapability of performance argument. It stated that, "[t]he possibility that Italian law might divest a panel of Italian arbitrators of jurisdiction is not determinative of this court's duty to enforce an otherwise valid arbitration agreement." The Federal Arbitration Act requires that federal law be controlling on the issue of the validity of an arbitration agreement falling under the 1958 Convention.

56. Id. at 939. See also Sedco, 767 F.2d at 1144-45.
57. Marchetto, 711 F. Supp. at 939.
58. Id. (citing Sedco, 767 F.2d at 1144-45; Ledee, 684 F.2d at 186-87).
59. Id.
60. Id. at 939. Italy acceded to the 1958 Convention on January 26, 1969. R. DAVID, supra note 24, at 425. The court found a relationship between the transaction in dispute and Italy in that Dekalb Italiana is an Italian corporation and that an Italian group of shareholders was allegedly injured. Marchetto, 711 F. Supp. at 939.
62. Id. at 939-40.
63. Id. at 939. See 1958 Convention, supra note 20.
64. Marchetto, 711 F. Supp. at 939-40.
65. Id. at 939 (citing Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 629-31 (1985); Scherk, 417 U.S. at 517-19; Rhone Mediterranee Compagnia v. Achille Lauro, 712 F.2d 50, 53-54 (3d. Cir. 1983)).
Plaintiffs attempted to rely on *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University,* for the position that arbitration cannot be ordered where non-parties to the arbitration agreement are involved. However, the Marchetto court distinguished *Volt* on its facts. The parties in *Volt* incorporated the California Arbitration Act into their arbitration agreement. The California Act allowed a stay of arbitral proceedings until litigation with non-arbitration-parties was resolved. The *Marchetto* court held that *Volt* did not mandate a stay on arbitral proceedings when non-parties were involved, but rather that arbitration agreements are to be enforced according to the terms set forth therein. Because the parties in *Volt* contracted to follow the California Rules, the court enforced those terms. The *Volt* court did not hold as a matter of federal law that arbitration was not enforceable where non-parties are involved.

In direct opposition to Plaintiffs' contention, the *Marchetto* court held that under federal law non-parties to an arbitration agreement are clearly allowed to participate in arbitration. Because arbitration between Plaintiffs and all defendants was possible under federal law, the court considered the clause performable.

Plaintiffs further asserted that the law of the forum state (Italy) should determine the validity of the arbitration clause. The court easily dispelled this argument by stating that the possibility that Italian law could divest the arbitration panel of jurisdiction did not render the agreement invalid and not performable. Rather, this was a question of fact for the panel to consider. United States Courts assume that under the 1958 Convention forum nations will honor arbitration agreements without interference from "legal principles unique to the signatory nation." It is assumed that arbitration panels will look to the contractual intent of the parties, rather than the law of the forum nation, to resolve the dispute. Therefore, the court assumed Italy would honor the arbitration agreement.

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70. CAL. CIV. PROC. CODE §§ 1280 -94 (West 1982).
73. *Id.*
74. *Id.* at 939 (citing *Moses H. Cone Memorial Hosp.*, 460 U.S. at 20; C. Itoh & Co. v. Jordan Int'l Co., 552 F.2d 1228, 1231-32 (7th Cir. 1977)). *See also* 9 U.S.C. § 203 (1982).
75. Plaintiffs' expert in Italian law testified that Italy would divest the arbitration panel of jurisdiction, while defendants' expert testified it would not. *Marchetto,* 711 F. Supp. at 940.
76. *Id.* at 939.
77. *Id.* at 940.
78. *Id.* (citing *Scherk,* 417 U.S. at 520 n.15; *Rhone,* 712 F.2d at 53-54).
79. *Marchetto,* 711 F. Supp. at 940 (citing *Mitsubishi,* 473 U.S. at 636, which states, There is no reason to assume at the outset of the dispute that international arbitration will not provide an adequate mechanism. To be sure, the international arbitral panel owes no prior allegiance to the legal norms of particular states; hence it has no direct obligation to vindicate their statutory dictates. The tribunal, however, is bound to effectuate the intentions of the parties.).
Plaintiffs’ final contention was that the arbitration clause did not cover the tort claim against defendants for willfully and intentionally interfering with the shareholders’ agreement. The court held that the claim did fall within the scope of the agreement because the transfer of shares in alleged violation of the shareholders’ agreement met the clause’s criteria of a dispute which pertained to, or arose out of, or a breach of, the shareholder’s agreement. The court further stated that a question regarding the scope of the agreement was itself a proper matter for arbitration. Thus, Plaintiffs’ argument had no basis.

In sum, the court held that the validity of the arbitration clause was to be determined under federal law. Validity under laws of the forum nation was not a consideration as the arbitration panel is to look to the parties’ contractual intent to resolve the dispute. Federal law allowed arbitration in this situation, so the arbitration clause was valid and performable. The court also held that the tort claim was within the scope of the agreement or at least a question of fact for the arbitration panel to determine. As a result of these findings, the action was dismissed and referred to the Italian arbitration panel.

V. ANALYSIS AND COMMENT

Marchetto is a good example of the method by which a court reviews a dispute that may be subject to a valid arbitration clause. The court first determined whether or not the four factors required by the 1958 Convention were met. Here, the four factors were clearly present. When these factors are found, arbitration is mandatory unless a valid defense is presented. In Marchetto, plaintiffs asserted two defenses, impossibility of performance and that the tort claim was beyond the scope of the arbitration agreement.

Id.

81. Id. at 938-39.
82. Id. at 939.
83. Id. at 940-41.
84. Id.
85. Id. at 939.
86. Id. at 939-40.
87. Id. at 939.
88. Id. at 939-40.
89. Id. at 941.
90. Id. at 939.
91. Id.
92. Id.
93. Sedco, 767 F.2d at 1145.
then reviewed and rejected each of the defenses and referred the dispute to arbitration. The reasoning of the court is clear and sound. The federal policy of promoting arbitration as an efficient and quick means of dispute resolution was followed as well as the trend toward strict enforcement of international arbitration agreements.

_Marchetto_ is also a good example of how a statute such as the Federal Arbitration Act may undermine the policy behind the 1958 Convention. The Federal Arbitration Act requires that, "[a]n action or proceeding falling under the Convention shall be deemed to arise under the laws and treaties of the United States." Therefore, the court applies the federal law of arbitration to determine the validity of an arbitration agreement. While the policy behind the Convention is to provide a predictable choice of forum and law, any signatory country could thwart that policy with language such as that in the Federal Arbitration Act. If the agreement is not valid according to the substantive law of a country with a statute such as the Federal Arbitration Act, that country can refuse to enforce the agreement and dispose of the dispute through its court system rather than the agreed upon arbitration panel. It is conceivable that a party could shop for such a forum which also has laws favorable to that party's interests in the dispute. Thus the policy of providing a known forum and choice of law may be avoided. In such a situation, the predictability and order necessary for international business is lost.

VI. CONCLUSION

The 1958 Convention increases the necessity of predictability in resolving disputes in international commercial transactions. Parties are able to negotiate a mutually acceptable forum and choice of law and expect to resolve disputes in that place and under that law. These agreements may be ignored, even in nations that have strong policies toward following the 1958 Convention, by statutes such as the Federal Arbitration Act. It is clear that the 1958 Convention has enhanced, but not met one of its primary goals: to prevent forum shopping.

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95. _Id._ at 940-41.
96. _Byrd_, 470 U.S. at 220.
100. _Scherk_, 417 U.S. at 516.