# THE ARBITRATION AGREEMENT: PRECLUDING RECOURSE TO THE COURTS ESPECIALLY IN FOREIGN OR INTERNATIONAL ARBITRATION

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Arbitration as an alternative to the more costly, tedious, time-consuming and oftentimes traumatic settlement of disputes by court action, whether the dispute is one of a pure domestic character (or domestic arbitration) or one of an international character (or foreign arbitration), has long been recognized and accepted by our courts. The Supreme Court has said:

> Arbitration, as an alternative mode of settling disputes, has long been recognized and accepted in our jurisdiction (Chapter 2, Title XIV, Book IV, Civil Code). Republic Act No. 876 (The Arbitration Law) also expressly authorizes arbitration of domestic disputes.
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> *Foreign arbitration* as a system of settling commercial disputes *of an international character* was likewise recognized when the Philippine adhered to the United Nations "Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958," under the 10 May 1965 Resolution No. 71 of the Philippine Senate, giving reciprocal recognition and allowing the enforcement of *international arbitration agreements* between parties of different nationalities within contracting states.[1]

Previously, our courts have looked with disfavor upon arbitration agreements. Earlier rulings provided that referral of disputes to arbitrations "and to them alone" is contrary to public policy under the principle that parties "cannot oust the courts of jurisdiction."[2] This parochial view has, however, long been abandoned by our courts. Instead, our courts have adopted a more amiable stand on arbitration. Later rulings echo the sentiments expressed by the court in the *Eastboard* case, where the court held:

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[1]National Union Fire Insurance Co. v. Stolt-Nielsen Phils., 184 SCRA 682, 688-689 (1990). (emphasis supplied.)

[2]Manila Electric Co. v. Pasay Transportation Co., 57 PHIL. 600, 603 (1932).

> [T]he more intelligent view that arbitration, as an inexpensive, speedy and amicable method of settling disputes, and as a means of avoiding litigation, should receive encouragement from the Courts which may be extended without contravening sound public policy or settled law" (3 Am. Jur., p. 835). Congress has officially adopted this modern view where it reproduced in the New Civil Code the provisions of the old Code on Arbitration. And only recently it approved Republic Act No. 876 expressly authorizing arbitration of future disputes.
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Considering this declared policy of Congress in favor of arbitration of all kinds of disputes, and the fact that, according to the explanatory note of Republic Act No. 876, "to afford the public a cheap and expeditious procedure of settling not only commercial but other kinds of controversies *most of the states of the American Union have adopted statutes providing for arbitration,* and American businessmen are reported to have enthusiastically accepted the innovation because of its obvious advantages over the ordinary court procedure." We find no plausible reason for holding that the arbitration agreement in question, simply because it refers to a future dispute, is null and void as being against public policy.[3] (emphasis supplied by the court.)

It is now settled that the resolution of controversies "is not vested in the courts of justice alone to the exclusion of other agencies or bodies."[4] When a controversy arises, the contending parties may resort to arbitration which according to the court itself "is a much faster way of settling their controversy, compared to how long it would take if they were to go to court."[5] Thus, when the parties choose to submit their controversy to arbitration, they have merely "opted to avail ... of an alternative mode of settling" their dispute.[6]

In many instances, the Supreme Court has recognized the validity of arbitration agreements providing for arbitration in another state under the

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[3]Eastboard Navigation v. Juan Ysmael & Co., 102 PHILS. 1, 16-17 (1957).
[4]Gascon v. Arroyo, 178 SCRA 582, 587 (1989).
[5]*Id.*
[6]*Id.*

rules of procedure of that state or under the rules of international institutions, as well as the arbitral awards made pursuant thereto.[7]

In furtherance of the settled and accordingly, "more intelligent view that arbitration as an inexpensive, speedy and amicable method of settling disputes, and as a means of avoiding litigation" should "receive every encouragement from the courts,"[8] the Supreme Court, like courts in other countries, has acknowledged the validity of arbitration agreements included in a document which has been incorporated into a principal contract between the contracting parties *by mere reference or incorporation* "even without a specific stipulation to that effect."[9] The Supreme court has ruled that a party may be bound by an arbitration agreement by *subrogation* of an original party to an agreement incorporating an arbitration clause by reference.[10]

The Supreme Court has also recognized broadly formulated arbitration clauses. In *Stolt-Nielsen* for instance, the arbitration clause provided that:

> 4. *Arbitration.* Any dispute arising from the making, performance or termination of this Charter Party shall be settled in New York. Owner and Charterer each appointing an arbitrator, who shall be a merchant, broker or individual experienced in the shipping business; the two thus chosen, if they cannot agree, shall nominate a third arbitrator who shall be an admiralty lawyer. Such arbitration shall be conducted in conformity with the provisions and procedure of the United States Arbitration Act, and a judgment of the court shall be entered upon any award made by said arbitrator. Nothing in this clause shall be deemed to waive Owner's right to lien on the cargo for freight, deed of freight, demurrage.[11]

In *Eastboard Navigation*, the arbitration clause recognized by the Supreme Court provides that:

> 29. It is mutually agreed that should any dispute arise between Owners and Charterers, the matter in dispute shall be referred to three persons at New York for arbitration, one to be appointed by each of the parties thereto, and the third by the two so chosen; their decision or that of any two of them,

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[7]*See* National Union Fire Insurance v. Stolt-Nielsen Phils., 184 SCRA 682 (1990); Learjet Phils., Inc. v. Gates; Learjet Corp., GR No. 77673, Resolution of 27 July 1987; Eastboard Navigation v. Juan Ysmael & Co., 102 PHILS. 1 (1957).

[8]Eastboard, *supra* note 3.

[9]Stolt-Nielsen Phils, *supra* note 7, at 687; see also Eastboard Navigation, *supra* note 3.

[10]Stolt-Nielsen Phils., *supra* note 7, at 687.

[11]*Id.*

> shall be final, and for the purpose of enforcing any award, this agreement may be made a rule of the Court. The Arbitrators shall be commercial men. Should the two so chosen not be able to agree who the third Arbitrator should be, then the New York Produce Exchange is to appoint the third Arbiter. The amount in dispute shall be placed in escrow at New York, subject to the decision of the arbitrators.[12]

Again, in *Mindanao Portland Cement Corp. v. McDonough Construction Company of Florida,*[13] the arbitration clause provides that:

> 39. In the event of disagreement between the Owner and the Contractor in respect of the rights or obligations of either of the parties hereunder except the interpretation of the plans and specifications and questions concerning the sufficiency of materials, the time, sequence and method of performing the work, which questions are to be finally determined by the Engineer, they shall submit the matter to arbitration, the Owner choosing one arbitrator, the Contractor one, and the two so chosen shall select a third. The decision of such arbitrators or a majority of them shall be made in writing to both parties and when so made shall be binding upon the parties thereto.[14]

The enforceability of the so called "short form" arbitration clause has been recognized by courts of foreign jurisdiction. It has been observed in this regard that:

> The [New York] Convention does not impose particular requirements with respect to arbitration agreements. It must appear from the agreement that the parties have submitted to arbitration disputes arising out of a defined legal relationship (usually a contract). Courts generally uphold the so-called 'short form' arbitration clause (*e.g.* "Arbitration: In City X).[15] (*words in brackets ours.*)

Professor Van Den Berg cites the following cases in support of the foregoing proposition:

> (i) " ... general average and arbitration to be settled in London" - Tribunal Supremo (*Supreme Court of Spain*), 17 June 1983, "Ludmila C. Shipping Co., Ltd. (Cyprus) v. Maderas G.L., S.A. (Spain)", published in Revista de la Corte Espanola de Arbitraje (1984), p. 187. (Yearbook, Vol. XI, 1986, pp. 525-526.).

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[12]Eastboard, *supra* note 3 at 11.
[13]19 SCRA 811 (1967).
[14]*Id.* at 811.
[15] Prof. Van den Berg, *Commentary*, XI YEARBOOK OF COMMERCIAL ARBITRATION 416 (1986).

> (ii) "Arbitration: in London if necessary" - Corte de Cassazzione (*Supreme Court of Italy*), 21 November 1983, no. 6925, "Conceria Fratelli Tollio s.n.c. (Italy) v. Ditta O.S. Blenkinsop (South Africa)", Rassegna dell Arbitrato (1983, n. 3-4) p. 217. (Yearbook, Vol. X, 1985, pp. 478-479).
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> (iii) "Any dispute concerning the goods referred to in this confirmation shall be settled by arbitration in accordance with the Arbitration Rules of the International Wool Association and the competent authority for the conduct of the arbitration proceedings, shall be the Association of the Italian Wool Industry." - Oberster Gerichtshof (*Supreme Court of Austria*), 21 February 1978, Parties not disclosed, published in Entscheidungen des Osterreichischen Obersten Gerichtshof in Zivilsachen (1978), p. 77 et seq. (Yearbook, Vol. X, 1985, pp. 418-421).

As the Austrian Supreme Court held in this case, "The contents required for an agreement in writing within the meaning of Art. II, par. 1, of the Convention are the exact description of a dispute which has already arisen or of a defined legal relationship [usually contracts] in respect of which disputes may arise in the future as well as the declaration of the will of the parties to have their cases decided by arbitration. The arbitration clause contained in the order confirmation meets these requirements."[16]

In the practice of international commercial arbitration, the following standard arbitration clauses have been prescribed. The *International Chamber of Commerce* for instance follows a standard clause which provides:

> All disputes arising in connection with the present contract shall be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.

This standard clause may be complemented, if the parties so desire, by stipulation as to the place of arbitration, the number of arbitrators, the law applicable to the merits of the dispute, the procedural law that is to be applied, the language to be used in the proceedings and, under some legal systems, the assigning to the arbitrators of the powers of "amiable compositeurs."[17]

The *American Arbitration Association* has adopted its own version:

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[16]*Id.*, at 419.

[17]International Chamber of Commerce, GUIDE TO ARBITRATION, p. 30 (1983).

> Any controversy or claim arising out of or related to this contract, or the breach thereof, shall be settled by arbitration in accordance with the Rules of the American Arbitration Association, and judgment upon the award rendered by the Arbitrator(s) may be entered in any Court having jurisdiction thereof."

Arbitration clauses in accordance with UNCITRAL[18] Rules provide:

> Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force.

Arbitration clauses in accordance with the Rules of the *UN Economic Commission for Europe,* on the other hand, read

> Any dispute arising out of, or relating to this contract, which the parties have not been able to settle amicably shall be finally settled by arbitration, in accordance with the ECE's Arbitration Rules which the parties declare to be known to them.[19]

For an arbitration clause to be effective, it is not necessary that the arbitration agreement be expressly stated in the principal agreement of the parties as it may be deemed included therein by reference or by incorporation (of another document). Neither is it necessary that parties expressly state therein that court action is precluded. To make the effectivity of the arbitration clause or agreement dependent on the parties' expressly stating in their principal agreement the terms of the arbitration agreement or to require the additional stipulation that recourse to the regular courts is prohibited, or that recourse to arbitration is being made to the exclusion of the regular courts, would not comport with settled jurisprudence, the recognized rationale and purpose of arbitration, and more importantly, international practice.

The Philippines as well as many other states are signatories to the United Nations "Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958."[20] The Philippines' ratification of the New York Convention is embodied in Senate Resolution No. 71 of 10 May 1965.[21]

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[18]United National Commission on International Trade Law.
[19]Von Mehren, COURSE OUTLINE IN INTERNATIONAL COMMERCIAL ARBITRATION, Harvard Law School.
[20]Hereafter termed THE NEW YORK CONVENTION.
[21]61 O.G. 8344-8355 (27 December 1965).

The New York Convention in Article II(1) and II(3) 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.
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> 3. 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 this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed:

It is a universally accepted principle of international law that a state must comply with its treaty obligations in good faith. It is in keeping with our treaty obligations under the New York Convention that our courts adhere to the mandate embodied in Article II of the Convention. It has been observed that the obligation imposed upon the contracting states under Article I(1) "implies the duty not to hold judicial proceedings upon the merits of the case covered by the terms of the arbitration clause, as otherwise the clause would be devoid of any practical meaning."[22] Hence, if in contravention of an arbitration agreement, one of the contracting parties files suit before a Philippine court, the other party may, by a mere motion to dismiss which qualifies as a "request" in contemplation of Article II(3) of the New York Convention, preempt or bar court action. The court before which the motion to dismiss is filed must dismiss the action on the ground of lack of jurisdiction unless it finds, on circumscribed grounds, that the agreement is "null and void, inoperative or incapable of being performed."[23] Should the trial court, in violation of a valid arbitration agreement refuse to dismiss the action, or at the very least suspend the same pending final outcome of the arbitration proceedings, the aggrieved party may institute the necessary action for certiorari or prohibition before a higher court.[24] It has been held that should recourse to the courts be made in violation of the arbitration agreement or, alternatively, to compel a party to proceed to arbitration in accordance with their agreement to arbitrate, the proceeding before the court "is merely a summary remedy to enforce the agreement to

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[22]Luzatto, *International Commercial Arbitration and Law of State*, 157 RECUEIL DES COURS 17, 37 (197

[23]Stolt-Nielsen, *supra* note 7, at 689.

[24]*Id.*, at 686.

arbitrate."[25] The duty of the court seized of such action "is not to resolve the merits of the parties' claims but only to determine if they should proceed to arbitration or not."[26]

In *Stolt-Nielsen,* the Supreme Court subscribed to the view that the law of the state of the forum where the arbitration agreement is sought to be enforced, governs the determination of the issues of whether the arbitration agreement is "null and void, inoperative or incapable of being performed" or whether the dispute is one that may properly be referred to arbitration (the "arbitrability" of the dispute).[27] In making this determination, the court should not address or take into consideration the merits of the controversy as it does not have the authority to do so. The existence of merits or want of it is for the arbitrators to determine.[28] As to any defense or argument that may be raised to nullify or invalidate an arbitration agreement within the contemplation of the New York Convention on the ground that it violates Philippine public policy, "[a]n increasing number of courts held that with cases falling under the Convention the concept of international public policy is to be applied ... thus, a subject matter which may not be submitted for arbitration in domestic cases, may, by virtue of the narrower international public policy, be submitted to arbitration in international cases."[29] In *Parsons and Whitemore Overseas, Co. v. Societe General de l'Industrie du Papier,*[30] for instance, the Second Circuit Court of Appeals of the United States held that the public policy defense under the New York Convention should be construed narrowly so as to include only the "most basic notions of morality and justice" of the forum.[31]

It is submitted that a Philippine court is authorized or justified in refusing to recognize the validity of and/or to enforce an arbitration agreement (as distinguished from the principal contract itself) only if the arbitration agreement covers a subject matter that is not susceptible of arbitration or compromise[32] or, though it covers a subject matter capable of arbitration or compromise, one or both of the contracting parties are clearly incapable of entering into the agreement for lack of the requisite capacity to enter into the contract (*e.g.* lack of mental or legal capacity or lack of

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[25]Mindanao Portland, *supra* note 13, at 815.
[26]*Id.*
[27]Stolt Nielsen, *supra* note 7.
[28]Mindanao Portland, *supra* note 13, at 815.
[29]YEARBOOK, *supra* note 15, at 433 (1986).
[30]508 F. 2D. 969 (2d Cir. 1974).
[31]*Id.*, at 974.
[32]CIVIL CODE, Article 2053.

authority). In this regard, the Supreme Court has held that the Philippine Government, through the Office of the President, may validly submit itself to arbitration with a private party, as arbitration is a settled "alternative mode of settling disputes among parties other than through court action.[33]

It should be noted that under Article II(1) of the New York Convention, a contracting state is bound to recognize an arbitration agreement. Under the Convention, an arbitration agreement is simply defined as "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." There is no requirement that an arbitration agreement or arbitration clause to be valid or effective upon contracting states in the contemplation of the Convention should contain any additional language, such as a stipulation expressly prohibiting or barring jurisdiction by local courts over the dispute. It is presumed under the clause that arbitration is the exclusive mode agreed upon by the parties for the settlement of their disputes.

As to what arbitration agreement qualifies for referral to arbitration within the contemplation of Article II(3) of the New York Convention, it has been aptly stated that:

> [I]t would be consistent to interpret Art. II(3) in conformity with Art. I which provides for the arbitral award. Art. I is mainly based on an award made in another State. Accordingly, Art. II(3) can be deemed applicable to an agreement providing for arbitration in another State. This interpretation is generally followed by courts in the Contracting States.[34]

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[33]Gascon, *supra note 4*, at 587.

[34]YEARBOOK, *supra* note 15, at 416.

Article I of the New York Convention provides:

> This Convention shall apply to the recognition and enforcement of arbitral awards made in the territory of a State other than the State where the recognition and enforcement of such awards are sought, and arising out of differences between persons, whether physical or legal. It shall also apply to arbitral awards not considered as domestic awards in the State where their recognition and enforcement are sought.

Article I(1) of the New York Convention:

> [A]pplies to all arbitral awards rendered in a country other than the state of enforcement as domestic in that state; it also applies to all awards not considered as domestic in the state of enforcement, whether or not any of such awards may have been rendered in the territory of that state.[35]

The New York Convention contemplates two types of "international" or "foreign" arbitral awards, or conversely "international" or "foreign" arbitration with reference to the procedure or process giving rise to the arbitral award. The first type of arbitration contemplated under Article I(1) refers to arbitration conducted in a country other than the state of enforcement of the award, whether or not any of such awards may be regarded as domestic in that state. The second type of arbitration refers to those not considered as domestic in the state of enforcement. For purposes of applying Article I(1) of the New York Convention in the Philippine context, the reservations made by the Philippines in ratifying the New York Convention to the effect that it shall apply the New York Convention only to the recognition and enforcement of awards made in the territory of another contracting State (the reciprocity provision) limits the application of the Convention in the first type of arbitration to arbitrations (or arbitral awards) conducted (or rendered) in the territory of a state which is a party to the Convention. Hence, if a "foreign" arbitral award that may be rendered in another state under an arbitration agreement or arbitration clause qualifies as an arbitral award under Article I of the New York Convention, the arbitration agreement or arbitration clause is an agreement for which referral to arbitration under the terms of Article II(3) is required upon the request of any of the parties thereto.

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[35]Contini, *International Commercial Arbitration, The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 8 AM.J.C.L. 283, 291-294 (1958); See also, *Report of the UN Secretary-General: Study on the Application and Interpretation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, X UNCITRAL YEARBOOK (1979), UN Doc. No. A/CN.9/168.

The second type of arbitral award referred to by the Convention are those "not considered as domestic in the state of enforcement." In the context of Philippine law, this second type includes awards not made pursuant to the provisions of the Arbitration Law (RA No. 876). The second type of award therefore covers awards which may be made pursuant to arbitration proceedings conducted in the Philippines (or abroad) under the rules of procedure of other states, international institutions such as the International Chamber of Commerce (ICC), or international commercial associations such as the National Institute of Oilseed Producers (NIOP), regardless of whether or not Philippine law is to govern the determination of the merits of the dispute or not.

The nationality of the parties to the arbitration is not a criterion under Article I of the New York Convention. Professor Van den Berg observes that:

> [T]he Convention's predecessors, the Geneva treaties of 1923 and 1927 require that parties were subject to the jurisdiction of the States Party to the treaties. Such condition for the field of application is *not required* by the New York Convention under which it suffices that the award be made in the territory of another (contracting) state.[36]

It has been observed that:

> In other contexts, however, nationality of the parties and the international character of their transaction may become relevant. It may, for instance, be used as a criterion for the applicability of Article II specifying the arbitration agreement ... It may also lead to non-application of national law in the context of arbitrability and public policy under Article V ... Another example is provided by the decision of a Tunisian court which held that a *public enterprise*, irrespective of whether under domestic law it can agree to arbitration, has the capacity to do so where it is a party to an international transaction with a foreign enterprise.[37]

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[36]YEARBOOK, *supra* note 15, at 405-406; citing Tribunal Federal (Supreme Court of Switzerland), 14 March 1984, *Denysiana S.A. (Switz.) v. Jassica S.A. (Switz.)*, 107 SEMAINE JURIDICAIRE 73-77 (1985), 110 Ib ARRET DU TRIBUNAL FEDERAL 191-195 (1985), YEARBOOK, Vol. XI (1986), 536-538; Tribunal Supremo (Supreme Court of Spain), 6 October 1983, *M. Compania Naviera S.A. (Panama) v. C. de C.E.S.A. (Spain)*, REVISTA DE LA CORTE ESPANOLA DE ARBITRAJE 193 (1984), YEARBOOK, Vol. XI (1986), 530-531; nationality of the parties "is irrelevant even where a national law prohibits its nationals to exclude the jurisdiction of its courts in agreeing on foreign arbitration," *Report of the Secretary-General, supra.*, par. 7, at 101-102.

[37]Report of the Secretary-General, *supra* note 36, par. 8, at 102.

In the light of settled jurisprudence affirming the validity of the arbitration process, and in the light of the Philippine adherence to the New York Convention pertaining to foreign arbitral awards - and as a necessary corollary thereto, foreign arbitrations - courts should be extremely circumspect in taking cognizance of suits when the parties have agreed on arbitration as a mode of settling their dispute. The existence of an arbitration agreement, if properly (through a motion to dismiss or any similar motion) and timely pleaded (any time before any party has commenced presentations of its evidence during trial on the merits should be deemed timely in this regard), bars court action and the trial court must either dismiss the complaint without prejudice (it should not dismiss the case "with prejudice" otherwise the party resisting arbitration may use dismissal "with prejudice" as a ground to say that the action has already been decided against the party seeking arbitration) or stay the proceedings and refer the parties to arbitration in accordance with their agreement, unless, of course, arbitration is waived as when the parties chose to voluntarily litigate their controversy and proceed with trial before the court. Any other action on the part of the court will clearly be in excess of its jurisdiction or will be made with grave abuse of discretion calling for the extraordinary writs of superior courts. Should a trial court deny a motion challenging its jurisdiction over an action which is a proper subject of arbitration, "the remedy of prohibition would lie since it would be useless and a waste of time to go ahead with the proceedings."[38]

[38]Stolt-Nielsen, *supra* note 7, at 636.