

## PHILIPPINE ARBITRATION UPDATES:

The case of Korea Technologies Co., Ltd. v. Hon. Alberto A. Lerma<sup>1</sup> and Pacific General Steel Manufacturing Corporation, G.R. No. 143581, Jan. 7, 2008.

### The Facts:

Korea Technologies Co., Ltd. [Korea Tech], a Korean corporation, entered into a contract with Pacific General Steel Manufacturing Corporation [Pacific General], a domestic corporation, whereby Korea Tech undertook to ship and install in Pacific General's site in Carmona, Cavite the machinery and facilities necessary for manufacturing LPG cylinders, and to initially operate the plant after it is installed. The plant, after completion of installation, could not be operated by Pacific General due to its financial difficulties affecting the supply of materials. The last payments made by Pacific General to Korea Tech consisted of postdated checks which were dishonored upon presentment. According to Pacific General, it stopped payment because Korea Tech had delivered a hydraulic press which was different in kind and of lower quality than that agreed upon. Korea Tech also failed to deliver equipment parts already paid for by it. It threatened to cancel the contract with Korea Tech and dismantle the Carmona plant. Korea Tech initiated arbitration before the Korea Commercial Arbitration Board [KCAB] in Seoul, Korea and, at the same time, commenced a civil action before the Regional Trial Court [the "trial court"] where it prayed that Pacific General be restrained from dismantling the plant and equipment. Pacific General opposed the application and argued that the arbitration clause was null and void, being contrary to public policy as it ousts the local court of jurisdiction. It also alleged that Korea Tech was not entitled to the payment of the amount covered by the two checks, and that Korea Tech was liable for damages.

The trial court denied the application for preliminary injunction and declared the arbitration agreement null and void. Korea Tech moved to dismiss the counterclaims for damages.

Meanwhile, Pacific General filed a motion "for inspection of things" to determine whether there was indeed alteration of the quantity and lowering of quality of the machineries and equipment and whether these were properly installed. Korea Tech opposed the motion arguing that these issues were proper for determination in the arbitration proceeding.

The court denied the motion to dismiss and granted the motion for inspection of things. The court also directed the Branch Sheriff to proceed with the inspection of the machineries and equipment in the plant. The Branch Sheriff later reported his finding that the enumerated machineries and equipment were not fully and

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properly installed.

Korea Tech filed a petition for certiorari before the Court of Appeals [CA]. The court dismissed the petition and held that an arbitration clause which provided for a final determination of the legal rights of the parties to the contract by arbitration was against public policy. Further appeal was made to the Supreme Court by way of a petition for review. The Supreme Court (the “Court”) held:

1. Re: The trial court’s order directing the Branch Sheriff to inspect the plant, equipment and facilities.

The sheriff lacked the competence to conduct an inspection of the Carmona plant, equipment and facilities. The trial court’s order directing the sheriff to do so is evidently flawed and devoid of legal basis. There was a real and imminent threat of irreparable destruction or substantial damage to the Korea Tech equipment and machineries. The trial court gravely abused its discretion. A resort to certiorari is proper.

2. Re: The validity of the arbitration clause.

“The arbitration clause is valid.<sup>2</sup> It has not been shown to be contrary to any law, or against morals, good customs, public order or public policy<sup>3</sup>. The arbitration clause stipulates that the arbitration must be done in Seoul, Korea in accordance with the Commercial Arbitration Rules of the KCAB, and that the award is final and binding. This is not contrary to public policy.<sup>4</sup> ***We find no reason why the arbitration clause should not be respected and complied with by both parties.***”

This ruling, the Court said, is consonant with the declared policy in Section 2 of the ADR Act that “the State (shall) actively promote party autonomy in the resolution of disputes or the freedom of the parties to make their own arrangements to resolve their disputes.” Citing Section 24 of the ADR Act<sup>5</sup>, the Court said the trial court does not have jurisdiction over disputes that are properly the subject of arbitration pursuant to an arbitration clause. In the earlier case of BF Corporation v. Court of Appeals and Shangri-la Properties, Inc.,<sup>6</sup> where the trial court refused to refer the parties to arbitration notwithstanding the existence

<sup>2</sup> Gonzales v. Climax Mining Ltd. G.R. No. 161957 and G.R. No. 167994m Jan. 22, 2007, 512 SCRA 148 citing Manila Electric Co. v. Pasay Transportation Co., 57 Phil. 600 (1932); Del Monte Corporation-USA v. Court of Appeals, G.R. No. 136154, Feb. 7, 2001; 351 SCRA 373, 381

<sup>3</sup> Citing Arts. 2044 in relation to Art. 2038, 2039 and 2040, Civil Code

<sup>4</sup> Eastboard Navigation Ltd. v. Juan Ysmael and Co., Inc., 102 Phil. 1 (1957); BF Corporation v. Court of Appeals, G.R. No. 120105, March 27, 1998; 288 SCRA 267, 286; LM Power Engineering Corporation v. Capitol Industrial Construction Groups, Inc., G.R. No. 141833, March 26, 2003; 399 SCRA 562, 569-570.

<sup>5</sup> Sec. 24. Referral to Arbitration. – A court before which an action is brought in a manner which is the subject matter of an arbitration agreement shall, if at least one party so requests not later than the pre-trial conference, upon the request of both parties thereafter, refer the parties to arbitration unless it finds that the agreement is null and void, inoperative or incapable of being performed.

<sup>6</sup> G.R. No. 120105, March 28, 1998; 288 SCRA 267

of an arbitration agreement between them, the Supreme Court said the trial court had prematurely exercised its jurisdiction over the case.

The Court further emphasized that a submission to arbitration is a contract<sup>7</sup>. As a rule, contracts are respected as the law between the contracting parties and produce effect between them, their assigns and heirs.<sup>8</sup> Courts should liberally review arbitration clauses. Any doubt should be resolved in favor of arbitration.<sup>9</sup>

### 3. Re: Termination of contract with arbitration clause

A party may not unilaterally rescind or terminate the contract (that contains an arbitration clause) for whatever cause without first resorting to arbitration. The rule allowing extrajudicial rescission of a contract in case of breach<sup>10</sup> does not apply when the contract contains a valid arbitration clause as the issues arising from such alleged breaches of the contract by a party must be brought first and resolved by arbitration. Thus, the issues arising from the contract between Korea Tech and Pacific General on whether the equipment and machineries delivered and installed were properly installed and operational in Carmona and other issues related thereto are proper for arbitration.

### 4. Re: Pacific General's counterclaim for damages

Where the issue of validity of the arbitration clause or of its proper scope is submitted to a trial court in a petition to compel arbitration, the Arbitration Law confines the court's authority to pass upon issue such in a summary proceeding. The trial court must refrain from taking up the claim of the contending parties for damages which may be ventilated in a separate proceeding at the appropriate time and venue.<sup>11</sup>

### 5. Re: the grant of interim relief:

While the issue of the proper installation of the equipment and machineries might well be under the primary jurisdiction of the arbitral body, the trial court, under the ADR Act, has the jurisdiction to hear and grant interim measures to protect vested rights of the parties.<sup>12</sup> Considering that the equipment and machineries are in the possession of Pacific General, it has the right to protect and preserve the equipment in the best way it can. Pacific General has the right to dismantle and transfer the equipment and machineries either for protection or preservation

<sup>7</sup> Gonzales v. Climax Mining Ltd. G.R. No. 167994, January 22, 2007; 527 SCRA 148

<sup>8</sup> Citing Del Monte Corporation-USA v. CA, 404 Phil. 192 (2001)

<sup>9</sup> LM Power Engineering Corp. v. Capitol Industrial Construction Groups, Inc., G.R. No. 141833, March 26, 2003

<sup>10</sup> The rescission, however, is valid provisionally only because whether or not there was a breach of contract that justified its rescission is not issue for later judicial determination. University of the Philippines v. De los Angeles G.R. No. L-28602, September 29, 1970; 35 SCRA 102, and reiterated in succeeding cases, vide: San Lorenzo Shipping Corp. v. BJ Marthel International, Inc., G.R. No. 14583, Nov. 19, 2004; 443 SCRA 163, etc.

<sup>11</sup> La Naval Drug Corp. v. CA, G.R. No. 103200, August 31, 1994; 236 SCRA 78

<sup>12</sup> Citing Section 28, RA 9285; Article 17, Model Law, and Transfield Philippines, Inc. v. Luzon Hydro Corporation, G.R. No. 146717, May 19, 2006; 490 SCRA 14, 20-21

or for the better way to make good use of them. It must therefore preserve and maintain them with the diligence of a good father of a family until final resolution of the dispute and the enforcement of the award, if any.

6. Re: Enforcement of award in a domestic or international arbitration

An arbitral award in a domestic or international arbitration is subject to enforcement by a court upon application of the prevailing party for the confirmation or recognition and enforcement of an award.<sup>13</sup> Under Section 42 of the ADR Act, “The recognition and enforcement of such (foreign) arbitral awards shall be filed with the Regional Trial Court in accordance with the rules of procedure to be promulgated by the Supreme Court.” An arbitral award is immediately executory upon the lapse of the period provided by law. For an award rendered in domestic or non-international arbitration, unless a petition to vacate the award is filed within thirty (30) days from the date of serve upon the latter,<sup>14</sup> the award is subject to confirmation by the court.<sup>15</sup> For an award rendered in a domestic, international arbitration, the period for filing an application to set it aside is not later than three (3) months from the date the applicant received the award,<sup>16</sup> otherwise the court shall recognize and enforce it.<sup>17</sup>

7. Re: Enforcement of foreign arbitral award

In an attempt to allay the fear by Pacific General of submitting its dispute to arbitration in Seoul, South Korea under the rules of the Korea Commercial Arbitration Board, the Supreme Court said in **obiter dictum**:

*In case a foreign arbitral body is chosen by the parties, the arbitral rules of our domestic arbitration bodies would not be applied. As signatory to the Arbitration Rules of the UNCITRAL Model Law on International Commercial Arbitration of the United Nations Commission on International Trade Law [UNCITRAL] in the New York Convention on June 21, 1985, the Philippine committed itself to be bound by the Model Law. We have even incorporated the Model Law in Republic Act No. 9285, otherwise known as the Alternative Dispute Resolution Act of 2004.”*

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“Thus, while the RTC does not have jurisdiction over disputes governed by arbitration mutually agreed upon by the parties, **still the foreign arbitral award is subject to judicial review by the**

<sup>13</sup> Section 23, RA 876; Article 35, Model Law

<sup>14</sup> Section 26, RA 876

<sup>15</sup> Section 23, RA 876

<sup>16</sup> Model Law Article 34(3)

<sup>17</sup> Model Law Article 35

***RTC which can set aside, reject or vacate it.”.... Chapter 7 of RA 9285 has made it clear that all arbitral awards, whether domestic or foreign, are subject to judicial review on specific grounds provided for.”***

There is obviously a confusion between or among the following:

- (a) The 1958 New York Convention;
- (b) The UNCITRAL Model Law on International Commercial Arbitration; and
- (c) The UNCITRAL Arbitration Rules.

The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards is, as the name itself implies, a multi-lateral treaty signed in New York City on June 10, 1958. The Philippines was among the original signers of the 1958 New York Convention<sup>18</sup>, although, as a treaty, it was subject to ratification by the Senate. This ratification was given on May 10, 1965 under Resolution No. 71 of the Philippine Senate.<sup>19</sup> The Philippines deposited its ratification of the Convention on July 6, 1967.

The UNCITRAL Model Law on International Commercial Arbitration was approved by the United Nations Commission on International Law on June 21, 1985 at the close of the Commission’s 18<sup>th</sup> annual session. In Resolution No. 40/72 approved on December 11, 1985, the General Assembly requested member States “to give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international arbitration practice.” The Model Law was therefore given as a model that member States can adopt with or without modification as their law to govern international commercial arbitration. By itself, it is not a statute. It becomes one when it is enacted into law by a State. Until the Philippine Congress adopted it as part of the ADR Act of 2004, the Model Law on International Commercial Arbitration was not part of our law.

The UNCITRAL Arbitration Rules were likewise the product of UNCITRAL adopted during its 9<sup>th</sup> session after extensive consultations with arbitral institutions and centers of international commercial arbitration. The United Nations General Assembly approved Resolution No. 31/98 on December 15, 1976 recommending the use of the Arbitration Rules in the settlement of disputes

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<sup>18</sup> The Philippine delegation signed *ad referendum* with reservation that it will apply the Convention, on the basis of reciprocity, to the recognition and enforcement of awards made only in the territory of another Contracting State and only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration.

<sup>19</sup> See National Union Fire Insurance Company of Pittsburgh v. Stolt-Nielsen Philippines, Inc., G.R. No. 87958, April 26, 1990; 184 SCRA 682

arising in the context of international commercial relations, particularly by reference to the Arbitration Rules in commercial contracts.“ These rules have been used widely in *ad hoc* arbitrations although arbitral institutions have been known to have adopted the UNCITRAL Arbitration Rules as part of their own rules of procedure. The Philippine Dispute Resolution Center, Inc., for example, uses the UNCITRAL Arbitration Rules as its arbitration rules, subject to certain modifications.

The Model Law or the UNCITRAL Arbitration Rules, unlike the 1958 New York Convention, was not opened “for signature” by member States as they are not treaties. For the same reason, they were not submitted to the Senate for ratification.

The 1958 New York Convention provides that recognition and enforcement of an award may be refused by a court upon specific grounds.<sup>20</sup> This is clear from Sections 42 and 45 of the ADR Act,<sup>21</sup> that the most a Philippine court can do is

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<sup>20</sup> Article V provides that: 1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where recognition and enforcement is sought, proof that:

- (a) The parties to the agreement referred to in Article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it, or failing any indication thereon, under the law of the country where the award was made; or
- (b) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
- (c) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decision on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized or enforced; or
- (d) The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place;
- (e) The award has not yet become binding on the parties, or has been set aside, or suspended by competent authority of the country in which, or under the laws of which, that award was made.

2. Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is sought finds that:

- (a) The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
- (b) The recognition or enforcement of the award would be contrary to the public policy of that country.

<sup>21</sup> Section 42. **Application of the New York Convention.** - The New York Convention shall govern the recognition and enforcement of arbitral awards covered by the said Convention.

The recognition and enforcement of such arbitral awards shall be filed with the regional trial court in accordance with the rules of procedure to be promulgated by the Supreme Court. Said procedural rules shall provide that the party relying on the award or applying for its enforcement shall file with the court the original or authenticated copy of the award and the arbitration agreement. If the award or agreement is not made in any of the official languages, the party shall supply a duly certified translation thereof into any of such languages.

The applicant shall establish that the country in which the foreign arbitration award has been made is a party to the New York Convention.

If the application for rejection or suspension of enforcement of an award has been made, the regional trial court may, if it considers it proper, *vacate its decision* and may also, on the application of the party claiming recognition or enforcement of the award, order the party to provide appropriate security.

Section 45. **Rejection of a Foreign Arbitral Award.** - A party to a foreign arbitration proceeding may oppose an application for recognition and enforcement of an arbitral award in accordance with the procedural rules to be promulgated by the Supreme Court only on those grounds raised under Article V of the New York Convention. Any other

to refuse recognition of a foreign arbitral award.

The Supreme Court further held:

*“The differences between a final arbitral award from an international or foreign arbitral tribunal and an award given by a local arbitral tribunal are the specific grounds or conditions that vest jurisdiction over our courts to review the awards.*

*“For foreign or international arbitral awards which must first be confirmed by the RTC, the grounds for setting aside, rejecting or vacating the award by the RTC are provided under Article 34(2) of the UNCITRAL Model Law.*

*“For final domestic arbitral awards, which also need confirmation by the RTC pursuant to Sec. 23 of RA 876 and shall be recognized as final and executory decisions of the RTC, they may also be assailed before the RTC and vacated on the grounds provided under Sec. 25 of RA 876.”*

Perhaps the following distinctions need to be made. When the place of arbitration is outside the Philippines, its foreign origin would be clear from the arbitral award itself. At the end portion of the award, the arbitrator will state the jurisdiction or country where the award is made, thus:

**Made in Hong Kong, February 27, 2008, or**

**Made in Singapore, February 27, 2008**

An arbitral award made in Hong Kong or Singapore or any other place outside the Philippines will be, in the Philippines, a foreign arbitral award.

An international commercial arbitration that is governed by the Philippine Model Law on International Commercial Arbitration *is a domestic arbitration*. This is obvious from the fact that our model law can only govern an international commercial arbitration in the Philippines.<sup>22</sup> If the place of arbitration is another country, such as, for example, Hong Kong or Singapore, it will be governed by the arbitration law of Hong Kong or Singapore as the case may be.

The decision in Korea Tech confused foreign arbitration with international commercial arbitration. An arbitration is international if the conditions provided in Article 1(3) of the Model Law are satisfied.

(3) An arbitration is international if:

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<sup>22</sup> ground raised shall be disregarded by the regional trial court.  
See Article 1(2), Model Law

- (a) the parties to an arbitration agreement have, at the time of the conclusion of that agreement, have their places of business in different states; or
- (b) one of the following places is situated outside the State in which the parties have their places of business:
  - (i) the place of arbitration if determined in, or pursuant to, the arbitration agreement;
  - (ii) any place where a substantial part of the obligations of the commercial relationship is to be performed or the place where the subject-matter of the dispute is most closely connected; or
- (c) the parties have expressed agreed that the subject matter of the arbitration agreement relates to more than one country.

If the dispute between Korea Tech and Pacific General will be submitted to arbitration in the Philippines, the arbitration will be international because Korea Tech has its place of business in Korea or outside the Philippines. It will nevertheless be domestic because the Philippines is the place of arbitration. In other words, an arbitration can be both domestic (as opposed to foreign) and international.

An arbitration is domestic if it is not international. If the arbitration does not include a foreign element, e.g., it does not fall under Article 1(3) of the Model Law, the arbitration will be domestic. To avoid confusion arising from the use of words having more than one meaning, it is well to make this clarification by classifying arbitration into domestic or foreign. As earlier mentioned, a foreign arbitration is an arbitration where the agreed place of arbitration is outside the Philippines. A domestic arbitration is an arbitration where the agreed place of arbitration is the Philippines. A domestic arbitration is further classified into: international or non-international. It is international where one of the elements of internationality enumerated in Article 1(3) of the Model Law is present; otherwise, the arbitration would be non-international.

A foreign arbitral award, unlike an award in a domestic international or non-international arbitration, cannot be set aside by a court. RA 9285 recognizes that an award rendered in a domestic, non-international arbitration which is governed by RA 876, may be vacated by a court upon any of the grounds enumerated in Section 24 of the law. The Model Law likewise provides that an award made in a domestic, international commercial arbitration may be set aside by a court upon any of the grounds enumerated in Article 34 thereof. Article V of the 1958 New York Convention enumerates the grounds upon which the court of a foreign jurisdiction **may refuse recognition and enforcement** of a foreign arbitral award. Section 42 of the ADR Act provides that: "The New York Convention shall govern the recognition and enforcement of arbitral awards covered by the said Convention." In the exercise of judicial review, a Philippine court cannot set aside

a foreign arbitral award. It can only refuse it recognition by rejecting an application for recognition and enforcement of a foreign arbitral award.

The Supreme Court finally held:

*“While it (Pacific General) may have misgivings on the foreign arbitration done in Korea by the KCAB, it has available remedies under RA 9285. Its interests are duly protected by the law which requires that the arbitral award that may be rendered by KCAB must be confirmed here by the RTC before it can be enforced.”*

The Korea Commercial Arbitration Board is a center or institution for arbitration in South Korea. A stipulation in the arbitration agreement to submit a dispute under the rules of an institution means that the institution administers the arbitration but the dispute is submitted, not to the institution, but to the arbitrator or arbitral panel appointed for the dispute. KCAB, therefore, does not make or render an award.

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