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Jurisdictional Expansion in Commercial Arbitration

JURISDICTIONAL EXPANSION IN COMMERCIAL ARBITRATION

Arbitration is being used to settle an ever increasing number of commercial and industrial disputes, with New York the acknowledged leader in the field. New York was the first state to adopt a statute, in 1920, making "submission agreements"[1] and "future agreements"[2] to arbitrate judicially enforceable.[3] The New York act was the model for the federal act, and for the American Arbitration Association draft act which, in turn, has been used as a guide in drafting arbitration statutes by many other states.[4] For these reasons, and because New

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very likely that damages to elderly plaintiffs could go unrectified. Moreover, adult children will bear the hardship of caring for the injured parent. Query whether this is pecuniary loss.

[1]Submission agreements to arbitrate are agreements to submit existing disputes to arbitration. At common law both "submission agreements" and "future agreements" to arbitrate were revocable. Discussions of the historical background of commercial arbitration and of the origins of the common law rule are found in Cohen, The Law of Commercial Arbitration and the New York Statute, 31 Yale L.J. 147 (1921); Wolaver, The Historical Background of Commercial Arbitration, 83 U. Pa. L. Rev. 132 (1934); 6 Corbin, Contracts § 1433 (1951). The present majority rule in the United States is that only submission agreements are binding and irrevocable. See 18 Wash. & Lee L. Rev. 92 n.4 (1961), where statutes from 29 states are cited. See 6 Corbin, Contracts § 1441 (1951) for a discussion of the general character of arbitration statutes.

[2]Future agreements to arbitrate are agreements to arbitrate any disputes which might arise out of the contract. 6 Corbin, Contracts § 1433 (1951); 6 Williston, Contracts § 1919 (rev. ed. 1938).

[3]N.Y. Civ. Prac. Act § 1448 (Clevenger 1961). "[T]wo or more persons may submit to the arbitration of one or more arbitrators any controversy existing between them at the time of the submission...or they may contract to settle by arbitration a controversy thereafter arising between them and such submission or contract shall be valid, enforceable and irrevocable, save upon such grounds as exist in law or in equity for the revocation of any contract."

Prior to the adoption of this statute New York had held "future agreements" to be invalid and revocable. Meacham v. Jamestown F. & C.R.R., 211 N.Y. 346, 105 N.E. 653 (1914); People ex rel. Union Ins. Co. of Philadelphia v. Nash 111 N.Y. 310 (1888); Delaware & Hudson Coal Co. v. Pennsylvania Coal Co., 50 N.Y. 250 (1872); Wood v. Lafayette, 46 N.Y. 484 (1871).

[4]The following statutes have been patterned after the New York statute, and provide for enforcement of both "submission agreements" and "future agreements" to arbitrate: Ariz. Rev. Stat. Ann. §§ 12-1509-11 (1956); Cal. Civ. Proc. § 1280-93; Colo. Rev. Civ. Proc. § 109 a-g; Conn. Gen. Stat. Rev. § 52-408 (1958); District of Columbia: 9 U.S.C. §§ 1-14 (1958); Hawaii Rev. Laws §§ 188-1-15 (1955); La. Rev. Stat. § 9:4201 (1950); Mass. Gen. Laws ch. 251, § 14 (1956); Mich. Comp. Laws § 645.1 (1948); N.H. Rev. Laws ch. 415 § 1 (1952); N.J. Rev. Stat. § 2T.24-1 (1952); Ohio Rev. Code Ann. § 2711.01 (Baldwin 1960); Ore. Rev. Stat. § 33.220; Pa. Stat.

York courts have been interpreting its statute for the longest period of time, the New York law is peculiarly indicative of trends in the field.

In light of the recent New York case of *Exercycle Corp. v. Maratta*,[5] there is indication that the scope of commercial arbitration is still expanding. In *Exercycle*, the plaintiff, James Maratta, entered into an employment agreement with Exercycle Corporation in which Exercycle agreed to employ Maratta as sales supervisor until he voluntarily left or died, but retained the right to terminate the agreement if sales fell below a specified level. Maratta, in turn, promised to devote his "best efforts and full time" to the company's sales activities. The agreement contained a broad arbitration clause providing that "any dispute arising out of or in connection with this agreement shall be settled by arbitration." In 1959, four years after the agreement was made, differences arose between Maratta and the company. Exercycle Corporation then moved in court for a stay of arbitration claiming that the agreement was "void and unenforceable" because it lacked mutuality in that it obligated Exercycle to employ Maratta for life while permitting Maratta to terminate the agreement at will.

The Supreme Court, Special Term, denied Exercycle's motion for a stay of arbitration. This decision was affirmed by the Appellate Division. The Court of Appeals also affirmed stating:

> "Once it can be ascertained that the parties broadly agreed to arbitrate a dispute arising out of or in connection with the agreement, it is for the arbitrators to decide what the agreement means and to enforce it according to the rules of law which they deem appropriate in the circumstances."[6]

The court declined to pass on the issue of whether there was a valid and enforceable contract in existence between Maratta and Exercycle, and held that it was error for the lower court to have done so. The court, however, did indicate that it would enjoin arbitration where: (1) fraud or duress renders the agreement voidable; (2) there is no bona fide dispute; (3) performance is prohibited by statute; or (4) a condition precedent has not been fulfilled or an applicable statute satisfied. The holding, then, indicates that a New York court will not interfere with arbitration unless the case can be brought within the scope of one of these four situations.

Ann. tit. 5, § 161 (1930); R.I. Gen. Laws Ann. § 47-1 (1938); Wash. Rev. Code § 7.04.010; Wis. Stat. 298.01 (1959).

Nevada has reached the same result by judicial decision. United Ass'n of Journeymen & App. of Plumbing Local 525 v. Stine, 351 P. 2d 965 (Nev. 1960).

[5] 9 N.Y.2d 329, 174 N.E.2d 463 (1961).

[6] 174 N.E.2d at 464.

Until *Exercycle,* the New York law in this area was in a state of some confusion. In fact, both the concurring and dissenting judges in *Exercycle* were of the opinion that a party in New York, seeking to enjoin arbitration, has the right to have the court determine the validity of the "main contract"[7] as well as the arbitration agreement.[8] There is much authority to this effect.[9] At any rate, the *Exercycle* decision, announcing a clear cut rule, does much to alleviate this confusion. Furthermore, the holding that a New York court will enforce an arbitration provision in an agreement whether or not that agreement constitutes a legal contract is a great step in arbitrational expansion. At the time of the drafting of the New York Civil Practice Act, it was urged that the court should determine only the validity of the arbitration agreement, and that the arbitrators should determine the validity of the "main contract."[10] Gradually New York seems to be approaching this position.

Although under the federal act only arbitration clauses concerning maritime or commercial transactions are enforced,[11] a similar

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[7]The term "main contract" is used in this comment to describe the parties' principal agreement and to distinguish this agreement from the subsidiary agreement to submit to arbitration all future disputes arising out of the principal agreement. See 6 Corbin, Contracts § 1436 (1951) for a discussion of this distinction. The New York Court of Appeals has described an arbitration agreement as an "incidental part of an indivisible contract." In re Kramer & Uchitelle, Inc., 288 N.Y. 467, 472, 43 N.E.2d 493, 496 (1942).

[8]That the arbitration agreement itself must be founded on sound contact principles and must not have been procured by fraud, duress, etc. is well settled in all states enforcing future agreements to arbitrate. Goldberg v. Mackay, 107 N.J.L. 412 153 Atl. 639 (1931); Singleton v. Benton, 114 Ga. 548, 40 S.E. 811 (1902); Metro Plan Inc. v. Miscone, 257 App. Div. 652, 15 N.Y.S.2d 35 (1st Dep't 1939); Smith v. Gladney, 128 Tex. 354, 98 S.W. 351 (Comm'n App. 1936); 6 Williston, Contracts § 1920 (rev. ed. 1938).

[9]"If the contract has not been made or is invalid, the court will proceed, as in any other case, to a determination of the merits. If it has been made and is valid, the court will stay its hand till the extrinsic fact is ascertained...." Berkovitz v. Arbib & Houlberg, Inc., 230 N.Y. 261, 130 N.E. 288, 291 (1921); Accord, Wrap-Vertizer Corp. v. Plotnik, 3 N.Y.2d 17, 143 N.E.2d 366 (1957); In re Kramer & Uchitelle, Inc., 288 N.Y. 467, 43 N.E.2d 493 (1942); Lipman v. Haeuser Shellas Co., 289 N.Y. 76, 43 N.E.2d 817 (1942); Finsilver, Still & Moss, Inc. v. Goldberg, Maas & Co., 253 N.Y. 382, 171 N.E. 579 (1930); Seymour Grean & Co. v. Grean, 274 App. Div. 279, 82 N.Y.S.2d 787 (1st Dep't 1948); Application of Manufacturers Chemical Co., 259 App. Div. 321, 19 N.Y.2d 171 (1st Dep't 1940); Metro Plan Inc. v. Miscone, 257 App. Div. 652, 15 N.Y.2d 35 (1st Dep't 1939); Application of Gruen, 173 Misc. 765, 18 N.Y.S.2d 990 (Sup. Ct. 1940); 6 Corbin, Contracts § 1444 (1951); Comment, 38 Cornell L.Q. 391 (1953).

[10]Arguments in support of this interpretation of the New York statute are found in: Comment, 36 Yale L.J. 866 (1927); Note, 24 N.Y.U.L.Q. Rev. 429 (1948).

[11]Bernhardt v. Polygraphic Co., 350 U.S. 198 (1956). For analyses of the various interpretations of the terms "maritime" and "commerce" see 6 Williston, Contracts § 1920 n.18 (Supp. 1961); Note, 34 St. John's L. Rev. 236 (1960).

arbitrational expansion is emerging in the federal courts. *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*[12] held that fraud in the inducement, where the contract contained a broad arbitration provision, was an issue for the arbitrators, as long as the arbitration agreement itself was not fraudulently procured.[13] *El Hoss Eng'r & Transp. Co. v. American Ind. Oil Co.*[14] declared that any issue intended by the parties to be within the scope of the arbitration agreement will be sent to arbitration.[15] As yet, the New York courts have not gone this far, as indicated by the four qualifications to the *Exercycle* holding. Though the New York courts have indicated that a defrauded party who affirms the contract will be compelled to arbitrate,[16] *Exercycle* confirms the rule that fraud is not an arbitrable issue.[17]

The practical result of this expansion of the arbitrators' jurisdiction is that arbitration will be more readily available to contracting parties. In fact, a party who signs an agreement containing a broad arbitration clause will find himself obligated to arbitrate regardless of the legal validity and enforceability of his contract.

Assuming the parties must arbitrate, the question is what will be arbitrated. In order for a party to compel arbitration there must be a "bona fide dispute."[18] But the dispute must be arbitrated with reference, at least, to some "agreement" which binds the parties. If there is not such a legally binding agreement, from where arises the duty to arbitrate? It could be said that the arbitration clause itself is an independent contract[19] supported by its own consideration and giving rise to the duty to arbitrate. Even if a duty to arbitrate is thus established, the arbitrators would still be confronted by the same dilemma. If the court does not pass upon the legal validity of the contract, then the arbitrators themselves must first establish that some binding agreement or contract is in existence between the parties. Other-

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[12]271 F.2d 402 (2d Cir. 1959) cert. granted, 362 U.S. 909 (1960), dismissed, 364 U.S. 801 (1960).

[13]271 F.2d at 410.

[14]289 F.2d 346 (2d Cir. 1961).

[15]289 F.2d at 349.

[16]Amerotron Corp. v. Maxwell Shapiro Woolen Co., Inc., 3 App. Div. 2d 899, 162 N.Y.2d 214, 215 (1st Dep't 1957) aff'd mem., 4 N.Y.2d 722, 148 N.E.2d 319 (1958).

[17]Wrap-Vertizer Corp. v. Plotnik, 3 N.Y.2d 17, 143 N.E.2d 366 (1957). See generally Parsell, Arbitration of Fraud in the Inducement of a Contract, 12 Cornell L.Q. 351 (1927); Sturges, Fraudulent Inducement as a Defense to the Enforcement of Arbitration Contracts, 36 Yale L.J. 866 (1927).

[18]Arbitration will not be enforced where the asserted claim is frivolous. Alpert v. Admiration Knitwear Co., 304 N.Y. 1, 105 N.E.2d 561, 563 (1952); S.A. Wenger & Co. v. Propper Silk Hosiery Mills, Inc., 239 N.Y. 199, 146 N.E. 203 (1924).

[19]See note 10 supra.

wise there is no frame of reference in which to arbitrate the "bona fide dispute."

Furthermore, it is well settled that arbitrators are not bound by traditional rules of law.[20] This is a rule that is succinctly stated in *Wilkins v. Allen*:[21]

> "The award of an arbitrator cannot be set aside for mere errors of judgment either as to the law or as to the facts. If he keeps within his jurisdiction, and is not guilty of fraud, corruption, or other misconduct attending his award, it is unassailable, operates as a final conclusive judgment and however disappointing it may be, the parties must abide by it."[22]

Herein lies the crucial problem inherent in the expansion of arbitrational jurisdiction. If arbitrators are not bound by the traditional rules of law and their awards may not be set aside for mistakes of law, then it appears that a party, by signing an agreement containing a broad arbitration clause, may sign away his right to a judicial remedy or judicial determination of the validity and enforceability of his contract.

Section 1450 of the New York Civil Practice Act, the statute used as a model by almost all states enforcing "future agreements" to arbitrate,[23] stipulates that the judge shall make an order directing arbitration only after he is satisfied that there is no substantial issue as to the making of the contract.[24] Heretofore, this section has been interpreted to mean that no issue should exist as to the making of a "valid contract."[25] The *Exercycle* decision seems to hold, however, that as long as no issue exists as to the making of a valid arbitration agreement, an order directing arbitration will be issued. Section

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[20]Fudickar v. Guardian Mutual Life Ins. Co., 62 N.Y. 392 (1875). Accord, Wetsel v. Garibaldi, 159 Cal. App. 2d 4, 323 P.2d 524 (1958); Mayberry v. Mayberry, 121 N.C. 248, 28 S.E. 349 (1897); Johnson v. Noble, 13 N.H. 286 (1842); Patriotic Order Sons of America v. Hartford Fire Ins. Co., 305 Pa. 107, 157 Atl. 259 (1931).

But the parties may provide in their agreement that the arbitrators must follow rules of law. White Star Mining Co. v. Hultberg, 220 Ill. 578, 77 N.E. 327 (1906); Application of Wachusett Spinning Mills, Inc., 12 Misc.2d 822, 177 N.Y.S.2d 938 (Sup. Ct. 1958).

[21]169 N.Y. 494, 62 N.E. 575 (1902).

[22]62 N.E. at 576.

[23]See note 4 supra.

[24]"If evidentiary facts be set forth raising a substantial issue as to the making of the contract or submission or the failure to comply therewith, the court, or the judge thereof, shall proceed immediately to the trial thereof." N.Y. Civ. Prac. Act § 1450 (Clevenger 1961).

[25]"[P]roceedings to enforce arbitration under article 84 of the Civil Practice Act presuppose the existence of a valid and enforceable contract at the time remedy is sought." In re Kramer & Uchitelle, Inc., 288 N.Y. 467, 43 N.E.2d 493, 495 (1942). Accord, see cases cited in note 9 supra.

1462 of the New York Civil Practice Act provides that fraud, corruption, partiality in the arbitration procedure, or the contention that there was no submission or contract, will be defenses to the enforcement of an award.[26] Since section 1462 contains essentially the same wording as section 1450,[27] it is likely that the *Exercycle* interpretation will apply there also. If such be the case, then, under this rationale, a party may indeed sign away his right to a judicial decision as to the validity and enforceability of his main contract.

If section 1462 is interpreted to mean "no valid main contract," a contracting party may have an award set aside by showing that no valid main contract was, in fact, made. This interpretation would be illogical and impractical. If the court were to set aside an award because no main contract ever came into legal existence, why should not a stay of arbitration be granted for the same reason? Even if this interpretation was adopted it is likely that the court would be more reluctant to set aside an award after arbitration on the grounds that there was no valid main contract than it would be to find the contract legally unenforceable before arbitration.

On an *ad hoc* basis the expansion of arbitrational jurisdiction may have just and meritorious results. In *Exercycle* the parties dealt at arms length, intended to bind themselves, and, in fact, treated the contract as binding for four years. It may seem inequitable to enjoin arbitration of the type of dispute the contract was intended to prevent because of a legal technicality. It is not necessarily unjust or inherently harmful for a party to waive his right to a judicial determination of his contract. But it is submitted that the *Exercycle* decision, taken as a general rule, creates a legal situation in which a party may unwittingly deprive himself of his right to a judicial remedy and find himself irrevocably bound to a contract which would not be enforced at law. In the words of an earlier New York holding:

> "It is a very easy thing for contracting parties to provide in a few words for a general arbitration, if they are minded so to do. They are not to be trapped by a strained and unnatural construction of words of doubtful import into an abandonment of legal remedies, unwilled and unforeseen."[28]

It must of course be remembered that in New York a party is still entitled to a stay of arbitration where: (1) fraud or duress is practiced,

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[26]N.Y. Civ. Prac. Act § 1462 (Clevenger 1961) states that the award of an arbitrator or arbitration board must be vacated "if there was no valid submission or contract, and the objection has been raised under the conditions set forth...."

[27]Compare notes 24 and 26 supra.

[28]Marchant v. Mead-Morrison Mfg. Co., 252 N.Y. 284, 169 N.E. 386, 393 (1929).