RECENT DEVELOPMENTS

WHETHER MUTUALITY OF OBLIGATION EXISTS IN A CONTRACT IS TO BE DETERMINED BY ARBITRATORS

Exercycle Corp. v. Maratta
9 N.Y.2d 329, 174 N.E.2d 463 (1961)

In 1955, Exercycle Corporation hired James Maratta as its vice president in charge of sales. The employment agreement provided that, "Any dispute arising out of or in connection with this agreement shall be settled by arbitration in accordance with the rules of the American Arbitration Association." In 1960, after a difference of opinion, Maratta wrote the owner of the corporation that he had "started" to seek employment elsewhere; the owner treated the letter as one of resignation. Maratta then sought arbitration. Exercycle brought a proceeding for a stay of the arbitration on the ground that the contract of employment was void because it lacked mutuality. The motion for a stay was denied by the court, and the decision was affirmed by the appellate division[1] on the ground that the contract was valid. The court of appeals affirmed for a different reason,[2] *i.e.*, the question of the contract's validity was to be decided by the arbitrators and not the court.[3] The court felt that the arbitrators should decide any dispute between the parties which was within the arbitration clause.

In cases involving arbitration clauses as broad as the one used in the present case, the New York courts have held that there must be a valid contract between the parties before the court will recognize jurisdiction in the arbitrators.[4] If the contract is challenged because one of the parties alleges fraud,[5] illegality,[6] or claims that there was no acceptance of the offer,[7] a *court* will decide the issue.[8] But when the dispute relates to

1 11 App. Div. 2d 677, 201 N.Y.S.2d (Sup. Ct. 1960).

2 Exercycle Corp. v. Maratta, 9 N.Y.2d 329, 174 N.E.2d 463 (1961).

3 The two justices concurred with the majority saying that the issue of mutuality of obligation was to be decided by the court. They felt the contract was not illusory, and the arbitrators could decide the question of cancellation. One justice dissented; he felt that the court should determine the question of mutuality of obligation. However, he felt the contract was illusory.

4 Finsilver, Still & Moss v. Goldberg, Maas & Co., 253 N.Y. 382, 171 N.E. 579 (1930); In the Matter of Wrap-Vertiser Corp., 3 N.Y.2d 17, 163 N.Y.S.2d 639 (1957); In the Matter of Lipman, 289 N.Y. 76, 43 N.E.2d 817 (1942); In the Matter of Berkovitz, 230 N.Y. 261, 130 N.E. 288 (1921).

5 In the Matter of Wrap-Vertiser Corp., *supra* note 4; In the Matter of Lipman, *supra* note 4; Application of Gruen, 173 Misc. 765, 18 N.Y.S.2d 990 (Sup. Ct. 1940), *aff'd*, 259 App. Div. 712, 18 N.Y.S.2d 1023 (1940).

6 In the Matter of Metro Plan v. Miscione, 257 App. Div. 652, 15 N.Y.S.2d 35 (1939); Abbey v. Meyerson, 274 App. Div. 389, 83 N.Y.S.2d 503 (Sup. Ct. 1948), *aff'd*, 299 N.Y. 557, 85 N.E.2d 889 (1949).

7 Finsilver, Still & Moss v. Goldberg, Maas & Co., *supra* note 4.

8 6 Corbin, Contracts § 1444 (1951). "Suppose, however, that the agreement to

performance, the issue is to be settled by *arbitration*,[9] unless the controversy is frivolous[10] or performance is prohibited by statute.[11] The court in the principal case, however, seems to have departed from the heretofore prevailing rule that the courts and not the arbitrators determine the validity of the contract. It is settled that the arbitrators are not bound by substantive rules of law, procedure, or evidence,[12] and their awards cannot be reversed because of errors of law.[13] Consequently, if the arbitrators decide the validity of the contract upon which their own jurisdiction depends, a party may be denied trial by jury on the issue of whether or not he entered into a contract.

If the courts are to decide all issues as to the contract's validity, an objecting party can hinder and delay arbitration by interposing defenses to the contract. This would frustrate and delay arbitration, and a primary purpose of arbitration is to give the parties an expeditious way to settle their disputes.[14] One solution is to treat the contract and the arbitration provision as separate and let the court determine the validity of only the latter.[15] The New York Arbitration Statute[16] provides that the court is to decide issues relating to the making of the contract.[17] But is this provision referring to the contract or the arbitration clause? If one reads this section in light of the preceding section of the statute where the term "contract" is described,[18] it would seem that the statute is referring only to the

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arbitrate disputes is a component part of the very bargaining transaction that is now asserted to be void for want of mutual assent. . . . It would seem that if the alleged defect exists, it affects the provision for arbitration just as much as it affects the other provisions. . . . In cases within this paragraph, the remedies for enforcement of arbitration agreements are not available, including the enforcing order, authorized by an arbitration statute. Before issuing such an order the court must know that a legal duty to arbitrate exists; this is an issue that the court itself must decide." See also 6 Williston, Contracts § 1920 (1936).

[9] In Re Kahn's Application, 284 N.Y. 515, 32 N.E.2d 534 (1940); In the Matter of Wenger & Co., 239 N.Y. 199, 146 N.E. 203 (1924).

[10] Albert v. Admiration Knitwear Co., 304 N.Y. 1, 105 N.E.2d 561 (1952); In the Matter of General Electric Co., 300 N.Y. 262, 90 N.E.2d 181 (1949); In the Matter of Wenger & Co., *supra* note 9.

[11] In the Matter of Kramer & Uchitelle Co., 288 N.Y. 467, 43 N.E.2d 493 (1942).

[12] Fudickar v. Guardian Mutual Life Ins. Co., 62 N.Y. 392 (1875).

[13] In the Matter of Wilkins, 169 N.Y. 494, 62 N.E. 575 (1902).

[14] Parsell, "Arbirtation of Fraud in the Inducement of a Contract," 12 Cornell L.Q. 351 (1927).

[15] Sturges, "Fraudulent Inducement as a Defense to the Enforcement of Arbitration Contracts," 36 Yale L.J. 866 (1927).

[16] N.Y. Civ. Prac. Act § 1450 (1937).

[17] *Ibid.* "If evidentiary facts be set forth raising a substantial issue as to the making of the contract . . . the court . . . shall proceed immediately to the trial thereof . . . if the court . . . find(s) that a written contract providing for arbitration was made . . . the parties shall proceed with the arbitration . . . if the court . . . find(s) that there was not such contract . . . then the proceedings shall be dismissed."

[18] N.Y. Civ. Prac. Act § 1448 (1937). "Two or more persons . . . may con-

arbitration provision.[19] With this interpretation, it appears the court would try only those issues relating to the validity of the making of the arbitration clause and not the main contract.[20] Once the arbitration clause is held valid, all other issues raised by the parties which are within the arbitration clause would be decided by the arbitrators. However, the New York courts in the past have interpreted "contract" in this section to mean the main contract.[21]

Although one might justify the novel position of the court of appeals in the instant case on the theory that the arbitration clause is an agreement separate from the contract itself, the court did not proceed on that basis.[22] It reasoned that a question of mutuality of obligation depends "primarily on a reading and construction of the agreement" and "involves substantial difficulties of interpretation"[23] which could best be decided by the arbitrators, even though, in this case, it involved a question of the contract's validity. The court did not overrule the cases cited above[24] which held that the validity of the contract is generally a matter reserved for judicial decision. However, since lack of mutuality affects validity, the present decision seems inconsistent with the earlier ones. It is therefore doubtful whether the earlier cases still have any value as precedents.

Moreover, the cases relied on by the majority do not support the result in the present case. In those cases the controversy involved developments which occurred subsequent to the making of the contract; such issues were, obviously, for the arbitrators to decide.[25] In *The Matter of*

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tract to settle by arbitration a controversy thereafter arising between them and such . . . contract shall be valid . . . ."

[19] See Sturges, *supra* note 15 at 872, to the effect that the New York Arbitration Statute "should be held to make written arbitration contracts or provisions severable from the general bargain which they may accompany . . . and out of which disputes may arise to be arbitrated . . . ." Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959) (dictum). The mutual promises to arbitrate would form the *quid pro quo* which is necessary to sever the agreement from the main contract.

[20] In Robert Lawrence Co. v. Devonshire Fabrics, Inc., *supra* note 19, the Court found a valid agreement to arbitrate and stated that the issue of fraud in the inducement on the main contract was to be decided by the arbitrators. The court deduced separate contracts by construing the word "contract" in the Federal Arbitration Act [9 U.S.C. § 2 (1958)] to refer only to the agreement to arbitrate.

[21] See cases in *supra* note 4; 6 Corbin, Contracts § 1444 (1951). The New York courts have felt that the arbitration provision is collateral to the main contract; therefore a denial of the validity of the main contract necessarily denies the validity of the arbitration provision.

[22] See the concurring opinion of Judge Froessel in Exercycle Corp. v. Maratta, *supra* note 2.

[23] But see, In the Matter of Grean & Co., 274 App. Div. 279, 82 N.Y.S.2d 787 (Sup. Ct. 1948), which also involved the question of mutuality of obligation in an employment contract. Here the court determined the validity of the contract.

[24] See cases cited in *supra* notes 4, 5, 6, and 7.

[25] In the Matter of Terminal Auxiliar Maritima v. Winkler Cr. Corp., 6 N.Y.2d 294, 160 N.E.2d 526 (1959); Paloma Frocks v. Shamokin Sports Corp., 3 N.Y.2d 575, 147 N.E.2d 779 (1958); In the Matter of Lipman, *supra* note 4; Marchant v. Mead-

Lipman,[26] the appellant argued that the issue of cancellation of the contract was to be determined by the court. The court held for the appellee and said:[27]

> A different question would be here if the issue was whether the contract never came into existence and hence was void, or if, although the contract was made, there arose an issue of fraud, duress, or other impediment which rendered the contract voidable, or if there were any conditions precedent.

The provision for arbitration in the *Lipman* case was as broad as the provision in the principal case.[28] The *Lipman* case, accordingly, supports the dissenting opinion of the principal case.[29]

Although the majority opinion is without case-support, the decision seems correct. When parties execute a contract to arbitrate and include a broad arbitration clause such as in the principal case, they seemingly intend to arbitrate any and all issues including the making and execution of the contract. Although these issues are not decided by substantive rules of law, the parties are not prejudiced because they have agreed that the arbitrators shall decide all controversies arising out of the agreement, thus waiving trial by jury. Parties choose to arbitrate because they want to obtain prompt decisions; hence, they regard the arbitral process as more efficient than judicial proceedings. Furthermore, arbitrators are as competent to decide the issue of validity as any other issue which does not involve difficult problems of public policy.[30] Therefore, the courts should limit themselves to determining only whether the parties have made a binding agreement to arbitrate.

The issue of whether the court or the arbitrators should determine the validity of the main contract has not yet been presented to an Ohio court. In the Ohio Arbitration Act,[31] however, the ambiguous word "contract" found in the New York Civil Practice Act is replaced by the words "agreement for arbitration." This wording of the Ohio statute seems to require explicitly that the arbitration agreement be considered as separate from the main contract. Therefore, it would seem that in Ohio the arbitrators should determine the validity of the main contract if the arbitration clause is as broad as in the principal case.

Morrison Mfg. Co., 252 N.Y. 284, 169 N.E. 386 (1929); In re Kelly, 240 N.Y. 74, 147 N.E. 363 (1925).

[26] In the Matter of Lipman, *supra* note 4.

[27] *Id.* at 79, 43 N.E.2d 818, 819.

[28] *Id.* at 80, 43 N.E.2d 819. ". . . the language of the provision providing for arbitration uses not only the phrase 'any and all controversies arising out of the contract' but also 'any and all controversies in connection with the contract,' this language would appear sufficiently broad to express the intention of parties to include within the exclusive jurisdiction of the arbitrators as a general rule all acts by the parties giving rise to issues in relation to the contract, except the making thereof."

[29] *Supra* note 3.

[30] Sturges, *supra* note 15, at 73.

[31] The Ohio Arbitration Act can be found in the Ohio Rev. Code § 2711, *et seq.*; see particularly sections 2711.01 and 2711.03.