Marquette Law Review

Volume 61
Issue 3 *Spring 1978*

Article 6

1978

# Commercial Arbitration Agreements: Let the Signers Beware

Cornelia Griffin Farmer

# COMMERCIAL ARBITRATION AGREEMENTS: LET THE SIGNERS BEWARE

## I. APPLICABLE LAW

*[T]he remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State . . . . The change from a court of law to an arbitration panel may make a radical difference in ultimate result. Arbitration carries no right to trial by jury . . . . Arbitrators do not have the benefit of judicial instruction on the law; they need not give their reasons for their results; the record of their proceedings is not as complete as it is in a court trial; and judicial review of an award is more limited than judicial review of a trial . . . .*[1]

Arbitration is a consensual, private and nonjudicial method of settling disputes which has important ramifications on the legal rights of the parties involved. Because of the finality usually accorded arbitration proceedings, the agreement to arbitrate is, essentially, an agreement to waive many of the protections one would have if litigating in a public forum. Yet, despite the "informalities and looser approximations as to the enforcement of their rights,"[2] arbitration can provide an economic and efficient method of dispute resolution which meets the needs and desires of the parties involved. Thus, long before courts and legislatures endorsed arbitration as a matter of public policy, businessmen were agreeing to arbitrate disputes.

### *A. Historical Development*

Historically, courts were reluctant to enforce arbitration agreements. At common law, agreements to arbitrate were revocable until the time of the award: "[E]ven if a submission has been made to arbitrators, who are named, by deed or otherwise, with an express stipulation, that the submission shall be irrevocable, it is still revocable and countermandable, by either party, before the award is actually made, although not afterwards."[3] By 1915 the various attitudes toward irrevocable agreements to arbitrate future disputes had crystalized. The

1. Bernhardt v. Polygraphic Co. of America, Inc., 350 U.S. 198 (1956).
2. Hart v. Orion Ins. Co., 453 F.2d 1358, 1361 (10th Cir. 1971).
3. Tobey v. County of Bristol, 23 Fed. Cas. 1313, 1321 (D. Mass. 1845).

most important of these views were summarized that year in *United States Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*[4]

> (1) The agreement to arbitrate is collateral to the main contract; if disregarded the other party could still sue for damages for breach of the collateral agreement.
> (2) Such agreements tend to oust the courts of their jurisdiction and thus violate public policy "in that it is not competent for private persons either to increase or diminish the statutory juridical power."[5]
> (3) "Arbitration may be a condition precedent to suit, and as such valid, if it does not prevent legal action, or seek to determine out of court the general question of liability."[6]

The gradual modification of both judicial and legislative attitudes toward arbitration was spurred by the enactment of the New York arbitration act of 1920 which permitted irrevocable agreements to arbitrate future disputes.[7] In 1921 Judge Cardozo authored an opinion which validated this new arbitration law. Finding the law applicable to preexisting contracts, he stated that the statute "declares a new public policy and abrogates an ancient rule,"[8] and he refuted challenges to the validity of the statute. It did not, he found, deny the right to jury trial since that right could be waived, as it was by the consent to arbitrate. Likewise, he saw little substance in the traditional argument that such agreements oust the courts of their jurisdiction. "Jurisdiction exists that rights may be maintained. Rights are not maintained that jurisdiction may exist."[9]

From 1920 to the present, arbitration has gained increasing favor with both legislatures and courts. Statutes authorizing agreements to arbitrate future disputes have been adopted by at least 35 states,[10] and the Federal Arbitration Act[11] expresses the congressional approval of arbitration in maritime and interstate commerce transactions. The present day Wisconsin

4. 222 F. 1006 (S.D. N.Y. 1915).
5. *Id.* at 1008.
6. *Id.*
7. 1920 N.Y. Laws, ch. 275; N.Y. LAB. LAW (Consol.), ch. 72 (1920), *as cited in In re* Berkovitz v. Arbib & Houlberg, Inc., 230 N.Y. 261, 130 N.E. 288 (1921).
8. 230 N.Y. at 269, 130 N.E. at 289.
9. *Id.* at 274, 130 N.E. at 291.
10. G. GOLDBERG, A LAWYER'S GUIDE TO COMMERCIAL ARBITRATION § 1.02, at 7 (1977) [hereinafter cited as GOLDBERG].
11. 9 U.S.C. §§ 1-14 (1970).

statute,[12] like many state arbitration statutes, is drawn from the Uniform Arbitration Act,[13] which is based upon the 1920 New York act. The pertinent part of Wisconsin Statutes section 298.01, dealing with the submission of contracts to arbitration, reads:

> A provision in any written contract to settle by arbitration a controversy thereafter arising out of such contract, or out of the refusal to perform the whole or any part thereof, or an agreement in writing between two or more persons to submit to arbitration any controversy existing between them at the time of the agreement to submit, shall be valid, irrevocable and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract; . . .[14]

This provision validates irrevocable agreements to arbitrate existing and future controversies, except where such arbitration would be barred by law.[15] The remainder of the Act deals with various elements of the arbitration procedure and award, and the situations under which an award may be vacated or modified by the court.[16]

### *B. Scope of the Agreement to Arbitrate*

Contractual arbitration provisions generally specify the scope of the submission and outline the procedures to be followed. For instance, many trade associations rely on the expertise of special arbitration groups to determine the standard meaning of contract language and the customary practices in the trade.[17] Other commercial arbitration agreements may refer to the rules of the American Arbitration Association or rely on statutory procedures. Arbitration agreements may involve either pre-existing or future disputes. They may be either broad and general, leaving all disputes arising under or relating to the contract for arbitration, or narrow, confining arbitration to issues of contract interpretation or measurement of performance.[18] The standard commercial arbitration clause suggested by the American Arbitration Association reads:

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12. WIS. STAT., ch. 298 (1975).
13. *See* GOLDBERG, *supra* note 10, at 137, app. B.
14. WIS. STAT. § 298.01 (1975).
15. GOLDBERG, *supra* note 10, § 1.04 at 14.
16. WIS. STAT. §§ 298.02-.18 (1975).
17. Mentschikoff, *Commercial Arbitration,* 61 COLUM. L. REV. 846, 849 (1961).
18. *Id.* at 853.

> Any controversy or claim arising out of or relating 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.[19]

This language binds the parties, irrevocably, to arbitrate future disputes arising out of the contract and relating to performance as well as interpretation of the contract.

When the language of either the state or the federal arbitration statutes is combined with a broad arbitration clause, such as that recommended by the American Arbitration Association, the submission to arbitration is virtually unlimited and almost all issues are left for the arbitrator.[20] Such broad arbitration agreements are not always enforceable, however. For instance, illegal contracts such as those involving usurious transactions[21] are not arbitrable.[22]

As the courts moved away from their initial distrust of arbitration, situations arose where arbitration conflicted with various other public policies and the courts had to balance their favor for arbitration and the private interest in freedom of contract against other policy considerations. This balancing was best expressed in *Wilko v. Swan,*[23] a 1953 United States Supreme Court decision holding that a stockholder may not, by agreeing to arbitrate, waive the protections legislatively provided by the Securities Act of 1933.

> Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustments. On the other hand, it has enacted the Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we

19. *See* Commercial Rules of the American Arbitration Association (1973) in GOLDBERG, *supra* note 10, at 128 app. A.

20. *See* Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967).

21. Durst v. Abrash, 22 App. Div. 2d 39, 253 N.Y.S.2d 351 (1964).

22. GOLDBERG, *supra* note 10, § 1.04 at 14.

23. 346 U.S. 427 (1953).

> decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act.[24]

A similar position has been taken with regard to antitrust claims.[25] The effect of the *Wilko* decision, however, has recently been narrowed by a court of appeals holding that the nonwaiver provisions of the Securities Act do not preclude enforcement of an arbitration agreement between stock exchange members.[26] In reaching this conclusion, the court referred to the increasingly favored position of arbitration as a matter of public policy.

The extent to which the Court now shields the agreement to arbitrate from countervailing legal considerations is exemplified by the 1967 *Prima Paint*[27] decision. There, the Supreme Court held that a claim of fraud in the inducement of the contract is arbitrable "[w]hen no claim is made that fraud was directed to the arbitration clause itself, a broad arbitration clause will be held to encompass arbitration of the claim that the contract itself was induced by fraud."[28] This majority position was strongly attacked in the dissent authored by Justice Black:

> The Court holds, what is to me fantastic, that the legal issue of a contract's voidness because of fraud is to be decided by persons designated to arbitrate factual controversies arising out of a valid contract between the parties. And the arbitrators who the Court holds are to adjudicate the legal validity of the contract need not even be lawyers, and in all probability will be nonlawyers, wholly unqualified to decide legal issues, and even if qualified to apply the law, not bound to do so. I am by no means sure that thus forcing a person to forgo his opportunity to try his legal issues in the courts where, unlike the situation in arbitration, he may have a jury trial and right to appeal, is not a denial of due process of law.[29]

The *Prima Paint* majority decision reflects the magnitude of the shift from common law attitudes. The case is, however,

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24. *Id.* at 438.

25. *See, e.g.*, Sam Reisfeld & Son Import Co. v. S. A. Eteco, 530 F.2d 679, 691 (5th Cir. 1976); Power Replacements, Inc. v. Air Preheater Co., 426 F.2d 980 (9th Cir. 1970).

26. Tullis v. Kohlmeyer & Co., 551 F.2d 632 (5th Cir. 1977).

27. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967).

28. *Id.* at 402.

29. *Id.* at 407.

consistent with lower court positions regarding the arbitrability of tort claims related to contracts containing arbitration clauses. "[T]hat a complaint [sounds] in tort will not in itself prevent arbitration if the underlying contract embraces the disputed matter."[30] Using this rationale, cases involving negligence,[31] misrepresentation,[32] improper business conduct,[33] architectural malpractice,[34] fraud,[35] trademark infringement and unfair competition[36] have been referred to arbitration. In line with the favored position accorded arbitration, courts analyzing the arbitrability of torts have held that "[t]he basic purpose of the United States Arbitration Act is to relieve the parties from costly litigation and help ease congested court dockets,"[37] and that torts are "arbitrable at least until and unless it is otherwise decided by the arbitrator."[38] However, tort claims will not be referred to arbitration where the language of the contract specifically excludes them or the referral is sufficiently narrow for the court to conclude that the parties did not intend to arbitrate torts.[39]

The New York State Court of Appeals took an interesting position in the 1976 case of *Garrity v. Lyle Stuart, Inc.*,[40] holding that punitive damages should not be awarded by arbitrators since such damages are a "social exemplary 'remedy' not [a] private compensatory remedy" and should not be awarded in private arbitration proceedings.[41]

> Actual damage is measurable against some objective standard — the number of pounds, or days, or gallons or yards;

30. Legg Mason & Co. v. Mackall & Coe, Inc., 351 F. Supp. 1367, 1370-71 (D.D.C. 1972) *citing* Saucy Susan Products, Inc. v. Allied Old English, Inc., 200 F. Supp. 724 (S.D. N.Y. 1951).

31. Acevedo Maldonado v. PPG Indus., Inc. v. Fluor, Inc., 514 F.2d 614 (1st Cir. 1975).

32. Lawson Fabrics, Inc. v. Akzona, Inc., 355 F. Supp. 1146 (S.D. N.Y.) *aff'd*, 486 F.2d 1394 (2d Cir. 1973).

33. Legg Mason & Co. v. Mackall & Coe, Inc., 351 F. Supp. 1367 (D.C. 1972).

34. *In re* Paver & Wildfoerster & Catholic High School Assoc., 382 N.Y.S.2d 22, 38 N.Y.2d 669, 345 N.E.2d 565 (1976).

35. Erving v. Virginia Squires Basketball Club, 468 F.2d 1064 (2d Cir. 1972).

36. Saucy Susan Products, Inc. v. Allied Old English, Inc., 200 F. Supp. 724 (S.D. N.Y. 1951).

37. Legg Mason & Co. v. Mackall & Coe, Inc., 351 F. Supp. 1367, 1372 (D.D.C. 1972).

38. Acevedo Maldonado v. PPG Indus., Inc., 514 F.2d 614 (1st Cir. 1975).

39. Bruno v. Pepperidge Farm, Inc., 256 F. Supp. 865 (E.D. Pa. 1966).

40. 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976).

41. *Id.* at 358, 353 N.E.2d at 795, 386 N.Y.S.2d at 833.

> but punitive damages take their shape from the subjective criteria involved in attitudes toward correction and reform, and courts do not accept readily the delegation of that kind of power. Where punitive damages have been allowed for those torts which are still regarded somewhat as public penal wrongs as well as actionable private wrongs, they have had rather close judicial supervision. If the usual rules [of arbitration] were followed there would be no effective judicial supervision over punitive awards in arbitration.[42]

Although in *Garrity* the court simply vacated the award of punitive damages, which was modest, the effect of *Garrity's* public policy reasoning on the scope of a submission to arbitration is not yet apparent. It may be an opening to judicial scrutiny and intervention where torts for which punitive damages are appropriate are involved or, if it stands for the proposition that although torts relating to a contract are arbitrable, punitive damages may not be awarded, it is a further example of the rights waived by the agreement to arbitrate.[43]

Thus, prodded by legislation the courts have swung from the jealous guarding of judicial prerogatives, reflected in the common law fear that arbitration agreements would oust the courts of their jurisdiction, to an unscrutinizing acceptance of arbitration. When dealing with other legislative enactments, the courts maintain a semblance of balancing the public policy favoring arbitration against conflicting policies reflected in those enactments.[44] However, when it comes to affording common law protections to contracting parties in situations such as fraud in the inducement of the contract, adhesion contracts and business torts committed by one of the contracting parties, the courts are loathe to interfere with the public policy favoring

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42. *Id.* at 359, 353 N.E.2d at 796, 386 N.Y.S.2d at 834, *citing In re* Publishers' Ass'n, 280 App. Div. 500, 503, 114 N.Y.S.2d 401, 404 (1952).

43. An interesting juxtaposition of the results of a broadly enforced agreement to arbitrate can be gleaned from recent N.Y.S. Court of Appeals cases. In *Garrity* the court held that punitive damages could not be awarded in arbitration. In another 1976 case, also authored by Chief Justice Breitel, the court found that although the submission encompassed a tort claim which in a court of law would be barred by the statute of limitations, the contractual claim was not so barred and that both could be considered by the arbitrators. Such a position is logical in light of the fact that arbitrators need not follow rules of substantive law and need not give reasons for their decisions. Thus, although these decisions limit the kinds of damages permitted in arbitration, they remove some limitations on the causes of action asserted. *See In re* Paver & Wildfoerster & Catholic High School Assoc., 38 N.Y.2d 669, 345 N.E.2d 565 (1976).

44. Lawson Fabrics, Inc. v. Akzona, Inc., 355 F. Supp. 1146, 1149 (S.D. N.Y. 1973).

arbitration.[45] Thus, not only are many arbitration procedures insulated from judicial review, but the initial agreement to arbitrate is subject to very little scrutiny both as to its making and as to the situations which the parties might reasonably have intended to be covered by the agreement.[46]

### C. *Effect of the Agreement to Arbitrate*

Once the submission to arbitration is made, the arbitration will proceed according to the rules designated in the contract or mandated by statute. The standard arbitration clause provides that arbitration will be held in accordance with the rules of the American Arbitration Association. Many of the fifty-two sections of the Commercial Arbitration Rules[47] deal with procedural matters, such as selection of arbitrators and locale, or with housekeeping matters, such as fees and expenses. Other sections are more directly related to the actual proceedings and the award. Although these rules prescribe standards which attempt to preserve the rights of the parties, an arbitration hearing is far more informal than a court trial and there are fewer restraints on the decisions of the arbitrator. For purposes of comparison with court procedures, the Association rules and court decisions regarding discovery and receipt of evidence are particularly pertinent. For instance, discovery is limited,[48] hearsay evidence may be accepted by the arbitrator,[49] and witnesses need not be under oath.[50]

The amount of pretrial discovery permitted varies among the jurisdictions.[51] Discovery actually ordered may be subject to the limitations of both the arbitrator's authorization and the court's approval.[52] Although discovery has been ordered,[53]

45. *See, e.g., Id.* Erving v. Virginia Squires Basketball Club, 468 F.2d 1064 (2d Cir. 1972); Federico v. Frick, 3 Cal. App. 3d 872, 84 Cal. Rptr. 74 (1970) (contract of adhesion arbitrable).

46. Lawson Fabrics, Inc. v. Akzona, Inc., 355 F. Supp. 1146, 1148 (S.D. N.Y. 1973).

47. The Commercial Arbitration Rules are set out in GOLDBERG, *supra* note 10, at 128 app. A.

48. *See* Mississippi Power Co. v. Peabody Coal Co., 69 F.R.D. 558 (S.D. Miss. 1976). *See also* GOLDBERG, *supra* note 10, § 3.03 at 41-42.

49. *In re* Norma Brill & Muller Bros., Inc., 40 Misc. 2d 683, 243 N.Y.S.2d 905 (1962), *aff'd* 13 N.Y.2d 776, 192 N.E.2d 34 (1963).

50. *See* Commercial Arbitration Rules of the American Arbitration Association § 26 in GOLDBERG, *supra* note 10, at 131 app. A.

51. GOLDBERG, *supra* note 10, § 3.03 at 42.

52. *See* GOLDBERG, *supra* note 10, § 3.03 at 42; WIS. STAT. § 298.07 (1975).

53. Bigge Crane & Rigging Co. v. Docutel Corp., 371 F. Supp. 240 (E.D. N.Y. 1973).

many courts feel that the imposition of a complicated judicially-supervised discovery process destroys the vaunted efficiency and economy of the arbitration process, and that discovery should, therefore, not be ordered.[54]

Arbitrators are their own judges of the relevancy and materiality of the facts, and they are not restricted by substantive law or rules of evidence.[55] Not only can the most blatant hearsay be accepted by the arbitrators,[56] but because the arbitrators need not give reasons for their decisions,[57] there may often be no record of how much weight was given to evidence which would never have been admitted to a court of law.

Because finality of arbitration results is considered desirable, judicial review is extremely limited. The review available to the signers of an arbitration agreement was discussed in a 1968 New York decision.

> A mistake or error of the arbitrator as to the law or facts will not vitiate an award "unless it results in a failure of intent or breach of authority or is so gross or palpable as to establish fraud or misconduct." Nor will the court concern itself with the form or sufficiency of the evidence before the arbitrators or some departure from formal technicalities in the absence of a clear showing that statutory grounds exist for vacator of the award . . . . Moreover, "arbitrators are not hampered in the discharge of their duty by rules of evidence, or the body of case and statutory law governing the prosecution of actions . . . ." In a valid submission questions of law and fact are for the arbitrators. "When parties agree to arbitrate, they agree to waive the rules of evidence and the inexorable application of substantive rules as well."[58]

Yet, despite the broad power of arbitrators to determine the scope of the arbitration and to make their own determinations of the law and facts involved, both statutory and case law provide fairly strict controls upon the conduct of the arbitrators.[59] The major problem, of course, with enforcing these con-

54. Mississippi Power Co. v. Peabody Coal Co., 69 F.R.D. 558 (S.D. Miss. 1976).

55. Korein v. Rabin, 287 N.Y.S.2d 975, 29 App. Div. 2d 351 (1968).

56. *In re* Norma Brill & Muller Bros., Inc., 40 Misc. 2d 683, 243 N.Y.S.2d 905 (1962), *aff'd* 13 N.Y.2d 776, 192 N.E.2d 34 (1963).

57. Sobel v. Hertz, Warner & Co., 469 F.2d 1211, 1214-15 (2d Cir. 1972).

58. Korein v. Rabin, 287 N.Y.S.2d 975, 980, 29 App. Div. 2d 351, 356 (1968) (citations omitted).

59. WIS. STAT. § 298.10 (1975); Commonwealth Coatings Corp. v. Continental Casualty Co., 393 U.S. 145 (1968), *reh. denied* 393 U.S. 1112 (1968).

trols is that the record of the proceedings need not be complete and the arbitrators need not set forth the reasons for their award.[60]

The statutory provisions regarding vacation or modification of awards are found in Wisconsin Statutes sections 298.10 and 298.11. An award must be vacated:

> (a) Where the award was procured by corruption, fraud or undue means;
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> (b) Where there was evident partiality or corruption on the part of the arbitrators, or either of them;
>
> (c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced;
>
> (d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.[61]

Thus, although fraud in the inducement of the contract will not keep a dispute from arbitration, if fraud is found in the procurement of the award, the award must be vacated. The statutory concern not only with fairness but also with the appearance of fairness was reflected in a 1968 United States Supreme Court decision, *Commonwealth Coatings Corp. v. Continental Casualty Co.*[62] This case involved a supposedly neutral arbitrator who had had business contacts with one of the parties to the arbitration but had not disclosed this to the other party. Construing a section of the Federal Arbitration Act which parallels Wisconsin Statutes section 298.10(1), the Court held that the award should be set aside because the arbitrator must not only "be unbiased but also must avoid even the appearance of bias."[63]

The Wisconsin Statutes also specify situations in which the court must either modify or correct an arbitration award:

> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing or property referred to in the award;

60. *See* Commercial Arbitration Rules of the American Arbitration Association, § 22; Sobel v. Hertz, Warner & Co., 469 F.2d 1211 (2d Cir. 1972).

61. WIS. STAT. § 298.10 (1975).

62. 393 U.S. 145, *reh. denied*, 393 U.S. 1112 (1968).

63. *Id.* at 150.

> (b) Where the arbitrators had awarded upon a matter not submitted to them unless it is a matter not affecting the merits of the decision upon the matter submitted;
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> (c) Where the award is imperfect in manner or form not affecting the merits of the controversy.
>
> (2) The order must modify and correct the award, so as to affect the intent thereof and promote justice between the parties.[64]

Despite the precautions against arbitrary awards contained in these statutory provisions, the fact that an arbitrator is not required to state the reasons for his award will often make it impossible for the court to determine whether there are grounds for vacation or modification of the award.

> The problem is how a court is to be made aware of the erring conduct of the arbitrators. . . . [A] rule [that arbitrators explain their reasoning in every case] would undermine the very purpose of arbitration, which is to provide a relatively quick, efficient and informal means of private dispute settlement. The sacrifice that arbitration entails in terms of legal precision is recognized, and is implicitly accepted in the initial assumption that certain disputes are arbitrable. Given that acceptance, primary consideration for the courts must be that the system operate expeditiously as well as fairly.[65]

## II. Policy Considerations

Arbitration often provides a swift and easy means to resolve disputed issues. When this is true, arbitration saves needless litigation expenses and court time. There are particular situations where the technical expertise of an arbitrator may be more desirable than the legal expertise of a judge. Additionally, arbitration has the benefit of finality for those parties who want a quick resolution of disputes without the likelihood of future court appeals. However, arbitration has several shortcomings. Since arbitrators are not bound by precedent, the results are not always predictable. Additionally, because of the limited scope of review of arbitral decisions concerning the facts and the law involved in the dispute, a fair hearing is not guaranteed in all cases.[66]

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64. Wis. Stat. § 298.11 (1975).

65. Erving v. Virginia Squires Basketball Club, 469 F.2d 1064, 1214 (2nd Cir. 1972).

66. *See* C. Wehringer, Arbitration Precepts and Principles, at 8 (1969) [hereinafter cited as Wehringer], *citing* Horowitz, *Guides for Resorting to Commer-*

The hands-off policy of courts reviewing the scope of arbitration clauses and the equities involved in particular cases is unsettling, since broad arbitration clauses, such as that suggested by the American Arbitration Association, reflect little recognition by the parties of the kinds of situations covered and of the rights being waived. Some situations are readily arbitrable. These include those involving simple issues of fact, or a special relationship between the parties such as might be found in a close corporation or partnership, or those where an expert can most appropriately resolve questions concerning the customary meaning of contract language or customary practices in the trade. However, where difficult questions of law or fact are involved, where the special knowledge of an arbitrator is not essential or could be provided by an expert witness, where a jury trial is desired, or where the expenses of the procedure outweigh its benefits, arbitration loses much of its desirability.[67]

Hypothetical and actual examples may help to illustrate these points. A contract, between a prime contractor and a subcontractor contains a clause calling for repair of equipment by the subcontractor, but replacement by the prime contractor. A dispute arises as to whether equipment should be repaired or replaced, and the arbitration clause is invoked. This is an excellent example of the kind of dispute which should be arbitrated since it was probably within the contemplation of the parties when the arbitration agreement was made. The dispute relates to a contractual provision, and resolution can appropriately draw upon the expertise of one who understands the equipment involved and the customary practices in the industry.

The same subcontract provides that the contract will be void if, due to an Act of God, the prime contract becomes void. In collusion with others and in an effort to involve a different subcontractor, the prime contractor induces the agency with which the prime contract was made to void that contract. The prime contractor then enters into a new, substantially similar contract with the agency and retains a different subcontractor. If tortious interference with business relationships is charged,

*cial Arbitration*, 8 PRACTICAL LAWYER 67, 75 (1962).

67. WEHRINGER, *supra* note 66, at 8-9.

proof of such a charge may require in depth, court-supervised discovery. Because of the complex legal and factual issues and the involvement of noncontracting parties, such a case should probably not be referred to arbitration.

No deep chasm divides arbitrable from nonarbitrable issues. One cannot readily conclude that contract issues should be arbitrated and tort issues not. Although the dissent in *Prima Paint*[68] made some good arguments for the nonarbitrability of fraud in the inducement of the contract, other courts dealing with different fact situations but similar legal issues, may present more compelling arguments for referring the dispute to arbitration. For example, in 1972 the Second Circuit Court of Appeals sent the case of *Erving v. Virginia Squires Basketball Club*[69] to arbitration, holding that the issue of whether Julius Erving had been defrauded into leaving college and signing a contract with the Virginia Squires, or whether he was simply attempting to jump teams for more money, was arbitrable. Two points must be made about the decision, however. First, the decision was written by Judge Harold Medina who authored the *Robert Lawrence*[70] decision upon which the *Prima Paint* majority relied heavily; and second, the court analyzed the facts and emphasized those which made the fraud charge seem secondary or even specious.[71] Thus, the legal precedent was laid by an earlier holding of the decision writer; yet despite this precedent and the court's evident partiality for arbitration, the court appeared to scrutinize the facts involved before ordering arbitration. Although the desirability of such judicial scrutiny of the facts and issues of law involved in an arbitration submission is often disclaimed, it is consistent with the review of the arbitrator's award which is statutorily prescribed, although often not available in fact.[72]

The view that arbitration is not favored in cases involving complex issues or numerous parties was recently voiced by the Minnesota Supreme Court:

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68. 388 U.S. 395 (1967).

69. 468 F.2d 1064 (2d Cir. 1972).

70. Robert Lawrence Co. v. Devonshire, 271 F.2d 402 (2d Cir. 1959), *cert. granted*, 362 U.S. 909 (1960), *dismissed* under Rule 60, 364 U.S. 801 (1960).

71. 468 F.2d at 1066-67.

72. WIS. STAT. §§ 298.10, 298.11 (1975); *but see* Aerojet-Gen'l Corp. v. American Arbitration Ass'n, 478 F.2d 248 (9th Cir. 1973); Sobel v. Hertz, Warner & Co., 469 F.2d 1211 (2d Cir. 1972).

> [T]he fact that arbitration is favored by this Court does not mean that it is our favorite remedy in situations where it would jeopardize other favored procedures and policies. Of at least equal stature and importance are our Rules of Civil Procedure, a major purpose of which is to encourage the efficient and expeditious resolution of controversies by facilitating joinder of all related parties and claims. . . . Where arbitration would increase rather than decrease delay, complexity and costs, it should not receive favored treatment.[73]

Thus, rather than liberally construing broad agreements to arbitrate future disputes, the courts should carefully scrutinize them. If contracting parties were required to specify the kinds of future disputes which they agree to arbitrate, there would be greater likelihood that they recognized the issues involved and the rights waived. Additionally, courts should closely scrutinize and be reluctant to enforce arbitration agreements where the dispute involves fraud in the inducement of the contract, punitive damages,[74] or an element of bad faith.[75]

CORNELIA GRIFFIN FARMER

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73. Prestressed Concrete, Inc. v. Adolfson & Peterson, Inc., 240 N.W.2d 551, 553 (Minn. 1976).

74. As discussed in Garrity v. Lyle Stuart, Inc., 386 N.Y.S.2d 831, 40 N.Y.2d 354, 353 N.E.2d 793 (1976), punitive damages are a form of public remedy for undesirable behavior, and should not be imposed by private arbitrators. On the other hand, behavior sufficiently abhorrent to give rise to punitive damages in a public forum, should not be insulated by a non-specific and irrevocable agreement to arbitrate future disputes. Rather, the policy of nonwaiver expressed in Wilko v. Swan, 346 U.S. 427 (1953) should be followed.

75. The obligation of good faith is implied in the making and performance of contracts (*see, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 231 (1973)). Situations involving bad faith may not rise to the level of fraud, or fraud may not be provable, but where bad faith is suspected, courts should carefully scrutinize the facts and the legal principles involved.