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## Arbitration—Arbitrator to Decide Issue Concerning Mutuality of Arbitration Contract

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## ARBITRATION

### ARBITRATOR TO DECIDE ISSUE CONCERNING MUTUALITY OF ARBITRATION CONTRACT

In 1955, respondent entered into a contract of employment with petitioner, whereby the latter agreed to employ respondent "until he voluntarily leaves the employ of Exercycle or dies." The agreement further provided that "Any dispute arising out of or in connection with this agreement shall be settled by arbitration. . . ." In 1959, a dispute arose between the parties when petitioner treated respondent's notification of his desire to seek employment elsewhere as his voluntary termination of the contract. Respondent sought arbitration and petitioner commenced the present action for a stay of arbitration on the grounds that the contract was void for lack of mutuality, and that irrespective of its validity, it was no longer in existence by reason of respondent's having voluntarily terminated it. The Supreme Court, Special Term, denied the stay and the Appellate Division affirmed on the grounds that the contract was not illusory nor lacking in mutuality.<sup>1</sup> Petitioner appealed and the Court of Appeals in *Exercycle Corp. v. Maratta*,<sup>2</sup> by a 6-1 vote (four in the majority, two concurring in result and one dissenting), although affirming the Appellate Division, stated that "the question whether the contract lacked mutuality of obligation, depending as it does primarily on a reading and construction of the agreement, and involving . . . substantial difficulties of interpretation, is to be determined by the arbitrators, not the court."<sup>3</sup> The Court further held that the issue of termination, raised by petitioner, must also be decided by the arbitrators.

The case presents an excellent opportunity for examining the problem of what issues a court may consider when ruling on an application for a stay of arbitration under Section 1458 of the New York Civil Practice Act or for an order compelling arbitration under Section 1450 of the Civil Practice Act.

It appeared to be clear in New York, prior to this case at least, that where the validity or existence of an arbitration contract was in issue, it was for the courts of law to decide. For example, Chief Judge Cardozo, writing for the Court of Appeals in *Finsilver, Still & Moss v. Goldberg, M & Co.*, stated:

Arbitration presupposes the existence of a contract to arbitrate. If a party to a controversy denies the existence of the contract and with it the jurisdiction of the irregular tribunal, the regular courts of justice must be open to him at some stage for the determination of the issue.<sup>4</sup>

In *In re Kramer & Uchitelle, Inc.*,<sup>5</sup> it was further stated that "Arbitration clauses . . . are directed solely to the remedy, not to the validity or existence of the contract itself. Thus proceedings to enforce arbitration under article 84 of

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1. 11 A.D.2d 677, 201 N.Y.S.2d 885 (1st Dep't 1960).
  2. 9 N.Y.2d 329, 214 N.Y.S.2d 353 (1961).
  3. *Id.* at 334, 214 N.Y.S.2d at 355.
  4. 253 N. Y. 382, 389, 171 N.E. 579, 581 (1930).
  5. 288 N.Y. 467, 471, 43 N.E.2d 493, 495 (1942).

the Civil Practice Act presuppose the existence of a valid and enforceable contract at the time the remedy is sought." (Citations omitted.) And in *In re Lipman (Haeuser Shellac Co.)* it was stated that:

Where, . . . , 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 contract,' this language would appear sufficiently broad to express the intention of the parties to include within the exclusive jurisdiction of the arbitrators . . . all acts by the parties giving rise to issues in relation to the contract, *except the making thereof*.<sup>6</sup> (Emphasis added.)

Judge Fuld, writing in *In re Terminal Auxiliar Maritima (Winkler)* stated:

Although the Court could not compel arbitration if an issue exists as to whether the contract ever came into existence, section 1450 of the Civil Practice Act, we have declared, 'seems to imply that all acts of the parties subsequent to the making of the contract which raise issues of fact or law, lie exclusively within the jurisdiction of the arbitrators. It is to be noted that . . . the statute only requires the contract to have been made and does not require that it shall continue to be in existence. (Citation omitted.)'<sup>7</sup>

It is difficult to reconcile the holding of the majority in *Exercycle* with the language of the prior cases cited. This decision further appears to be in conflict with the statutory provisions of Sections 1450 and 1458 of the Civil Practice Act which confer upon the court the power to resolve a "substantial issue as to the making of the contract."<sup>8</sup> A possible justification for the majority's position is that the arbitration clause can be considered as a separate, distinguishable contract, the consideration being the mutual promises of the parties to arbitrate. Judge Froessel, in his concurring opinion, felt that this may have been the rationale of the majority. But he further states, and this writer agrees, that the majority did not proceed upon this basis. It appears that they have recognized that an arbitration provision under New York law is considered to be a clause or part of the entire contract, for they refer to it as a *provision* of the contract. If the latter was the Court's reasoning, it is certainly not consistent with their result. Another possible justification for the holding is that the majority has construed the language of the prior case law and statutory material—the existence or making of a contract—to encompass only

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6. 289 N.Y. 76, 80, 43 N.E.2d 817, 819 (1942).

7. 6 N.Y.2d 294, 298, 189 N.Y.S.2d 655, 658 (1959).

8. N.Y. Civ. Prac. Act § 1450:

If evidentiary facts be set forth raising a substantial issue as to the making of the contract . . . the court, or the judge thereof, shall proceed immediately to the trial thereof.

N.Y. Civ. Prac. Act § 1458:

Where such opposing party, either on a motion for a stay . . . sets forth evidentiary facts raising a substantial issue as to the making of the contract . . . an immediate trial of the same shall be had.

the purely factual dispute as to whether the respective parties agreed (using the term in a non-legal sense) as to the employment of respondent and the submission of any dispute concerning this employment to arbitration; thereby excluding from the domain of the courts any resolution as to whether the so-called agreement reached by the parties is a valid and legally binding contract, enforceable at law. Using the term "agree" in the non-technical sense, certainly it cannot be said that the parties did not reach an agreement. Support for this rationale of the majority's position can be found in the following statement by the Court:

there can be no doubt that Maratta and Exercycle made a contract. . . . In fact, the agreement, entered into . . . was continued in force, its terms and provisions complied with and carried out, until . . . , a period of almost five years. It may hardly be said, therefore, that the making of the present agreement is in issue under Section 1450 of the Civil Practice Act.<sup>9</sup>

In addition, it is interesting to note the Court's treatment of a similar problem in *S. M. Wolff Co. v. Tulkoff*,<sup>10</sup> decided by the Court of Appeals a week after the case at bar. In this case, a unanimous Court held that the factual dispute concerning the making of a contract to arbitrate should be resolved at a hearing to be held at Special Term. The dispute consisted "essentially of a disagreement over whether the parties' initial telephone conversations 'closed the deal' or whether they were preliminary, or subject to the subsequent 'Bought Notes' containing the arbitration clause."<sup>11</sup>

It is submitted that this is the type of dispute concerning the validity of an arbitration contract which the majority in *Exercycle* must have felt that prior law addressed itself to. If so, then the unanimous treatment of the issue in the *Wolff* case can be reconciled with the wide split taken by the Court in *Exercycle*, which decided that the contract in dispute was factually entered into (this was not the situation in the *Wolff* case) and that, as the only issue remaining was one of interpreting this contract to determine its legal validity, it was for the arbitrators to decide.

Irrespective of whether the majority's position is a reasonable interpretation of statutory and prior case law, their position does not appear to be a sound or logical one. The arbitrator is now placed in a position where he is to decide the very issue upon which his jurisdiction and legal existence depends, for as stated by Chief Judge Cardozo in the *Finsilver* case and reiterated by Judge Froessel in *Exercycle*: "If in truth there is *no contract at all* or none calling for arbitration, the self-constituted tribunal is a nullity. . . ."<sup>12</sup>

The reader is also urged to consider the case of *DeLaurentiis v. Cinema-*

9. Matter of *Exercycle Corp.*, supra note 2 at 335, 214 N.Y.S.2d at 356.

10. 9 N.Y.2d 356, 214 N.Y.S.2d 374 (1961).

11. *Id.* at 363, 214 N.Y.S.2d at 378.

12. *Finsilver, Still & Moss v. Goldberg, M. & Co.*, supra note 4 at 390-391, 171 N.E. at 582.

*tografica etc.*,<sup>13</sup> decided by the Court a month after the *Exercycle* case. In the *DeLaurentiis* case, petitioner, seeking a stay of arbitration, contended that a contract between himself, a film distributor, and an author for production and distribution of a film, leaving to future agreement approval of a story outline and scenario, was illusory; therefore, he was not bound by the arbitration agreement embodied in the allegedly invalid contract. The Court, citing the *Exercycle* case, held that "it is for the arbitrators to decide what, under all the circumstances, these covenants contemplated. . ."<sup>14</sup>

Although the Court has recognized that they are bound by their decision in *Exercycle* to refer the issue of mutuality to arbitration, it appears that they are nevertheless deciding that very issue themselves when they state:

Thus, in addition to the implication of good faith read into every contract (see *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214), we had an express promise of consultation and of good-faith effort to bring to completion a scenario of such form and quality as to be acceptable.<sup>15</sup>

It is submitted, therefore, that the Court is retreating somewhat from its position in *Exercycle*.

Although the *DeLaurentiis* case leaves us with some doubt as to the Court's convictions concerning the power of an arbitrator to decide the issue of mutuality of contract, the *Exercycle* case is still the law in New York. Therefore, an attorney faced with a problem concerning the validity of an arbitration contract must first decide whether his case fits under the factual pattern of *Exercycle* (or *DeLaurentiis*) or the *Wolf* case, since the answer will dictate whether a court of law or an arbitrator will decide the issue.

J. D.

#### ARBITRATOR TO DECIDE EXTENT OF DAMAGES

In *DeLaurentiis v. Cinematografica, Etc.*,<sup>16</sup> petitioner (producer of motion pictures) and respondents (a film distributor and an author) entered a written agreement whereby they were to do what was necessary for the production and distribution of a motion picture. The contract further provided that any dispute arising thereunder should be submitted to arbitration under the rules of the American Arbitration Association in New York City. Under the agreement, petitioner covenanted to prepare a story outline and scenario, subject to respondent's approval. Respondents, through their New York agents, alleged that petitioner had never performed any of his obligations under the contract and sought arbitration, claiming among other damages, loss of profits and loss of business reputation. Petitioner's agent wrote a series of letters to respond-

13. 9 N.Y.2d 503, 215 N.Y.S.2d 60 (1961).

14. *Id.* at 510, 215 N.Y.S.2d at 64.

15. *Id.* at 509-510, 215 N.Y.S.2d at 63.

16. *DeLaurentiis v. Cinematografica, Etc.*, 9 N.Y.2d 503, 215 N.Y.S.2d 60 (1961), affirming 12 A.D.2d 467, 207 N.Y.S.2d 317 (1st Dep't 1960).