

12-1-1953

Contracts—Arbitration

Lowell Grosse

Follow this and additional works at: <https://digitalcommons.law.buffalo.edu/buffalolawreview>



Part of the [Contracts Commons](#)

Recommended Citation

Lowell Grosse, *Contracts—Arbitration*, 3 Buff. L. Rev. 85 (1953).

Available at: <https://digitalcommons.law.buffalo.edu/buffalolawreview/vol3/iss1/28>

This The Court of Appeals Term is brought to you for free and open access by the Law Journals at Digital Commons @ University at Buffalo School of Law. It has been accepted for inclusion in Buffalo Law Review by an authorized editor of Digital Commons @ University at Buffalo School of Law. For more information, please contact lawscholar@buffalo.edu.

THE COURT OF APPEALS, 1952-53 TERM

It is important to note that the court approached the present problem by the use of traditional choice of law rules. By holding the foreign substantive law to govern the contract, the action failed because there was no breach of obligation under the foreign law. We should not place too much weight on the reference to the International Monetary Fund, since it is well recognized that courts generally refrain from invoking the public policy exception unless the case has relatively important "contacts" with the forum.⁴⁴ Although the reference to the Fund appears justified in order to show no repugnancy to our public policy, the mere mention of the Fund for this purpose does not warrant its use as a stepping stone for the argument that the Fund Agreement should be the sole basis of decision.⁴⁵ Such a rationale would lead to results consistent with those reached through the use of the traditional approach where, as in the present case, the foreign substantive law was indicated as the law of the contract. However, as the "contacts" of a case lean substantially more toward the forum,⁴⁶ the Fund approach would still render the contract unenforceable; whereas the use of ordinary conflict rules would apply the law of the forum, which would enforce it.⁴⁷ Until there is a clear indication that currency restrictions of fellow Fund members are to be enforced in all cases, we should not be forced to forsake our ordinary choice of law rules.

V. CONTRACTS

Arbitration

Today a greater percentage of commercial contracts are providing for the settlement of disputed terms through arbitration.

44. "Only an actual, strong and adverse interest of the forum will prompt the court to refuse the application of the foreign law that would govern under general conflict of laws rules." Nussbaum, *Public Policy and the Political Crisis in the Conflict of Laws*, 49 YALE L. J. 1027, 1031 (1940). "[I]t cannot be against the public policy of this State to hold nationals to the contracts which they have made in their own country to be performed there according to the laws of that country." *Dougherty v. Equitable Life Assurance Soc.*, *supra* note 43 at 90, 193 N. E. at 903.

45. It has been suggested that even more consistency of result would occur if the court had not used traditional choice of law rules of the forum, but rather had used the International Monetary Fund Agreement as a "superimposed" rule of decision. See note 38, *supra*; Meyer, *Recognition of Exchange Controls After the International Monetary Fund Agreement*, 62 YALE L. J. 867 (1953); 2 AM. J. COMP. L. 389 (1953). This would call for an interpretation of several terms in Art. VIII, § 2 (b), especially "exchange contracts", before the section could be used as the basis of decision. However, there has been material written to indicate that the instant case could have been decided under this section. See Meyer, *supra*. But see Nussbaum, *Exchange Control and the International Monetary Fund*, 59 YALE L. J. 421 (1950).

46. Especially where the place of performance is also the forum.

47. See *Central Hanover Bank & T. Co. v. Siemens & Halske G.*, 15 F. Supp. 927, 929 (S. D. N. Y. 1936), *aff'd mem.*, 84 F. 2d 993 (2d Cir. 1936), *cert. denied*, 299 U. S. 585 (1936); *Glynn v. United Steel Works Corporation*, 160 Misc. 405, 289 N. Y. Supp. 1037 (Sup. Ct. 1935).

This method has advantages¹ over resorting to the courts; it is less expensive, speedier, avoids unfavorable publicity and the parties are able to choose their own judge. Paradoxically, the attempt to avoid court proceedings through arbitration clauses has been thwarted in many instances by disputes over the arbitration agreement itself. Several different aspects of this problem faced the Court of Appeals in the 1952 term.

a) *Agreements*: In New York arbitration is governed generally by statute.² The parties may question whether an arbitration agreement has been made through a proceeding to stay arbitration.³ This was the situation before the court in *Level Export Corp. v. Wolz Aiken & Co.*⁴ A buyer and a seller of textiles negotiated two purchase agreements which were signed by both parties. They incorporated by direct reference⁵ the provisions of the Standard Cotton Textiles Sales Note, which calls for arbitration according to the terms of the Note. The buyer petitioned under C.P.A. § 1458 (2) for a stay, contending, that since he had not seen nor read the Standard Sales Note, he was unaware of the arbitration provision; thus, he had never agreed to arbitration. The court, observing that the petitioner was a man of wide experience in the export field and that he was not misled in his dealings with the seller, held (6-1) that the plain language of the contract called for arbitration.

The court, taking note that no one is under a duty to arbitrate unless by clear language he has so agreed,⁶ adhered to the proposition that the determination of whether there is an agreement to arbitrate is based on ordinary contract rules.⁷ They apparently felt that this determination did not deserve a closer surveillance than that given to other agreements.⁸ In compliance with the established rules, one who signs an instrument in the

1. Phillips, *Commercial Arbitration*, 44 YALE L. J. 31 (1934).

2. C. P. A. Art. 84, Arbitration.

3. C. P. A. §§ 1450, 1458 (2).

4. 305 N. Y. 82, 111 N. E. 2d 218 (1953).

5. "This sales note is subject to the provisions of Standard Cotton Textile Sales note which, by reference, is incorporated as a part of this agreement and together herewith constitutes the entire contract between buyer and seller."

6. *Lehman v. Ostrovsky*, 264 N. Y. 130, 190 N. E. 208 (1934).

7. "But although arbitration agreements in this State are now enforceable, that does not mean that the rules, heretofore applicable to the interpretation of contracts to determine whether the parties have agreed to arbitration have been abrogated." *General Silk Importing Co. v. Gerseta Corp.*, 200 App. Div. 786, 798, 194 N. Y. Supp. 15, 19 (1st Dep't 1922) (Which held a provision incorporating rules of "Silk Association of America" had not indicated a sufficient intent to agree to arbitration. Distinguished in the instant case).

8. Phillips, *Rules of Law in Arbitration*, 47 HARV. L. REV. 590 (1933); But see *General Silk Importing Co. v. Gerseta*, *supra* note 7 at 792, 194 N. Y. Supp. 15 at 20 (1st Dep't 1922), "But on the other hand since the contract to arbitrate presupposes an agreement to forego the right to resort to the courts for redress an alleged contract to arbitrate, which is disputed, will be subject to strict construction in order that the parties may not be deprived of their constitutional right in the courts."

THE COURT OF APPEALS, 1952-53 TERM

absence of fraud is conclusively presumed to know and agree to its contents whether or not he has read them.⁹

Judge Desmond, in dissent, which was concurred in by Judge Fuld, believed that consent to arbitrate was a matter of fact and not of law. He would not apply the conclusive presumption rule, applicable to cases where a person signs a contract without having read the contents, to arbitration cases.¹⁰

The idea that a closer scrutiny should be given to alleged agreements to arbitrate, because such agreements prevent the parties from seeking relief in the courts, is not deserving any longer. The parties to commercial contracts are aware that arbitration agreements are a commonly used method to settle controversies. The proceeding is quite comparable to court proceedings along the lines of fair standards and decisions.

A recent holding of the Appellate Division in *Riverdale Fabrics Corp. v. Tillinghast-Stiles Co.*,¹¹ emphasises the effect of the decision in the instant case.

b) *Arbitrator*: Once arbitration has been settled upon as the method to determine controversies, the parties must then choose, or make provisions for selection of, an arbitrator.¹² Generally, any person, persons, or body may be agreed upon by the parties.¹³ The quasi-judicial nature of the arbitrator's position would appear to require that he have no interest in the outcome other than to render a fair and justifiable decision on the merits.¹⁴ An award rendered on the basis of prejudice or bias is subject to

9. *Metzger v. Aetna Ins. Co.*, 227 N. Y. 411, 416, 125 N. E. 814, 816 (1920); *Matter of Levy*, 271 App. Div. 431, 65 N. Y. S. 2d 860 (1st Dep't 1946), *aff'd*, 296 N. Y. 837, 72 N. E. 2d 25 (1947); 1 CORBIN, CONTRACTS § 107 (1951).

10. Compare the RESTATEMENT, CONTRACTS § 70 (1932), on an assumption clause in a deed. "Although a grantee who signs a deed is bound by all the clauses and must fulfill his undertaking as stated in the deed a mortgage assumption clause in a deed must be explicitly shown to be assented to because it is not normally a part of the deed."

11. In 281 App. Div. 983, 121 N. Y. S. 2d 261 (2d Dep't April 1953) (Contract subject to "Cotton Yarn Rules" containing arbitration provision). The court on re-argument reversed by a 3-2 decision an order they had made in *Riverdale Fabrics Corp. v. Tillinghast-Stiles Co.*, 281 App. Div. 831, 118 N. Y. S. 2d 569 (2d Dep't Feb. 1953) which had been granted on the authority of *Level Export v. Welz Aiken*, 280 App. Div. 211, 112 N. Y. S. 2d 549 (1st Dep't 1952). In reversal the majority specifically relied on the Court of Appeals decision in the *Level Export* case.

12. C. P. A. § 1452 provides that the court shall appoint an arbitrator when the parties fail to provide for one or where their arrangement has not succeeded.

13. "Although the parties may exercise their right to name the arbitrator in the clause at the time the contract is made, it is not desirable. Under the Arbitration Rules it is not encouraged for the following reasons: (1) . . . ; (2) . . . ; (3) The status of the arbitrators may have changed, rendering them incompetent or, by reason of their changed relation to a party, open them to the suspicion of partiality . . . ; (4) . . . ; (5) . . . ;" CODE OF ARBITRATION: PRACTICE AND PROCEDURE 50-51 (1931).

14. *American Eagle F. Ins. Co. v. New Jersey Ins. Co.*, 240 N. Y. 398, 148 N. E. 562 (1925);

Matter of Friedman, 215 App. Div. 130, 135, 213 N. Y. Supp. 369, 374 (1st Dep't 1926).

being set aside.¹⁵ But, to set aside an award on the basis of partiality requires a clear and well-founded showing that it was thereby influenced.¹⁶

However necessary impartiality is to the arbitrator's decision it is merely a desirable asset and not required of one selected to serve as arbitrator. If the arbitrator is found to have some interest or relationship that raises doubt as to his ability to render an impartial decision, it is incumbent upon the objecting party to voice his disapproval. If he allows the dispute to proceed to, or continue in, arbitration, without objection, then he is deemed to have waived his complaint.¹⁷ Also, where the arbitrator has been agreed upon at the execution of the contract and his interest is known or should have been known, neither party can be heard to complain later.¹⁸

The fact, that one of the parties to an agreement was a corporation owned beneficially by the Soviet Government and the arbitrator agreed upon was the U.S.S.R. Chamber of Commerce Foreign Trade Arbitration Commission, was enough to establish that the complainant should have had knowledge of a possibly unfavorable interest of the arbitrator. In *Amtorg Trading Corp. v. Camden Fibre Mills*¹⁹ the Court of Appeals maintained that since the parties contracted for this arbitrator, "Camden . . . may not now ask the courts to relieve it of its contractual obligation it assumed." The dispute must proceed to arbitration before the arbitrator selected. However, the court pointed out that if he rendered an evidently partial decision it could be vacated by proper proceedings.

Apparently, the rationale for the waiver rule and the court's decision is threefold: (1) No fraud is committed at the outset if the parties are aware or should be aware of the arbitrator's interest. (2) Merely because an arbitrator has some relationship with one of the parties, his decision will not necessarily be biased. The parties may have chosen the arbitrator for his capabilities and familiarity with the problem involved²⁰ despite his ostensible dis-

15. "[T]he court must make an order vacating the award, . . . (2) Where, there was evident partiality or corruption in the arbitrators or either of them." C. P. A. § 1462.

16. *Davy v. Faw*, 7 Cranch. 171 (U. S. 1810); *Brush v. Fisher*, 20 Mich. 469, 38 N. W. 446 (1888).

17. *Matter of Newberger v. Rose*, 228 App. Div. 526, 528, 240 N. Y. Supp. 436, 438, 439 (1st Dep't 1930), *aff'd without opinion*, 254 N. Y. 546, 173 N. E. 659 (1930); 6 WILLISTON, CONTRACTS § 1929 A (Rev. ed. 1938).

18. *Matter of Avalon Fabrics*, 195 Misc. 267, 89 N. Y. S. 2d 166 (Sup. Ct.), *aff'd without opinion*, 275 App. Div. 1032, 92 N. Y. S. 2d 310 (1st Dep't 1949); 6 WILLISTON, CONTRACTS § 1923A (Rev. ed. 1938).

19. 304 N. Y. 519, 109 N. E. 2d 606 (1953).

20. "[M]ost arbitrators are reasonably familiar with the practices of the industry in which they arbitrate . . . Many have wide experience in arbitrating, frequently have handled previous cases for the parties and may be highly skilled specialists in the field." Summers, *Judicial Review of Labor Arbitration*, 2 BFLQ. L. REV. 1 at 23.

THE COURT OF APPEALS, 1952-53 TERM

qualification. (3) There is always available a remedy in case of a basically unfair and unjustifiable determination.

c) *Effect on legal action:* Having agreed to arbitrate all disputes, the parties are required to abide by this provision before they may pursue legal action,²¹ unless, of course, they waive their rights by consent or conduct.²² Coincidentally, the parties may provide that waiver will be effected if a designated period of time is allowed to lapse before a demand for arbitration is made.²³ It is an obvious proposition that waiver by one party cannot affect the rights of the other. Furthermore, it would be a misapplication of the waiver principal to invoke it when a party was merely seeking to enforce the agreement.²⁴ This is essentially the rationale used by Judge Conway in *River Rice Mills v. Latrobe Brew. Co.*²⁵ A dispute arose between seller (petitioner) and buyer on a contract which provided that all claims or controversies were to be settled by arbitration. The contract contained a further clause stating that a demand for arbitration must be made within five days after tender. No demand was made until a year later, at which time the seller obtained an injunction to stay arbitration. Two months subsequent the buyer brought an action on the contract in City Court; before answer, the seller petitioned, under C.P.A. § 1451, for a stay of the proceedings until arbitration could be had. The lower court refused the stay but the Appellate Division²⁶ reversed (3-2) and this court unanimously affirmed the reversal. Judge Conway, speaking for the court, made it clear that if they were to permit the law action, the effect would be to make the arbitration agreement revocable at the will of one of the parties. Either party could merely allow the time limit to expire and then seek damages in a court of law on the theory that arbitration was no longer available (as here argued by the buyer). To succumb to this argument, Judge Conway decided, would undermine the policy behind the Arbitration Laws.²⁷

Judge Conway also considered whether C.P.A. § 1451 was to apply to a situation where a party pursued his legal remedy after

21. C. P. A. § 1451 provides that if there is in existence an arbitration agreement and the issue which is raised between the parties is "referrable to arbitration," then any law suit must be stayed "until such arbitration has been had in accordance with the terms of the contract."

22. *Zimmerman v. Cohen*, 236 N. Y. 15, 139 N. E. 764 (1923).

23. C. P. A. § 10 (1); See *Matter of Broadway-40th Street Corp.*, 271 App. Div. 219, 62 N. Y. S. 2d 888 (1st Dep't 1946), *aff'd*, 296 N. Y. 165, 71 N. E. 2d 451 (1947).

24. See generally 3 CORBIN, CONTRACTS § 753.

25. 305 N. Y. 36, 110 N. E. 2d 545 (1953); see 8 ARB. J. N. S. 40.

26. *River Brand Rice Mills v. Latrobe Brew. Co.*, 280 App. Div. 247, 113 N. Y. S. 2d 132 (1952).

27. See *American Reserve Ins. Co. v. China Ins. Co.*, 297 N. Y. 322, 79 N. E. 2d 425 (1948); *Matter of Fever Transp. Local No. 445*, 295 N. Y. 87, 91, 65 N. E. 2d 178, 180 (1946).

demanding arbitration although arbitration had been precluded by the lapse of a time limit. C.P.A. §1451 contemplates that a party to an arbitration agreement tries to avoid arbitration by first suing at law; upon application by the opposing party the statute makes a stay of such suit mandatory²⁸ and thereby compels the claimant to resort to arbitration. He determined, that although the latter was the customary procedure, the former was within the meaning of the "whole spirit and purpose" of C.P.A. Art. 84, Arbitration. Its intendment is to enforce arbitration where the parties have so agreed and to make this their exclusive remedy.²⁹

The decision leaves no doubt that a valid self imposed statute of limitations effecting arbitration agreements will apply equally to the ability to sue at law on a dispute referable to arbitration.

d) "Penalty" Provisions: Usually a court will not review an arbitrator's award unless it is based on fraud or the issue decided is beyond that submitted.³⁰ Where, however, the contract involved is illegal or contains illegal provisions, or offends public policy, review is warranted and the award may be set aside.³¹

The relative bargaining power of the parties to a contract is determinate of the concessions that may be won. The law, based on a distaste for coercion, superimposes limits and consequently will not enforce a penalty provision³² which does not bear a reasonable relation to actual compensatory damages.³³

The problem then presented is whether a contract provision, empowering an arbitrator to set a "penalty", will be reviewed and set aside. In 1952 the Appellate Division³⁴ upheld a contract provision "authorizing a penalty, as determined by arbitration, of not less than 2% and not more than 10% of the market value."³⁵

28. See note 21 *supra*.

29. *American Reserve Ins. Co. v. China Ins. Co.*, *supra* note 27.

30. C. P. A. §1462; *Matter of Marchant v. Mead-Morrison Mfg. Co.*, 252 N. Y. 234, 298, 169 N. E. 386, 391 (1929).

31. *Western Union Tel. Co. v. American Communications Ass'n.*, 299 N. Y. 177, 86 N. E. 2d 162 (1949); *Matter of Metro Flan v. Miscione*, 257 App. Div. 652, 15 N. Y. S. 2d 35 (1st Dep't 1939); *Matter of Gate v. Hilts*, 176 Misc. 277, 27 N. Y. S. 2d 18 (Sup. Ct. 1941) (usurious contracts).

32. See generally, 5 COREIN, CONTRACTS §1057; McCormick, *Liquidated Damages*, 17 VA. L. REV. 103 (1930); RESTATEMENT, CONTRACTS § 339, comment a.

33. See 5 CORBIN, CONTRACTS §1077; Demogue, *Validity of the Theory of Compensatory Damages*, 27 YALE L. J. 585 (1918).

34. *East India Trading Co. v. Halari*, 280 App. Div. 420, 214 N. Y. S. 2d 93 (1st Dep't 1952), 62 COL. L. REV. 943, 28 N. Y. U. L. Q. REV. 217 (1953), 27 ST. JOHN'S L. REV. 346 (1953). But cf. *Publisher's Ass'n v. Newspaper's Union*, 280 App. Div. 500, 144 N. Y. S. 2d 401 (1st Dep't 1952); 2 B'FLO. L. REV. 157; 52 COL. L. REV. 943; 28 N. Y. U. L. Q. REV. 217 (1953); 27 ST. JOHN'S L. REV. 346 (1953) (vacating an arbitrator's award of a conditional \$5,000 penalty for a union violation of a no-strike provision of a collective contract).

35. Incorporated in the rules of the American Spice Trade Association.

THE COURT OF APPEALS, 1952-53 TERM

The Court of Appeals in *East India Trading Co. v. Halari*³⁶ affirmed, without opinion, by a scant 4-3 majority.

The dissenters, led by Judge Van Voorhees, would not accept the reasoning of the majority in the Appellate Division as applied to this case. The lower court had stated, that since judicial notice can be taken of expenses of litigation and the inadequacy of ordinary costs,³⁷ the "penalty" here was in the nature of liquidated damages.³⁸

Judge Van Voorhees reasoned that the percentage limits were not related by the terms of the contract to extra damages or litigation expenses because the percentage was to be computed on the market value at the time of the default, not upon the appreciated market value above the contract price. The arbitrator was not given discretion as to whether a "penalty" should or should not be awarded. Thus, the "penalty" was to be awarded regardless of whether the market price had risen or decreased at the time of default. This would permit the purchaser to refuse to accept the goods and still receive two percent in the event of a falling market. Nor, did the contract provide a reasonable standard to guide the arbitrator in making an award for compensatory damages caused by special circumstances.

Several reasons have been advanced which serve as a basis for the majority's affirmance: (1) The danger of an unfair bargain is obviated by the court's review power over arbitration awards.³⁹ (2) The policy favoring non-interference with the arbitration process overrides the penal aspect of the provision. (3) The hands-off attitude of the law, which allows a wide range of bargaining, makes it difficult to distinguish between a penalty and liquidated damages.⁴⁰

However, the dissenters feel that the assumption that arbitrators are reasonable men is not necessarily valid. They contend further that the courts are forbidden in most instances to go behind the arbitrator's award to search the evidence with the purpose of determining what actuated the decision.⁴¹ Lastly, since the courts themselves are disinclined to enforce punitive clauses formulated by individuals, the arbitrator who lacks punitive authority should not be so empowered.

36. 305 N. Y. 866, 114 N. E. 2d 213 (1953).

37. PERS. PROP. LAW § 148; 5 CORBIN, CONTRACTS § 1054.

38. *East India Trading Co. v. Halari*, *supra* at 421, 114 N. Y. S. 2d at 94; see WILLISTON, CONTRACTS § 778 (3d rev. ed. 1936).

39. 52 COL. L. REV. 943, 944, 945 (1952).

40. 28 N. Y. U. L. Q. REV. 217, 218 (1953).

41. 2 BFLO. L. REV. 157 (1952); Summers, *Judicial Review of Labor Arbitration* 2 BFLO. L. REV. 1 (1952); *Matter of Motor Haulage and International Brotherhood of Teamsters*, 272 App. Div. 382, 383, 71 N. Y. S. 2d 352, 353 (1st Dep't 1947).

Undoubtedly the decision is not precedent value for the proposition that a similar penalty provision in a contract would be upheld in an action at law for damages. Furthermore, the strong dissent by three members of the Court of Appeals indicates a disfavor with any similar provision even if awarded within the framework of arbitration. Had the "penalty" been a fixed sum, or the percentage range been at a higher bracket, or if the arbitrator had made his award on the basis of 10% rather than 2% this writer believes the award would not have been allowed as liquidated damages.

Impossibility of Performance

In 1647 a general rule was expounded that the parties to a contract ought not be excused from their self-created duties because a subsequent event had rendered performance impossible.⁴² The contract should have provided for such contingencies. This strict rule has since been hacked away by many exceptions. The feeling now prevails that at least a portion of the risk of disappointment from supervening unforeseen events should be allocated to the promisee.⁴³ It is recognized that if the law prevents performance on the part of the promisor he should not be penalized for yielding to its commands.⁴⁴ This rationale will also apply to judicial orders and decrees instituted by a third party, unless the proceedings were a result of the defendants own negligence or breach of duty to others, and if no means of avoiding such interference with performance are reasonably available.⁴⁵ Under the latter circumstances the event could not be said to be fortuitous.

With this background in mind it is not difficult to follow the extreme logic of the Court of Appeals when it disallowed the defense of impossibility in *General Aniline Film Corp. v. Bayer Co.*⁴⁶

The plaintiff brought suit on a contract its assignor's had executed with the defendant. The U. S. Government instituted anti-trust proceedings against the defendant and on a consent decree issued an injunction restraining the defendant from performing any terms of the agreement. The plaintiff had not been made a party to the anti-trust action. The court spoke in terms of the effect of a consent decree, its admissability in evidence, and its validity. They concluded that the plaintiff would be deprived

42. *Pardine v. Jane*, Aley 26 (1647).

43. 6 CORBIN, CONTRACTS § 1320.

44. *Id.* § 1343.

45. *Id.* § 1346.

46. 305 N. Y. 479, 113 N. E. 2d 844 (1953).