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Arbitration Clauses and Fraudulent Inducement

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RECENT DEVELOPMENTS

ARBITRATION CLAUSES AND FRAUDULENT INDUCEMENT

Plaintiff and defendant entered into a contract containing a provision that "any controversy or claim arising out of or relating to this Agreement . . . shall be settled by arbitration." A dispute arose and defendant demanded arbitration. Plaintiff brought an action in federal district court to rescind the contract on the ground of fraudulent inducement, moving to stay arbitration. Defendant cross-moved to stay trial pending arbitration. The district court granted defendant's motion and denied plaintiff's. The Second Circuit Court of Appeals affirmed. *Held*: Unless there is an allegation that the arbitration provision itself was fraudulently induced, an issue of fraudulent inducement of a contract containing an arbitration provision must be arbitrated even if the relief sought is rescission. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 360 F.2d 315 (2d Cir.), *cert. granted*, 87 Sup. Ct. 202 (1966).

New York, in 1920, and Congress, in 1925, passed statutes[1] which abrogated the common law rule that executory arbitration agreements were not specifically enforceable.[2] Under those statutes, which have been the pattern for similar legislation in other jurisdictions,[3] written

[1] 9 U.S.C. §§ 1-14 (1965); N.Y. CIV. PRAC. LAW §§ 7501-14 (McKinney 1963).

[2] Standard Magnesium Corp. v. Fuchs, 251 F.2d 455, 457 (10th Cir. 1957); RESTATEMENT, CONTRACTS § 550 and comment (1932).

[3] *E.g.*, WASH. REV. CODE § 7.04.010-.220 (1956), which provides that agreements to submit existing controversies to arbitration and provisions in written agreements providing for arbitration of future disputes arising out of or in relation to the agreement are "valid, enforceable and irrevocable save upon such grounds as exist in law or equity for the revocation of any agreement." WASH. REV. CODE § 7.04.010 (1956). If any party to a written arbitration agreement institutes any legal or equitable action which involves an issue referable to arbitration under the terms of the agreement, any other party to the arbitration agreement may move for a stay of the action pending arbitration. WASH. REV. CODE § 7.04.030 (1956). Upon a motion to compel arbitration, a court may order a party to comply with an arbitration agreement if the dispute is referable to arbitration under the terms of the agreement and if there is no "substantial issue . . . as to the existence or validity" of the arbitration agreement. If there is a substantial issue as to the existence or validity of the arbitration agreement or as to a failure to comply with such an agreement, a trial will be held as to those issues, and either party may demand a jury. Questions of existence or validity of an arbitration agreement or failure to comply therewith can be raised only by (1) pleading evidentiary facts raising the issues and (2)

arbitration provisions are enforceable[4] and judicial proceedings may be stayed pending arbitration.[5] Before a court may compel arbitration, however, it must find that the parties did agree to arbitrate and that the dispute is within the terms of the agreement.[6] One of the more troublesome questions arising under these statutes is whether specific enforcement of an arbitration provision shall be granted if rescission of a contract containing an arbitration clause is sought on the ground of fraudulent inducement.[7] It can be argued that in such a case the allegation of fraud raises the non-arbitrable issue of whether there exists an enforceable agreement to arbitrate.

In the principal case, plaintiff contended that the arbitration provision was a part of the contract to be rescinded, and, therefore, the existence of the provision was in issue. The court determined that under federal law an arbitration provision is separable from the "principal contract" containing it, and an allegation of fraudulent inducement of the principal contract does not reach the arbitration provision, citing *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*[8] The second

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moving to stay arbitration or contesting a motion to compel arbitration. WASH. REV. CODE § 7.04.040 (1956).

Other sections of the Washington statute deal with representation by counsel at arbitration hearings, provisions for compelling witness attendance at arbitration hearings, confirmation of an arbitration award, and vacation, modification, or correction of an award and the grounds therefor.

[4] 9 U.S.C. § 2 (1965); N.Y. CIV. PRAC. LAW § 7501 (McKinney 1963). The federal statute provides:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract ... shall be valid, irrevocable, and enforceable save upon such grounds as exist at law or in equity for the revocation of any contract.

This language, with the exception of the commerce qualification, was copied from the former New York statute, originally enacted in 1920. N.Y. Sess. Laws 1920, ch. 275, § 2.

The New York statute was amended and renumbered in 1963 and now provides that "a written agreement to submit any controversy thereafter arising ... to arbitration is enforceable ...." The reviser's notes indicate that the words "valid, irrevocable" and the saving clause were regarded as unnecessary. Thus the change in language was not intended to alter the statutory effect.

Compare WASH. REV. CODE § 7.04.010 (1956), *supra* note 3.

[5] 9 U.S.C. § 3 (1965); N.Y. CIV. PRAC. LAW § 7503(a) (McKinney 1963). See also WASH. REV. CODE § 7.04.030 (1956).

[6] 9 U.S.C. § 4 (1965); N.Y. CIV. PRAC. LAW § 7503(a) (McKinney 1963). The federal statute provides that:

> [U]pon being satisfied that the *making of the agreement for arbitration* or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. [Emphasis added.]

Compare WASH. REV. CODE § 7.04.040 (1956) which requires that there be "no *substantial* issue ... as to the *existence or validity* of the agreement to arbitrate..." (Emphasis added.)

[7] See generally Annot., 91 A.L.R.2d 936 (1963).

[8] 271 F.2d 402 (2d Cir. 1959), *cert. granted*, 362 U.S. 909 (1960), *dismissed per stipulation of parties*, 364 U.S. 801 (1960) [hereinafter cited as *Robert Lawrence*].

circuit in *Robert Lawrence* had reasoned that policy considerations and the language of the federal statute[9] required a holding that an arbitration clause is separable.[10] The policy considerations deemed controlling were: (1) parties should be free to agree that fraudulent inducement should be arbitrated; (2) arbitrability should not depend on the words used in pleading a claim;[11] (3) courts should not encourage delay of arbitration; and (4) maximum effect should be given to the legislatively announced policy in favor of arbitration. Plaintiff in the principal case attempted to distinguish *Robert Lawrence* on the ground that claimant there sought damages, affirming the contract, whereas plaintiff in the principal case sought rescission, putting the contract's existence in issue. Without discussion, the court held that the relief sought had no bearing on the separability of an arbitration provision or the arbitrability of an issue of fraudulent inducement of the principal contract.[12]

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[9] 9 U.S.C. § 2 (1965). See note 4 *supra*.

The court argued that the statute "envisages a distinction between the entire contract on the one hand and the arbitration clause of the contract on the other" because the statute deals only with arbitration clauses and not with contracts as a whole. 271 F.2d at 409. This seems unlikely since the only purpose of the statute was to validate arbitration agreements. Standard Magnesium Corp. v. Fuchs, 251 F.2d 455, 457 (10th Cir. 1957); S. REP. No. 536, 68th Cong., 1st Sess. (1924). Arbitration clauses were singled out because they need special statutory treatment which contracts and other contract clauses do not need. They were not singled out with the purpose of making arbitration clauses separate from contracts.

[10] The doctrine of separability was qualified in El Hoss Eng'r & Transp. Co. v. American Independent Oil Co., 289 F.2d 346 (2d Cir.), *cert. denied*, 368 U.S. 837 (1961). The court held that where express conditions precedent to the existence of a contract are made applicable to the arbitration provision, an issue of satisfaction of the conditions is a question for the court. Although the court reasoned that the parties had manifested an intent to treat the arbitration clause as inseparable from the principal contract, the decision may also be explained on the ground that until the conditions are satisfied there is no arbitration agreement. Eastern Marine Corp. v. Fukaya Trading Co., 364 F.2d 80, 84 (5th Cir. 1966); *cf. In re* Kinoshita & Co., 287 F.2d 951, 953 (2d Cir. 1961) (dictum that an arbitration clause is not "separable" if "there had at no time existed ... any contractual relation"). *El Hoss* may stand for the proposition that separability of an arbitration clause depends on the particular facts of each case and is not a rule of law. See Note, 3 B.C. IND. & COM. L. REV. 85, 88 (1961).

The basic doctrine of separability of arbitration clauses was adopted in Electronic & Missile Facilities, Inc. v. Moseley, 306 F.2d 554, 558 (5th Cir. 1962), *rev'd on other grounds*, 374 U.S. 167 (1963). *But see* Eastern Marine Corp. v. Fukaya Trading Co., *supra* at 83 (dictum). The doctrine was approved in Lummus v. Commonwealth Oil Ref. Co., 280 F.2d 915 (1st Cir.), *cert. denied*, 364 U.S. 911 (1960).

[11] *Robert Lawrence*, 271 F.2d at 410. Plaintiff and defendant entered into a contract whereby defendant promised to deliver goods to plaintiff by a certain date. The goods were delivered late. Plaintiff alleged that he would not have entered into the contract had he known that defendant never intended to deliver the goods on the appointed date. The court found that it was difficult to tell whether plaintiff was complaining of a failure of performance or fraud in the inducement. It may be that plaintiff alleged fraudulent inducement, rather than breach, to avoid arbitration, especially when it is considered that he kept the goods and sought damages rather than rescission.

[12] Consistency between the holding in the principal case and the opinion in

The precise holding of the principal case was that a complainant must allege fraudulent inducement of the arbitration provision itself before he may avoid his promise to arbitrate on the ground of fraud. The court failed, however, to discuss adequately the substantive implications of its procedural holding. Assume that there is an allegation that the arbitration provision was itself fraudulently induced. The rule as announced in the principal case may mean that the allegation completely ousts the arbitrator of his jurisdiction, leaving the court as the proper body to determine all issues of fraudulent inducement, both as to the arbitration provision and as to the principal contract. Because this interpretation of the holding is inconsistent with the policy against having the outcome of litigation determined by pleadings,[13] the policy favoring arbitration, and the statute limiting the court's jurisdiction to determining whether an arbitration agreement exists,[14] it appears incorrect. The court's judgment must, therefore, be limited to a determination of whether the arbitration provision was fraudulently induced.

Uncertainty remains as to what kinds of issues raised by allegations of fraudulent inducement of an arbitration provision a court will decide under the Second Circuit rule. A complainant might allege a fraud as to an arbitration provision which is separate from the fraud which allegedly induced the principal contract. Thus, it might be alleged that defendant represented to complainant that X would be an unbiased arbitrator, whereas, unknown to complainant, X is the defendant's brother. Clearly a court would decide the issues raised by such an allegation.[15]

Robert Lawrence is demonstrated by this statement from *Robert Lawrence*, 271 F.2d at 411:

> And we would suppose that generally where the arbitration provision of the contract is sufficiently broad to encompass the issue of fraud, the mutual promises to arbitrate would form the *quid pro quo* of one another and constitute a separable and enforceable part of the agreement. We do not decide this point, however, as it is not necessarily before us.

[13] Victory v. Manning, 128 F.2d 415, 417 (3d Cir. 1942); Laverett v. Continental Briar Pipe Co., 25 F. Supp. 80, 81 (E.D.N.Y. 1938), where the court stated: "only too frequently in the past have procedural rules been regarded as ends in themselves upon whose rigid altar has ultimate justice been sacrificed."

[14] 9 U.S.C. § 4 (1965). See also WASH. REV. CODE § 7.04.040 (1) (1956); N.Y. CIV. PRAC. LAW § 7503(a) (McKinney 1963).

[15] The following kinds of allegations might also be in this "separate fraud" category:

(1) Defendant represented to claimant that X was an expert on the textile industry, whereas, unknown to claimant, X is an attorney and knows nothing about the textile industry.

(2) The arbitration clause was in extremely fine print and was hidden on the back of defendant's printed form among fifteen other clauses in similar fine print.

A complainant might also allege that insertion of an arbitration provision was part of a larger fraudulent scheme. Such an overall scheme might include a plan whereby the wrongdoer intended to bind a party residing in one state to arbitration in a different state and deliberately to make unreasonable demands, hoping that extra expenses and inconvenience would induce the other party to yield to the wrongdoer's demands without resistance. It has been held that such an allegation would charge fraud as to the arbitration provision itself and that the court must pass on the issues raised before arbitration may be compelled.[16]

Probably the most common allegation would be that the same fraud inducing the principal contract also induced the arbitration provision. It might be argued that the complainant would never have entered into the contract had the defendant not made certain false representations.[17] If a court entertained such an allegation and found no fraud, then an order to arbitrate the issue of fraud as to the principal contract would follow since the court's jurisdiction is limited to deciding whether an agreement to arbitrate exists. But the issues before the arbitrator would be the same as those previously decided by the court. Such a procedure would involve wasteful and time-consuming duplication of effort and would afford a complainant two "days in court" on the same issues. For these reasons a court should refuse to entertain an allegation that fraud induced the arbitration provision if the fraud alleged is not distinct from that claimed to have induced the principal contract.

Thus, the Second Circuit rule may be reduced to the following: an issue of fraudulent inducement of a contract containing an arbitration provision must be arbitrated, even if rescission is sought, unless (a) the arbitration provision was itself fraudulently induced by a "separate fraud" (a fraud running only to the arbitration provision) or (b) insertion of the arbitration provision was part of an overall scheme to defraud. This rule depends upon adoption by the Second Circuit of the doctrine that an arbitration provision is separable from the principal contract. If an arbitration provision is not separable and rescission

(3) Defendant, subcontractor, represented to claimant, materialman, that defendant's contract with P, general contractor, obligated defendant to insert arbitration clauses in defendant's contracts, whereas, unknown to claimant, defendant was under no such obligation.

[16] Moseley v. Electronic & Missile Facilities, Inc., 374 U.S. 167 (1963), *reversing* 306 F.2d 554 (5th Cir. 1962). For a detailed description of the alleged scheme, see Brief for Petitioner, pp. 8-12. The court neither passed on nor discussed the merits of the Second Circuit rule, which purportedly was applied by the Fifth Circuit.

is sought, then the existence of an agreement to arbitrate is in issue since an action for rescission reaches all parts of the contract.[18] If the existence of an agreement to arbitrate is in issue, then the making of an agreement to arbitrate is in issue[19] in which case a court may not compel arbitration.[20] Having established the Second Circuit rule, the next question is whether that rule is preferable to an alternative rule derived from a holding of non-separability.

Although the present state of its law is unclear,[21] New York is the only jurisdiction to formulate an alternative to the second circuit rule. New York courts have held that fraudulent inducement is a question for the court if plaintiff seeks rescission[22] but is arbitrable if damages

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[17] In the principal case it was alleged that defendant's business, which plaintiff had contracted to purchase, was nearly bankrupt when the contract was executed and defendant had not disclosed this fact to plaintiff. Plaintiff might never have entered into the contract had he known of the business' financial condition and, therefore, would never have agreed to arbitrate. Arguably, therefore, the same fraud that induced the principal contract also induced the arbitration provision.

[18] RESTATEMENT, CONTRACTS § 487 (1932).

[19] Prima Paint Corp. v. Flood & Conklin Mfg. Co., 360 F.2d 315 (2d Cir.), *cert. granted*, 87 Sup. Ct. 202 (1966); *In re* Cheney Bros., 218 App. Div. 652, 219 N.Y. Supp. 96 (1st Dept., 1926), *rev'd on other grounds*, 245 N.Y. 375, 157 N.E. 272 (1927). *Contra*, Lipman v. Haeuser Shellac Co., 289 N.Y. 76, 43 N.E.2d 817, 819 (1942).

[20] 9 U.S.C. § 4 (1965). See also WASH. REV. CODE § 7.04.040(1) (1956); N.Y. CIV. PRAC. LAW § 7503(a) (McKinney 1963).

[21] *In re* Cheney Bros., 218 App. Div. 652, 219 N.Y. Supp. 96 (1st Dept. 1926), *rev'd on other grounds*, 245 N.Y. 375, 157 N.E. 272 (1927), held that if plaintiff seeks rescission, an issue of fraudulent inducement of a contract is a question for the court. Subsequent decisions have held that if plaintiff in any way affirmed the contract, an issue of fraudulent inducement is a question for the arbitrator. See, *e.g.*, Amerotron Corp. v. Maxwell Shapiro Woolen Co., 3 App. Div. 2d 899, 162 N.Y.S.2d 214 (1957) (plaintiff sought damages); Milton L. Ehrlich, Inc. v. Swiss Constr. Corp., 21 Misc. 2d 506, 197 N.Y.S.2d 668 (Sup. Ct. Spec. Term), *modified on other grounds*, 11 App. Div. 2d 644, 201 N.Y.S.2d 133 (1st Dept. 1960) (plaintiff attempted to rescind after participating in the selection of arbitrators); Stupell v. Laver, 195 Misc. 177, 89 N.Y.S.2d 192 (Sup. Ct. Spec. Term 1949) (after learning of the fraud, plaintiff made conditional offer to perform but subsequently sought rescission).

It has also been held that *all* issues arising out of conduct subsequent to the making of a contract are for the arbitrator although mutual rescission is alleged. Lipman v. Haeuser Shellac Co., 289 N.Y. 76, 43 N.E.2d 817 (1942). And, in Exercycle Corp. v. Maratta, 9 N.Y.2d 329, 174 N.E.2d 463, 464, 214 N.Y.S.2d 353, 355 (1961), arbitration was required although the contract was allegedly void for lack of mutuality, the court broadly stating:

> Once it 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 ....

Both *Lipman* and *Exercycle* contained dicta to the effect that arbitration would not have been ordered had plaintiff sought rescission for fraud. That result is based on the premises that an arbitration provision is not separable from the contract and that an existing arbitration agreement is a condition precedent to the arbitrator's jurisdiction. Finsilver, Still & Moss, Inc. v. Goldberg, Maas & Co., 253 N.Y. 382, 171 N.E. 579, 581, 583 (1930). However, in *Lipman, supra* at 819, the court stated: "[C]ontrary to the contention of appellant, the statute only requires the contract to have been made and does not require that it shall continue to be in existence." Furthermore, both the *Lipman* and *Exercycle* holdings undercut the nonseparability rationale

are sought.[23] The courts reasoned from an unexplained determination that arbitration provisions are not separable from the underlying contracts.[24] From this premise it was concluded that if a plaintiff seeks rescission and fraud is proved, the arbitration provision will fall with the contract,[25] ousting the arbitrator of jurisdiction.[26] If a plaintiff

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despite its prior approval in *In re* Kramer & Uchitelle, Inc., 288 N.Y. 467, 43 N.E.2d 493, 496 (1942). If a contract is rescinded, or is void, and the arbitration provision is not separable, then under contract law there is no enforceable agreement to arbitrate. 6A CORBIN, CONTRACTS § 1444A, at 465 (1962); RESTATEMENT, CONTRACTS §§ 406, 122, comment *b* (1932); *cf.* Sanchez v. Crandon Wholesale Drug Co., 173 So. 2d 687 (Fla. 1965). Therefore, a holding that arbitration is required under such circumstances necessarily implies that the agreement to arbitrate is not part of the rescinded or void contract. See Exercycle Corp. v. Maratta, 9 N.Y.2d 329, 174 N.E.2d 463, 468, 469, 214 N.Y.S.2d 353, 360, 361 (1961) (concurring opinion of Froessel, J.; dissenting opinion of Dye, J.); 75 HARV. L. REV. 835 (1962); 110 U. PA. L. REV. 113 (1961).

In the most recent case on the question it was held that an issue of fraudulent inducement is one for the arbitrator even if rescission is sought. *In re* Amphenol Corp., 49 Misc. 2d 46, 266 N.Y.S.2d 768 (Sup. Ct. Spec. Term 1965), *aff'd without opinion*, 267 N.Y.S.2d 477 (App. Div., 1966). *Cf.* Fabrex Corp. v. Winard Sales Co., 23 Misc. 2d 26, 200 N.Y.S.2d 278 (Sup. Ct. Spec. Term 1960) (arbitration ordered upon court's finding that the fraud alleged was fraud in performance not fraud in inducement). The *Amphenol* court may have been influenced by a peculiar circumstance. It was the defrauded party who was attempting to enforce arbitration. *Cf.* Milton L. Ehrlich v. Swiss Constr. Co., *supra*. The only reason given for the decision in *Amphenol* was that the terms of the arbitration provision were sufficiently broad to include a dispute over fraudulent inducement.

[23] *E.g.*, Exercycle Corp. v. Maratta, 9 N.Y.2d 329, 174 N.E.2d 463, 214 N.Y.S.2d 353 (1961) (dictum); Wrap-Vertiser Corp. v. Plotnick, 3 N.Y.2d 17, 143 N.E.2d 366, 163 N.Y.S.2d 639 (1957); *In re* Cheney Bros., 218 App. Div. 652, 219 N.Y. Supp. 96 (1926), *rev'd on other grounds*, 245 N.Y. 375, 157 N.E. 272 (1927).

[24] See, *e.g.*, Wrap-Vertiser Corp. v. Plotnick, *supra* note 22; Amerotron Corp. v. Maxwell Shapiro Woolen Co., 3 App. Div. 2d 899, 162 N.Y.S.2d 214 (1st Dept. 1957).

[25] "If the contract was voided by fraud the arbitration provision therein falls." *In re* Cheney Bros., 218 App. Div. 652, 219 N.Y. Supp. 96, 96 (1926), *rev'd on other grounds*, 245 N.Y. 375, 157 N.E. 272 (1927); Finsilver, Still & Moss, Inc. v. Goldberg, Maas & Co., 253 N.Y. 382, 171 N.E. 579, 583 (1930); *cf. In re* Kramer & Uchitelle, Inc., 288 N.Y. 467, 43 N.E.2d 493, 496 (1942).

One court, without discussing separability, argued that fraud, duress and usury (labelled as issues of "public policy voidability") should not be arbitrable, whereas issues of consideration, mutuality, and assent (labelled as issues of "common law invalidity") are arbitrable. Durst v. Abrash, 22 App. Div. 2d 39, 253 N.Y.S.2d 351 (1964), *aff'd without opinion*, 17 N.Y. 2d 445, 213 N.E.2d 887, 266 N.Y.S.2d 806 (1965). The court reasoned that the judiciary should not lose control over questions of "public policy." The chief difficulty with this rationale is that, faced with *any* allegation, a court has jurisdiction only to consider whether there is an agreement to arbitrate and whether the dispute is within the terms of the agreement. N.Y. CIV. PRAC. LAW § 7503(a) (McKinney 1963). Moreover, the statute does not indicate that the courts were intended to retain jurisdiction over questions of "public policy," even when reviewing arbitrators' decisions. N.Y. CIV. PRAC. LAW §§ 7509-11 (McKinney 1963). See also 9 U.S.C. §§ 9-11 (1965); WASH. REV. CODE §§ 7.04.150-.170 (1956). Furthermore, once a clearly defined public policy has been established, its application by an arbitrator should present no new difficulties and create no greater problems than those found in issues of lack of consideration or mutuality.

[26] See, *e.g.*, *In re* Cheney Bros., *supra* note 24; *In re* Grossman, 203 N.Y.S.2d 393, 396 (Sup. Ct. Spec. Term 1959).

[27] See, *e.g.*, *In re* Grossman, *supra* note 25; Royal Hair Pin Corp. v. Rieser Co., 15 App. Div. 2d 539, 222 N.Y.S.2d 719 (2d Dept. 1961).

seeks damages, however, he necessarily affirms the contract,[27] including the arbitration provision, and no dispute exists over the validity of the agreement to arbitrate.[28] This reasoning was expressly rejected in the principal case and appears questionable even in New York.[29]

Two arguments are advanced in support of New York's holding of non-separability.[30] First, it is contended that because businessmen bargain primarily over price, quality, and quantity (all noncommercial terms usually incorporated in a printed form), the other terms, including arbitration provisions, are not intended to be binding if the com-

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[27] See, *e.g.*, Amerotron Corp. v. Maxwell Shapiro Woolen Co., 3 App. Div. 2d 899, 162 N.Y.S.2d 214 (1st Dept. 1957); RESTATEMENT, CONTRACTS § 484 and illustration 5 (1932).

[28] The New York rule has been followed by Kentucky River Mills v. Jackson, 206 F.2d 111 (6th Cir.), *cert. denied*, 346 U.S. 887 (1953), and Murphey v. Morris, 12 N.J. Super. 544, 80 A.2d 128 (1951). It was approved in Reynolds Jamaica Mines, Ltd. v. La Societe Navale Caennaise, 239 F.2d 689 (4th Cir. 1956), and Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 986 (2d Cir. 1942) (overruled by *Robert Lawrence*).

Compare McElwee-Courbis Constr. Co. v. Rife, 133 F. Supp. 790, 793 (M.D.Pa. 1955), compelling arbitration on the grounds that the affidavits were insufficient to establish fraudulent inducement. The court decided that one could not avoid arbitration merely by "glibly" charging fraud but reserved the right to grant the allegedly defrauded party appropriate relief if the hearings before the arbitrator established fraud. This is a rather strange combination of the second circuit and New York rules. The result is to allow an arbitrator to take evidence of fraud without giving him jurisdiction to decide the fraud issue. The court would apparently decide the issue after the arbitration hearings were completed. It was not clear from the court's opinion whether a trial de novo would be granted. If not, the procedure is unsatisfactory because crucial fact determinations may turn on the credibility of the witnesses. If a trial de novo is granted the procedure is unsatisfactory because of delay and duplication of effort.

[29] See note 21 *supra*.

[30] Neither of these arguments have received the approval of the New York judiciary. The New York courts have never adequately explained the reasons for their determination of nonseparability.

One possible explanation can be found in an analysis of the New York statute as it was first enacted. N.Y. Sess. Laws 1920, ch. 275, § 2 provided:

> A *provision* in a written *contract* to settle by arbitration ..., or a *submission* ... of an existing controversy to arbitration, shall be valid, enforcible [sic] and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any *contract*. [Emphasis added.]

And N.Y. Sess. Laws 1920, ch. 275, § 3 provided:

> [U]pon being satisfied that the making of the *contract* or *submission* ... is not in issue, the court ... shall make an order directing the parties to proceed to arbitration in accordance with the terms of the *contract* or *submission*. [Emphasis added.]

Thus, it may be argued that the "contract" referred to in § 3 is the same "contract" referred to in § 2. For this reason, a court is required to determine the existence of the entire contract.

While this construction could explain the earlier New York determinations of nonseparability, it can no longer be made because the 1963 amendment eliminates any distinction between arbitration provisions and contracts. N.Y. CIV. PRAC. LAW § 7501 (McKinney 1963) provides: "A written agreement to submit any controversy thereafter arising or any existing controversy to arbitration is enforceable ...."

An argument similar to the one made above may be made with respect to the Washington statute. WASH. REV. CODE § 7.04.010 (1956) provides:

mercial bargain is not.[31] But to say that bargaining relates primarily to other terms is an admission that businessmen have no actual intent as to the separability of an arbitration provision. The "intent" ascribed to them is a fiction based on conjecture as to what they would have intended had they thought about the question. Second, it is contended that if fraud permeates a contract to the extent that the injured party would not have entered it had he known of the fraud, then there is no intention to be bound by any part of that contract. Thus, enforcement of the arbitration clause would require an unwarranted assumption that there would have been a contract even if the injured party had known of the fraud.[32] However, regardless of the injured party's knowledge of the fraud, his original *actual* intent was to enter into a contract *and* to arbitrate disputes concerning the contractual relationship, which would include a claim of right to rescind. It does not seem unfair nor unsound to compel arbitration when there is such an actual intent.

The Second Circuit has contended,[33] and some commentators agree,[34] that fraudulent inducement should be arbitrated because public policy favors arbitration due to its speed, economy, and ability to relieve court congestion and the general expertise of the arbitrators.[35] This public

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> Two or more parties may *agree* in writing to submit to arbitration ... any controversy ... existing between them at the time of the *agreement* to submit, or they may include in a written *agreement* a *provision* to settle by arbitration any controversy thereafter arising between them out of or in relation to such *agreement*. Such *agreement* shall be valid, enforceable and irrevocable save upon such grounds as exist in law or equity for the revocation of any *agreement*. [Emphasis added.]

And, WASH. REV. CODE § 6.04.040(1) (1956) provides:

> If the court is satisfied ... that no substantial issue exists as to the existence or validity of the *agreement* to arbitrate ... the court shall make an order directing the parties to proceed to arbitrate in accordance with the terms of the *agreement*. [Emphasis added.]

The argument which leads to nonseparability is that *agreement* to arbitrate in § 7.04.040(1) means *agreement* to submit and *agreement* containing an arbitration provision. Thus, if the existence of an *agreement* containing an arbitration clause is in issue, arbitration may not be ordered.

Section 7.04.040(1), however, refers to an *agreement to arbitrate*, a more narrow term than *agreement* as expressed in § 7.04.010. For this reason it could be argued that § 7.04.040(1) requires the court to determine the validity only of the arbitration "provision" and not the entire agreement mentioned in § 7.04.010.

[31] See 46 VA. L. REV. 340, 343 (1960); *cf.* Comment, *The Arbitrable Issue: The Problem of Fraud*, 28 FORDHAM L. REV. 802, 807 (1960).

[32] See Comment, *Judicial Control of the Arbitrator's Jurisdiction: A Changing Attitude*, 58 NW. U.L. REV. 521, 531 (1963); *but cf.* 45 CORNELL L.Q. 795, 801 (1960).

[33] *Robert Lawrence*, 271 F.2d at 410.

[34] Nausbaum, *The "Separability Doctrine" in American and Foreign Arbitration*, 17 N.Y.U.L. REV. 609 (1940); Parsell, *Arbitration of Fraud in the Inducement of a Contract*, 12 CORNELL L.Q. 351 (1927); Comment, *Fraudulent Inducement as a Defense to the Enforcement of Arbitration Contracts*, 36 YALE L.J. 866 (1927).

[35] See S. REP. No. 536, 68th Cong., 1st Sess. (1924).

policy is then taken to justify a rule of separability. It is also suggested that a person who has agreed to arbitrate should not be allowed to complain when the arbitration process is invoked by the other party.[36] However, to say that arbitration is valuable, or that arbitration agreements should be enforced, leaves unanswered the underlying issue of what circumstances justify rescission of an arbitration agreement. This issue must be resolved before a choice between separability or nonseparability becomes necessary. Separability is only a means to an end and need not be considered until the desired end has been determined.

The basic question is whether a complainant should be allowed to avoid his promise to arbitrate because of the same circumstances which allow him to avoid his substantive or "principal" promises. If this question is answered in the affirmative, then a court will hold the arbitration provision not separable, find that there is an issue as to the making of an agreement to arbitrate, if rescission is sought, on that ground refuse to compel arbitration, and proceed to decide the issue of fraud as to the whole contract. If the question is answered in the negative, then a court will hold the arbitration provision separable and proceed in a manner opposite from that outlined above. One commentator,[37] answering the question in the affirmative, contends that though there may be more than one promise, there was only one bargaining transaction and an assent to all the terms involved only one mental calculation; therefore, any fraud inducing this assent is a fraud as to all the terms, including arbitration clauses. However, other considerations are relevant. First, from the promisor's point of view, a promise to arbitrate involves considerations different from those attendant on promises made in the principal contract. Whether a person will promise to arbitrate will depend on his attitude toward the desirability of arbitration as a dispute resolution technique, whereas a promise to buy, sell, manage, or whatever, will typically depend on considerations of personal gain. Fraud inducing a person to promise to buy in no way misleads the defrauded party as to the desirability of arbitration, and, therefore, enforcing an arbitration clause would not contradict his intent even if avoidance of the promise to buy is sought. Second, a rule that an arbitration clause may be avoided on the ground of fraud only if the clause was itself fraudulently induced

[36] See Comment, *The Arbitrable Issue: The Problem of Fraud*, 28 FORDHAM L. REV. 802, 808 (1960).
[37] 6A CORBIN, CONTRACTS § 1444, at 449 (1962).

would afford ample protection against being forced into unintended arbitration. Third, assuming that the defrauded party has a valid claim of a right to rescind the principal contract and that the arbitrator is competent, it should make no difference if the dispute is resolved by arbitration rather than by the judicial process unless the claimant is forum-shopping or seeking a jury determination.[38] The last three considerations, combined with a public policy in favor of arbitration, outweigh the single assent consideration and require a negative answer to the basic question.

The Second Circuit has apparently chosen the better rule: arbitration provisions are separable and a claim of fraudulent inducement of a contract containing an arbitration clause should be arbitrated regardless of the relief sought unless the arbitration clause was itself fraudulently induced or the arbitration clause was inserted as part of an overall scheme to defraud.

FTC PRELIMINARY RELIEF POWERS UNDER SECTION 7 OF THE CLAYTON ACT

Respondents Dean Foods Company and Bowman Dairy Company, substantial competitors in the sale of packaged milk, planned to merge. Dean was to purchase substantially all of Bowman's assets and Bowman was to cease doing business. The Federal Trade Commission, after issuing a formal complaint under section 7 of the Clayton Act[1] and section 5 of the Federal Trade Commission Act,[2] applied to the Seventh Circuit Court of Appeals for a preliminary injunction to maintain the status quo until the Commission could hold hearings to determine the legality of the merger. Dismissal of the Commission's petition was appealed to the Supreme Court which reversed and *held*: The FTC has the power to seek preliminary injunctions in the courts of

[38] At least one court has rejected what appeared to be a forum-shopping attempt. Exercycle Corp. v. Maratta, 9 N.Y.2d 329, 174 N.E.2d 463, 466-67, 214 N.Y.S.2d 353, 357-58 (1961) (contract allegedly void for lack of mutuality.) Plaintiff apparently argued that because no court would enforce his promise to employ defendant for life, no arbitrator should be given an opportunity to do so. The court rejected the contention, reasoning that by agreeing to arbitrate, plaintiff had agreed to forgo courts in favor of a private judge. By implication the court held that plaintiff had assumed the risk that an arbitrator might resolve a dispute differently from a court.

[1] 64 Stat. 1125 (1950), as amended, 15 U.S.C. § 18 (1964).
[2] 38 Stat. 719 (1914), as amended, 15 U.S.C. § 45 (1964).