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Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense

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ENFORCEABILITY OF AGREEMENTS TO ARBITRATE: AN EXAMINATION OF THE PUBLIC POLICY DEFENSE

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INTRODUCTION

Arbitration is no longer an unwelcome stepchild in the courts. Judicial jealousy and mistrust of the arbitration process have been replaced by an era in which arbitration is embraced as an effective and efficient mechanism for resolving disputes.[1] Agreements to submit future disputes to arbitration are enforced almost universally,[2] and attempts to evade such agreements are discouraged by court declarations that strong public policy favors arbitration.[3]

This widespread acceptance and approval of arbitration has been accompanied in recent years by an awareness that arbitration is unsatisfactory for resolving certain classes of disputes. Federal courts, for example, have refused to enforce agreements to arbitrate disputes that turn on the antitrust or patent laws.[4] State courts have not permitted arbitration of child custody disputes without subsequent judicial review.[5] Courts have held that in these and other areas, where an issue of strong public policy, usually derived from statute, must be encountered in resolving a dispute, the matter must be considered by a court and not decided finally by arbitrators.[6]

The scope of the doctrine, that matters involving issues of public policy may not be decided by arbitrators, remains undetermined. Various arguments, some cogent and others not, have been advanced for applying the public policy doctrine to a broad range of cases; yet no comprehensive rationale has emerged to distinguish those disputes

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[1] *Compare* Weinrott v. Carp, 32 N.Y.2d 190, 199, 298 N.E.2d 42, 47-48, 344 N.Y.S.2d 848, 856 (1973) *and* Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 406-07 (2d Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960) *with* Hurst v. Litchfield, 39 N.Y. 377, 379 (1868).

[2] The first statute authorizing specific enforcement of arbitration agreements was enacted in New York in 1920. The current New York provisions are contained in N.Y. CIV. PRAC. LAW §§ 7501-7514 (McKinney 1980). The New York statute served as a model for the United States Arbitration Act, 9 U.S.C. §§ 1-14 (1976) (enacted 1947), and numerous state statutes. In addition, the Uniform Arbitration Act has now been enacted in 22 states and the District of Columbia. *See generally* M. DOMKE, THE LAW AND PRACTICE OF COMMERCIAL ARBITRATION §§ 4.01-.03 (1968).

[3] *See, e.g.*, Riess v. Murchison, 384 F.2d 727, 734 (9th Cir. 1967); Nationwide Gen. Ins. Co. v. Investors Ins. Co., 37 N.Y.2d 91, 95, 332 N.E.2d 333, 335, 371 N.Y.S.2d 463, 466 (1975).

[4] *See, e.g.*, Hanes Corp. v. Millard, 531 F.2d 585 (D.C. Cir. 1976); American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968).

[5] *See, e.g.*, Agur v. Agur, 32 A.D.2d 16, 298 N.Y.S.2d 772 (1969).

[6] Finality of the arbitrator's award, despite errors of law or fact, is one of the principal advantages of the arbitration process. If arbitration awards were subject to judicial review for error, the process would be neither speedy nor inexpensive. Arbitration statutes, therefore, typically limit judicial review severely. *See, e.g.*, 9 U.S.C. § 10 (1976).

that courts have permitted to go to arbitration from those where arbitration has been prohibited.

To say that public policy prohibits arbitration in a particular instance explains little; "public policy" is a catchphrase elusive of meaning without reference to the context in which it is used. Despite the apparent opacity of the term, this Article seeks to show that its use by courts, in apparently discrete areas, to refuse enforcement of arbitration agreements, can be explained and justified by a common rationale.

Public policy should be invoked to prevent arbitration[7] when at issue is a legislative expression or a basic case law principle designed for some purpose other than to foster justice between the parties to the dispute. Conversely, when the legal principles involved in a particular dispute are designed primarily to promote justice between the parties, there is little reason to prohibit arbitration. The purpose of arbitration is to do justice between the parties; if arbitrators are entrusted to accomplish that purpose, they should not be prevented from doing so solely by a statute more particularly directed towards attaining the same goal.

The situation changes where the legal principles involved are not primarily directed towards the needs of the disputing parties. The antitrust laws, for example, are designed to produce economic effects that often have little to do with the immediate needs of the contracting parties. Custody statutes are focused not on the needs of the disputing parents, but on the welfare of children not parties to the dispute. When such statutes are involved arbitration is inappropriate, not because of the complexity or importance of the issues, but because the design of these statutes and the mechanism of arbitration are at cross purposes.

Arbitrators in this country are not bound by substantive private law. In many cases, however, justice between the parties will require a decision based on legal principles. This will be true especially if the parties have indicated, explicitly or otherwise, that they expect disputes to be resolved according to law. In such cases, an arbitrator might be ethically bound to follow the law in large measure, even if not rigorously. Nevertheless, even in such cases, arbitrators are not required to support their decisions with reasons, and are not subject to judicial review for errors of law or fact.[8]

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[7] To prevent arbitration may mean, in the varying contexts in which it is used in this Article, to stay arbitration, or to subject an award to review for errors of law or fact.

[8] Indeed, it is somewhat misleading to speak of an arbitrator's "error" of law when he is not required to decide in accordance with law. *See* Mentschikoff, *Commercial Arbitration*, 61

It is against this background that the problems discussed in this Article arise. All such problems could, of course, be obviated by requiring arbitrators to be bound by law. But if arbitrators are to be bound by law, their application of that law must be subject to review. Without such review, the fetters that bind them would be loose indeed.[9] If arbitrators are to be subject to review, however, they might be required to state the reasons for their conclusions. But if arbitrators were bound by legal rules, required to write opinions, and subject to review for errors of law, the process would no longer resemble arbitration as it has developed in this country, and no longer offer many of the advantages for which arbitration is known.[10] In

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COLUM. L. REV. 846, 860-62 (1961). The author notes that 90% of American Arbitration Association (AAA) arbitrators surveyed "believed that they were free to ignore [substantive rules of law] whenever they thought that more just decisions would be reached by so doing." Professor Mentschikoff also indicates that opinion-writing by arbitrators is affirmatively discouraged by the AAA. *Id.* at 866. *See also* M. DOMKE, *supra* note 2, at 260-62, 286-89.

Arbitration awards are, however, generally subject to limited review in cases of partiality, corruption, or other misbehavior of the arbitrator. *See* note 136 *infra*.

[9] It should be noted that there are at present no legal rules that subject arbitration awards to challenge if they do not in fact work justice between the parties. There is another constraint, however, that is probably nearly as effective. So long as arbitration is not compulsory, but is based instead on the consent of the parties, parties will only consent to arbitrate if they have faith in the arbitral process. Should arbitrators stray too far in too many cases, fewer parties will likely agree to arbitration. Thus, although there is no check against errors of judgment by arbitrators in any single case, except for the rarely applicable statutory provisions for vacation, there is unlikely to be widespread injustice as a result of arbitral misjudgments.

There is another aspect to the constraint imposed on arbitrators by the consensual nature of agreements to arbitrate. So long as arbitration is set into motion by an agreement of two parties, it is only natural to expect the arbitrator to reach a result that accords as closely as possible with the expectations of the two parties who agreed to arbitrate and who, perhaps, participated in selecting the arbitrator. Satisfying those parties, if not as to particular conclusions then as to the adequacy of the process, is necessary if those or similarly situated parties are to choose arbitration in the future. Perhaps this provides arbitrators, at least so long as they are committed to preserving arbitration as an acceptable alternative to litigation, with an incentive to strive for a resolution that seems equitable to the parties and with a disincentive to consider factors extraneous to justice between those parties.

[10] The development of arbitration in England has not paralleled its growth in this country. Even with the recently enacted Arbitration Act of 1979, the English have not entirely shed their resistance to permitting parties by agreement to "oust" the court's jurisdiction. Under the Arbitration Act of 1950, 14 Geo. 6, c. 27, presentation of an arbitration agreement did not alone provide sufficient cause for staying judicial proceedings. *See id.* § 4(1). A leading English treatise states: "The court has in the past shown itself less disposed to grant a stay where the principal issue is a question of law or the proper construction of an agreement than if the dispute involved principally questions of fact." A. WALTON, RUSSELL ON ARBITRATION 159 (18th ed. 1970). The English system views arbitration as useful chiefly when questions of fact are involved, and remains distrustful when questions of law are primary. *See generally* LORD PARKER OF WEDDINGTON, THE HISTORY AND DEVELOPMENT OF COMMERCIAL ARBITRATION (1959).

Moreover, once a case has proceeded to arbitration, "[i]t is the duty of an arbitrator, in the absence of express provision in the submission to the contrary, to decide questions submitted to

effect, arbitrators would become judges, subject to similar constraints.

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him according to the legal rights of the parties, and not according to what he may consider fair and reasonable under the circumstances." A. WALTON, *supra*, at 186.

Before enactment of the 1979 Act, two checks existed to insure that arbitrators did, in fact, strictly follow the law. First, § 21 of the 1950 Act, now repealed, provided:

(1) An arbitrator or umpire may, and shall if so directed by the High Court, state-
(a) any question of law arising in the course of the reference; or
(b) an award or any part of an award, in the form of a special case for the decision of the High Court.

Thus, a party not satisfied to have any question of law finally determined by arbitrators was able to seek a ruling by the court. *See generally* A. WALTON, *supra*, at 244-62.

Even if neither party had requested that a "special case" be stated, the ultimate award could have been set aside for any errors of law that appeared on the face of the award. Other errors of law were not reviewable, however, if neither party had requested that the award be stated in the form of a special case. *Id.* at 366-68.

The Arbitration Act of 1979 limited substantially the right to appeal from an arbitration award. Eliminated were both the "special case" procedures and the power of the High Court to set aside or remit an award on an arbitration agreement on the ground of errors of fact or law on the face of the award. Arbitration Act, 1979 c. 42, § 1(1). Arbitrators, however, are still obliged to decide in accordance with law because an appeal to the High Court still lies by leave of the court (and, probably of less importance, with the consent of all the other parties). *Id.* §§ 1(2), 1(3). Another provision of the 1979 Act, permitting the parties to agree to eliminate almost all judicial review, does not apply to domestic arbitration agreements. *Id.* § 3.

Although the parties may specifically refer questions of law to the arbitrators, in which case the English courts will not set aside an award for errors of law, the parties' power in this respect is limited by the discretion of the courts, in the first instance, to refuse to stay judicial proceedings brought in contravention of an arbitration agreement, a discretion which might well be exercised to prevent arbitrators from deciding cases in which questions of law play a significant role. *See* A. WALTON, *supra*, at 20, 56, 359-61. The 1979 Act does not appear to alter the law in this regard.

Under the English system, then, at least until the 1979 reform, arbitration had few of the advantages that it possessed in this country. Finality of the arbitrator's decision was severely limited. The broad powers of judicial review raised costs and eliminated the speed that is touted as an advantage of arbitration in the United States. In fact, as one English commentator noted, arbitration possessed advantages over judicial proceedings chiefly in cases where issues of fact, particularly product quality, predominate, and where arbitrators would, therefore, possess more expertise than judges unfamiliar with the issues involved. LORD PARKER, *supra*, at 23-24. Even with the 1979 reform, the potential for judicial intervention in the arbitration process remains. What effect the reform will have remains to be seen. *See generally* Park, *Judicial Supervision of Transnational Commercial Arbitration: The English Arbitration Act of 1979*, 21 HARV. INT'L L.J. 87 (1980).

Given the limited scope of arbitration in England, especially with respect to questions of law, the issues discussed in this article do not arise. If no questions of law may be finally determined by arbitrators, there is no need to determine whether any particular questions of law ought to be arbitrable.

The English system, with some variation, prevails in the Canadian provinces and Australia as well. *See* J. DORTER & G. WIDMER, ARBITRATION (COMMERCIAL) IN AUSTRALIA, LAW AND PRACTICE (1979); 2 INTERNATIONAL COUNCIL FOR COMMERCIAL ARBITRATION, YEARBOOK OF COMMERCIAL ARBITRATION 19-22 (1977).

The potential advantages of arbitration even under the hypothesized system should not, however, be ignored. One significant advantage is the ability of parties to arbitration to select their own "judge."[11] The parties might therefore have greater confidence in the private judge's intelligence, knowledge, and neutrality—characteristics that could produce a better record for appeal.

Nevertheless, to require arbitrators in every case to comply with legal rules, particularly those not designed to settle justly the dispute between the parties, is to ignore years of development of arbitration law and to strip the arbitration process of several of its principal advantages—speed, efficiency, and relatively low cost. This Article proceeds on the assumption that this solution to the public policy problem is unacceptable because the advantages of our present system of arbitration are too great to permit such evisceration of the process.

In accordance with case law development, it is suggested that, for the reasons stated, agreements to arbitrate disputes should not be enforced in the limited instances where the dispute involves questions of "public policy."

This Article seeks to demonstrate that the public policy doctrine should be, and in general has been, limited to two types of cases. First, as already discussed, an agreement to arbitrate should not be enforced when the statute or case law principle at issue has aims other than promoting justice between the parties. Second, when a party to the agreement belongs to a class peculiarly subject to imposition by the class to which the other party belongs, an agreement to arbitrate will not and should not be enforced.

In the latter class of cases, the susceptibility to imposition may be the product of unequal bargaining power, or of unequal transaction costs that make it likely that one party will draft an agreement that the other will sign without first questioning or reviewing the agree-

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The Swedish system, however, bears some resemblance to our own. Although Swedish arbitrators are supposed to be bound by law, "there is no wholly reliable check that arbitrators really do apply the law strictly since Swedish law does not allow an appeal to the courts on the merits of an award." STOCKHOLM CHAMBER OF COMMERCE, ARBITRATION IN SWEDEN 123 (1977). As a result, whether parties may agree to arbitrate future disputes about which they are not free to agree explicitly, that is, whether "non-excludable rules" may be the subject of arbitration, is a question of some significance. It has apparently not arisen in any cases. *Id.* at 150-52. It has been said, however, that "[i]t must still be regarded as an open question whether an award is void because a non-excludable rule of the applicable substantive law has been disregarded, but it is probable that at any rate the contravention of a non-excludable rule of the first category [matters of 'public policy'] will make the award void." *Id.* at 152.

[11] For a discussion of the market for private judges in California, where retired judges are, under certain circumstances, permitted upon agreement of the parties to hear cases, subject to the usual appellate review, see N.Y. Times, Oct. 26, 1980, at 25, col. 1; Wall St. J., Aug. 6, 1980, at 1, col. 1.

ment's arbitration clause.[12] As with arbitration clauses in the former class of cases, arbitration clauses in contracts of adhesion are unenforceable, not because the subject matter of the dispute does not lend itself to arbitration, but rather because courts are unwilling to permit parties to relinquish so casually their right to judicial remedies.[13]

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[12] In this last group of cases would be consumer transactions, as, for instance, residential apartment leases and professional retainer agreements.

[13] Not included within the scope of this Article is consideration of public policy problems arising out of arbitration clauses in collective bargaining agreements. For a recent discussion of this problem, see Kaden, *Judges and Arbitrators: Observations on the Scope of Judicial Review*, 80 COLUM. L. REV. 267 (1980). Labor arbitration has somewhat different purposes and employs different procedures than those commonly found in commercial arbitration. As the Supreme Court stressed in a landmark labor arbitration case: "In the commercial case, arbitration is the substitute for litigation. Here arbitration is the substitute for industrial strife . . . . [A]rbitration of labor disputes has quite different functions from arbitration under an ordinary commercial agreement . . . ." United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574, 578 (1960).

Because of these differences, the public policy doctrine that has developed in the commercial context may not be equally well adapted for labor arbitration. Nevertheless, it is significant that parallel problems have, on occasion, arisen. Thus, in Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974), the issue was whether arbitration, final and binding under the terms of the collective bargaining agreement, of an employee's complaint that he was discharged for racially discriminatory reasons, precluded a subsequent action in federal court under Title VII of the Civil Rights Act of 1964, 42 U.S.C. §§ 2000e to 2000e-16 (1976). In holding the employee entitled to a de novo hearing of his claim in federal court, the Supreme Court noted that

> the arbitrator's task is to effectuate the intent of the parties. His source of authority is the collective-bargaining agreement, and he must interpret and apply that agreement in accordance with the "industrial common law of the shop" and the various needs and desires of the parties. The arbitrator, however, has no general authority to invoke public laws that conflict with the bargain between the parties. . . .

415 U.S. at 53. *See also* Wertheim & Co. v. Halpert, 48 N.Y.2d 681, 397 N.E.2d 386, 421 N.Y.S.2d 876 (1979). It is the thesis of this Article that a similar conflict, between the societal desire to achieve ends which may be unrelated to a fair resolution of contractual disputes and the responsibility of arbitrators to achieve such a fair resolution, underlies the public policy doctrine in the commercial arbitration context. The problem is complicated when labor arbitration is involved both because of the special relationship of the labor union as representative, and also potential adversary, of individual employees, and because of the different goals of labor arbitration.

Many of the public policy cases that have arisen in the field of labor arbitration have involved public employee grievances. With some frequency, the issue has been whether permitting arbitration of a particular grievance would be an improper delegation by the public employer of statutorily imposed duties. Thus, it has been held that an arbitration award granting tenure to a public school teacher would be vacated as against public policy because only the school board has the power to make tenure decisions. Cohoes City School Dist. v. Cohoes Teachers Ass'n, 40 N.Y.2d 774, 358 N.E.2d 878, 390 N.Y.S.2d 53 (1976). *See generally* Board of Educ. v. Rockford Educ. Ass'n, 3 Ill. App. 3d 1090, 280 N.E.2d 286 (1972); School Comm. of Hanover v. Curry, 3 Mass. App. Ct. 151, 325 N.E.2d 282 (1975); Port Jefferson Station Teachers Ass'n v. Brookhaven-Comsewogue Union Free School Dist., 45 N.Y.2d 898, 383 N.E.2d 553, 411 N.Y.S.2d 1 (1978); Port Washington Union Free School Dist. v. Port Washington Teachers Ass'n, 45 N.Y.2d 411, 419, 380 N.E.2d 280, 284, 408 N.Y.S.2d 453, 456 (1978) (Breitel, C.J., concurring); Susquehanna Valley Cent. School Dist. v. Susquehanna Valley Teachers Ass'n, 37 N.Y.2d 614, 339 N.E.2d 132, 376 N.Y.S.2d 427 (1975).

I. An Analytical Framework

Why should a court close its doors to a litigant who seeks redress of a grievance that the litigant has contracted to submit to another forum, be it arbitral or judicial? This question has not always stimulated reasoned analysis. Historically, agreements to resolve a dispute in a particular forum were treated by the courts as unenforceable attempts to "oust" the courts from lawful jurisdiction.[14] The same hostility to such agreements was evident whether the forum agreed upon was a court of another jurisdiction or a panel of arbitrators.[15] The effect of the rule was to permit either party to evade its forum selection agreement simply by seeking relief in a forum other than the one specified in the agreement.

Judicial reluctance to enforce forum selection clauses produced an anomaly. Courts would readily enforce to the letter express agreements by the parties providing for an explicit resolution of a wide range of potential disputes; the same courts would not, however, enforce a more flexible agreement by the parties providing for future resolution of potential disputes by a particular court or impartial arbitrator.

The enactment of arbitration statutes in part eliminated the anomaly by making enforceable agreements to submit future disputes to arbitration.[16] However, judicial resistance to the enforcement of agreements restricting suit on a contract to particular courts continued unhindered by statutory mandate.[17] Only in recent years has enforcement of such forum selection clauses, except when "unfair or unreasonable,"[18] become routine.[19]

For learned discussion of the conflict between the goals of labor arbitration and other statutory policies, see Meltzer, *Labor Arbitration and Overlapping and Conflicting Remedies for Employment Discrimination*, 39 U. Chi. L. Rev. 30 (1971); Meltzer, *Ruminations About Ideology, Law, and Labor Arbitration*, 34 U. Chi. L. Rev. 45 (1967).

[14] A brief, but classic, discussion of the development and decline of the ouster concept appears in Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978, 982-85 (2d Cir. 1942) (Frank, J.).

[15] *Compare* the discussion in Kulukundis Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942) *with*, *e.g.*, Carbon Black Export, Inc. v. The S.S. Monrosa, 254 F.2d 297, 300-01 (5th Cir. 1958), *cert. dismissed*, 359 U.S. 180 (1959). *See generally* Pryles, *Comparative Aspects of Prorogations and Arbitration Agreements*, 25 Int'l & Comp. L.Q. 543 (1976), in which the emphasis is on a comparison of approaches.

[16] *See* note 2 *supra*.

[17] *See*, *e.g.*, Annot., 56 A.L.R.2d 300, 306-20 (1957) (validity of contractual provision limiting place or court in which action may be brought).

[18] *See*, *e.g.*, Restatement (Second) of Contracts § 234, Comment e, Illustration 6 (Tent. Draft No. 5, 1970), suggesting that a forum selection clause in a printed form agreement might be unenforceable on unconscionability grounds if there were no acceptable reason for the selection and if the selected forum were seriously inconvenient for the party that did not draft the agreement.

The rationale for enforcing both arbitration clauses and forum selection clauses rests largely on what the Supreme Court has termed "ancient concepts of freedom of contract."[20] To the extent that an arbitration clause or other forum selection clause is the product of arm's-length negotiation between informed parties, there is generally no reason not to enforce the agreement between the parties. Where parties are free to resolve particular contract questions explicitly, there is little reason to forbid them to delegate the resolution of the same questions to an impartial third party.

Freedom of contract, however, has its limits. When a rule of law transcends an agreement of the parties, that is, when the parties are not free to resolve a particular question as they see fit, the freedom of contract argument alone does not provide a sufficient basis for enforcing a forum selection clause. For example, suppose that in a sales contract the seller expressly disclaims any warranty of fitness for use. The state in which the agreement is made and in which the product will be used forbids such disclaimers, and implies such a warranty regardless of the terms of the contract. If the contract also includes a forum selection clause, the seller is consequently unable to resist suit for breach of warranty in the state of agreement by invoking "freedom of contract." As to the issue in dispute, the parties were not free to contract explicitly, and if the right to select a forum depends entirely on the right to provide for a particular resolution of the dispute, then the choice of forum should not be enforced either.

But enforcement of forum selection clauses does not depend entirely on the parties' right to provide for particular resolution of disputes, and there may be adequate reason to enforce a forum selection clause where a provision for a particular result would not be enforced. Arbitrators and certain courts may possess special expertise in given areas.[21] Trade may be encouraged if parties from different states or countries are permitted to provide for resolution of disputes

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[19] The most influential decision in the area is undoubtedly The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972), in which the United States Supreme Court encouraged enforcement of forum selection clauses. *See also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 80 (1971).

[20] 407 U.S. at 11.

[21] *See, e.g.*, American Almond Prods. Co. v. Consolidated Pecan Sales Co., 144 F.2d 448, 450 (2d Cir. 1944) (L. Hand, J.):

> In trade disputes one of the chief advantages of arbitration is that arbitrators can be chosen who are familiar with the practices and customs of the calling, and with just such matters as what are current prices, what is merchantable quality, what are the terms of sale, and the like.

Particular courts, too, may possess special expertise because of a large volume of a particular type of case. Thus, English courts might be more familiar with maritime disputes and New York courts with commercial disputes than would the courts of, for example, Iowa.

in what is perceived to be a neutral or impartial forum and a particular forum might have been chosen to avoid inconvenience and uncertainty.[22] And, in the case of agreements to arbitrate, enforcing the agreement may avoid the considerable expense and delay of litigation.[23]

Moreover, even where, as in the example postulated, the courts of the jurisdiction most closely connected to a dispute[24] would not enforce a contractual resolution of a particular issue, those courts need hesitate to enforce a forum selection clause only when there is reason to believe the chosen forum would ignore the legal prohibition involved. Where the chosen forum would operate under the same legal constraints as the forum most closely connected to the dispute, no significant policy would be frustrated by giving effect to the parties' choice.

At this point, analysis of arbitration clauses diverges from analysis of other forum selection clauses. All courts are bound by law, and applicable choice-of-law rules may lead the courts of another jurisdiction to apply the same legal rules as the courts of the most closely connected jurisdiction. Furthermore, if the courts of the chosen jurisdiction do not apply the legal rules of the jurisdiction most closely connected to the dispute, they will, in most instances, at least evaluate under their prevailing choice-of-law theory the argument for applying the rule of the most connected jurisdiction. Finally, if the chosen forum is a court of a sister state, there may be constitutional limitations arising out of either the due process clause or the full faith and credit clause, on the court's right to ignore a rule of the most closely connected jurisdiction.[25] Thus, a court faced with a request to enforce a forum selection clause by dismissing or staying an action has at least the assurance that if it enforces the clause, a neutral court, bound by law, will evaluate the issues involved. The contention that the legal prohibition of the most closely connected jurisdiction should apply may be rejected by the neutral court, but it will not be ignored.

Arbitrators,[26] by contrast, are not bound by any rules of law,[27] and a fortiori are not bound by the substantive rules of private law of

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[22] *See* 407 U.S. at 12-14.

[23] *See, e.g.*, Federal Commerce & Navigation Co. v. Kanematsu-Gosho, Ltd., 457 F.2d 387, 389-90 (2d Cir. 1972); Mobil Oil Indonesia, Inc. v. Asamera Oil (Indonesia) Ltd., 43 N.Y.2d 276, 282, 372 N.E.2d 21, 23, 401 N.Y.S.2d 186, 188 (1977).

[24] The often complex conflict of laws problem in determining which jurisdiction is most significantly connected or more precisely, which rule of law should apply to a given issue, will be ignored for present purposes.

[25] *See, e.g.*, Allstate Ins. Co. v. Hague, 101 S. Ct. 633 (1981); Home Ins. Co. v. Dick, 281 U.S. 397 (1930).

[26] The situation is not always the same abroad. *See* note 10 *supra*.

the jurisdiction most closely connected to the dispute. To permit enforcement of the arbitration clause, that jurisdiction must be willing to permit the parties to contract not only out of dispute resolution in its courts, but also out of dispute resolution according to its laws. In this respect, an arbitration clause is akin to a clause that provides not only for selection of a particular forum, but also for the application of a particular forum's laws. And choice-of-law clauses, because they are subject to abuse by parties seeking to avoid particular legal prohibitions of the most closely connected jurisdiction, are even today enforced less automatically than forum selection clauses. In particular, choice-of-law clauses are not generally enforced where "application of the law of the chosen state would be contrary to a fundamental policy" of the most closely connected jurisdiction.[28]

Without discussing in detail the choice-of-law principle, it is submitted that similar considerations should restrict enforcement of arbitration clauses. Arbitrators, however, are not bound by the law of any forum; they are bound only to resolve fairly the dispute between the parties. In most instances, this will not be contrary to the fundamental policy of a state. There are, however, some areas in which the resolution of a dispute with fairness to the parties involved will contravene a fundamental policy of the state as expressed in statute or case law.

It may reasonably be asked what is meant by "justice between the parties." Most law, public and private, is ultimately intended to do justice, however elusive that concept may be. The emphasis in the current context, however, should be placed not on the term "justice," but rather on "between the parties." Most legal rules governing private agreements are designed principally to protect various interests of the contracting parties, and not to affect third parties or the public at large. A rule requiring a party to pay compensatory damages for breach of contract, for example, is designed primarily to protect the expectation interests of other parties to the contract.[29] Application of this rule in any individual case is designed to accommodate the concerns of third parties in only two ways. First, it provides the assurance of precedent. Because compensatory damages are assessed in one case, other potential contracting parties are assured that they will be treated fairly in future cases. This public concern, however, does not

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[27] *See generally* M. DOMKE, *supra* note 2, § 25.01. The issue was "well settled" in New York at least by 1924. *See* A. Wenger & Co. v. Propper Silk Hosiery Mills, Inc., 239 N.Y. 199, 203, 146 N.E. 203, 204 (1924).

[28] RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2)(b) (1971).

[29] *But see* note 185 *infra*.

arise out of a stake in the particular controversy, and will evaporate if the parties agree among themselves on a noncompensatory resolution. Second, application of the rule of compensatory damages provides a basis for resolving the conflict, and the public at large has a strong interest in final conflict resolution. This interest, too, is not tied to any particular resolution of a dispute.

Aside from those two public concerns, the object of most private contract rules, including the rule requiring compensatory damages, is to treat the contracting parties fairly, and not to account for other social goals, even if such goals would be better served by permitting the breaching party to escape liability.[30]

In some areas, however, legal rules are designed to foster ends other than the fair resolution of the dispute between the parties. In these areas, the public policy doctrine should prevent enforcement of agreements to arbitrate because the public at large or individuals not parties to the arbitration agreement have legally protected interests that make them, in effect, "necessary parties" to any dispute resolution between the contracting parties. That is, because any resolution of the dispute between the contracting parties would significantly affect the interests of these parties, statute or case law will not permit disputes to be resolved without representation, in some form, of those interests. Yet there may have been no agreement by these "necessary parties" to have the issues resolved in arbitration, and arbitrators would thus be under no obligation to consider the interests of these nonparties to the arbitration. Arbitration is, therefore, an inappropriate forum for resolution of the dispute. As a result, to protect those interests of individual third parties or the public at large, public policy will prevent enforcement of arbitration agreements when those interests could be prejudiced by an arbitration award, even if the award technically binds only the parties to the arbitration. Only in these areas—where legal rules are designed to protect the interests of third parties or the public at large, and thus foster ends other than

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[30] For instance, if a party in breach is a large employer who would be liable for damages resulting from the breach, it might be socially useful and more "just" to permit the employer to escape liability if the victim of the breach is a wealthy but nonproductive member of society. Of course, economic theorists would argue that contracts are enforced generally out of a desire to promote trade and out of recognition that without enforcement, many potential traders would be reluctant to enter the market. *See generally* R. POSNER, ECONOMIC ANALYSIS OF LAW 65 (2d ed. 1977). *See also* note 137 *infra*. This is in part true. But enforcement of contracts is probably based more firmly on the belief that a man ought to keep his promises, and that it is unjust for an innocent party to suffer because he has relied on the promise of a man who has proven untrustworthy.

fairly resolving the dispute between the parties—should public policy prevent enforcement of arbitration agreements.[31]

II. Family Law[32]

A mother and father enter into a separation agreement granting custody to the mother and obligating the father to make support payments of fifteen dollars for his wife and sixty dollars weekly for their three children. The separation agreement also provides that "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 arbitrators may be entered in any court having jurisdiction thereof." Five years later, the mother files a petition for support for herself and the children, alleging both the agreement and the father's refusal to provide support according to his means. Two of the three children have been living for a considerable time with the father rather than with the mother, contrary to the provision of the separation agreement. The father responds to the mother's petition by moving that the issues of support and custody be

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[31] In most cases, perhaps even in all cases, there is a policy in favor of doing justice between the parties. Frequently, however, cases involve other policies as well. Various contract rules, for example, may be designed to encourage trade by providing trading parties with certainty and predictability of resolution in case disputes do arise. There is little risk, however, that arbitrators seeking to do justice between the parties will contravene general contract policies designed to promote trade. First, because arbitration awards do not have the precedent effect of a court judgment, no award is likely to have a chilling effect on future trading decisions, especially since future trading partners are free not to insert arbitration clauses in their contracts. Second, the concerns of potential trading partners are likely to be the same as the concerns of arbitrators seeking to do justice between the parties: Will any disputes between trading partners be resolved in a way that treats both parties justly? Even though there may be a public concern beyond assuring that justice is done between the parties to the dispute, that concern is in no way compromised by permitting arbitration of the dispute.

On the other hand, some public policies are at cross purposes with the policy in favor of doing justice between the parties. In these cases, the risk may be great that substantial public policies will be frustrated if arbitration is permitted. The basic question, then, is whether the public policy at issue is so unrelated to the desire to resolve fairly the dispute between the partners that entrusting the dispute to arbitrators would produce a significant risk that the public policy would be frustrated.

[32] This section deals only with cases arising in New York. This is entirely due to the absence of case law in other jurisdictions. The New York arbitration statute was the first to be enacted in this country, *see* note 2 *supra*, and arbitration has become more prevalent in that state more quickly than elsewhere. Presumably, the family law problems discussed in this section will arise elsewhere in the future.

It should also be noted that throughout this Article, the preponderance of cases cited are either federal cases or New York cases. This, again, is due to the more rapid and widespread enforcement of arbitration agreements in those courts.

referred to the American Arbitration Association in accordance with the terms of the separation agreement.[33]

This and similar fact patterns have demanded the attention of the New York courts with some frequency over the past two decades. The principal issue involved is whether public policy prohibits arbitrators from conclusively resolving support and custody disputes. If parents could conclusively resolve disputes over custody and child support by private agreement, there would be no reason to prohibit resolution of such disputes by arbitrators;[34] a matter which society is content to leave entirely to private agreement is one that may be referred by private agreement to arbitration. This principle is basic whenever public policy forms the basis of an objection to enforcing an arbitration agreement.

In New York,[35] as elsewhere,[36] however, parents cannot by private agreement place the level of a minor child's support beyond the reviewing power of courts. The rule regarding parents' custody agreements is even stronger. Such agreements are not binding on the courts. Instead, the court as *parens patriae* must make support and custody decisions in the best interest of the children involved, despite any contrary agreement of the parents.[37] By contrast, where support of a spouse is concerned, courts routinely enforce agreements between the parties.[38] Although it has been asserted that the public has an interest

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[33] Fence v. Fence, 64 Misc. 2d 480, 481-82, 314 N.Y.S.2d 1016, 1017-18 (1970).

[34] *See* text following note 20 *supra*.

If public policy prohibits arbitration of a dispute, a subsidiary issue may then arise as to whether arbitration may be a useful mechanism for a preliminary evaluation of the issues before the dispute reaches a court for final resolution. The issue is discussed briefly in connection with child custody disputes. *See* note 60 *infra* & accompanying text. *See also* text accompanying notes 66-67 *infra*. In connection with antitrust cases, *see* note 76 *infra* & accompanying text.

[35] *See* Boden v. Boden, 42 N.Y.2d 210, 212, 366 N.E.2d 791, 793, 397 N.Y.S.2d 701, 703 (1977).

[36] *See* cases collected in 1 A. LINDEY, SEPARATION AGREEMENTS AND ANTE-NUPTIAL CONTRACTS § 15-160, n.361 (rev. ed. 1978).

[37] N.Y. DOM. REL. LAW § 240 (McKinney Supp. 1980); *see, e.g.*, People *ex rel.* Wasserberger v. Wasserberger, 42 A.D.2d 93, 94, 345 N.Y.S.2d 46, 48, *aff'd*, 34 N.Y.2d 660, 311 N.E.2d 651, 355 N.Y.S.2d 580 (1973). Of course the agreement of the parties may be relevant to the court's determination "for the light it sheds on the motives and disposition of the parties." Agur v. Agur, 32 A.D.2d 16, 19-20, 298 N.Y.S.2d 772, 776-77 (1969), *appeal dismissed*, 27 N.Y.2d 643, 261 N.E.2d 903, 313 N.Y.S.2d 866 (1970), *appeal dismissed*, 32 N.Y.2d 703, 296 N.E.2d 458, 343 N.Y.S.2d 607 (1973).

[38] Even when support of a spouse is involved, however, enforcement of a support provision in an agreement will be denied if the amount is inadequate or unreasonable. Thus, in a New York case where the level of support was held to be inadequate, the general rule was enunciated:

> [A] wife may not voluntarily release her husband from his *duty* to support her and neither may the husband for a consideration purchase exemption from that duty. Nonetheless, where the husband and wife agree upon the *measure* of the support

in assuring that a spouse receives adequate support,[39] there is little reason to deny the parties the right to settle the details of a financial arrangement so long as it affects only husband and wife.[40]

The distinction between spouse support on the one hand and child custody and support on the other has been evident in the New York cases involving arbitration clauses in separation agreements. When support of a spouse has been the sole issue, arbitration awards have been held final; when a child is involved, arbitration awards, if given weight at all, have not been determinative of the issue.

A. *Support of a Spouse*

In *Hirsch v. Hirsch*,[41] husband and wife entered into a separation agreement providing that upon the husband's retirement, he would be obligated to pay for his wife's support and maintenance "such sum as may be mutually agreed upon between them." Failure to agree was to result in arbitration. The husband retired, no agreement could be reached, and the wife served a demand for arbitration. The husband contended that no support was required because the wife's income exceeded his and because the wife had, under the terms of the separation agreement, obtained the bulk of their joint wealth. The arbitrator sustained the husband's position, and the wife brought a proceeding to vacate the award.[42]

The New York Court of Appeals, in affirming confirmation of the award, noted that "in matrimonial cases, public policy considerations abound" and cited statutory provisions requiring a husband to support his wife.[43] Yet the court dismissed the public policy argument without elaboration, citing an earlier case,[44] decided without

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> which they deem proper for the benefit of the wife, then the court will not compel the husband to support the wife in a greater sum unless the amount agreed upon is plainly inadequate.

Kyff v. Kyff, 286 N.Y. 71, 74, 35 N.E.2d 655, 657 (1941) (emphasis in original; citations omitted).

[39] *See, e.g., id. See also* 1 A. LINDEY, *supra* note 36, § 15-75.

[40] Of course, if the financial arrangements provided by agreement between the parties will leave one spouse without adequate means of support, so that the state rather than the other spouse will be burdened with a support obligation, the matter does not affect only husband and wife. *See* note 48 *infra* & accompanying text. Absent such considerations, if the husband and wife have agreed to arrangements each finds satisfactory, the desirability of intervention by the state to upset their agreement appears questionable.

[41] 37 N.Y.2d 312, 314, 333 N.E.2d 371, 373, 372 N.Y.S.2d 71, 73 (1975).

[42] *Id.* at 314, 333 N.E.2d at 372, 372 N.Y.S.2d at 72.

[43] *Id.* at 315, 333 N.E.2d at 373, 372 N.Y.S.2d at 74. *See* N.Y. GEN. OBLIG. LAW § 5-311, 1963 N.Y. Laws, ch. 576, § 1 (current version at McKinney Supp. 1980); N.Y. FAM. CT. ACT §§ 412, 415 (McKinney Supp. 1976-1980).

[44] Luttinger v. Luttinger, 294 N.Y. 855, 62 N.E.2d 487 (1975).

opinion, in which a similar arbitration provision had been enforced. Both the scope and the rationale of the court's decision are uncertain. The court found no violation of public policy "on the record before us," a record which presented a particularly sympathetic case for the retired husband. In a footnote, the court observed that "[w]hile hardly determinative, it is to be noted that defendant was in no danger of becoming a public charge."[45] Left unresolved was whether the holding would apply if the spouse were destitute or the award patently unjust. The court did indicate that a spouse might succeed in obtaining support despite a previous arbitration award barring such support, if changed circumstances were demonstrated. The remedy in such a case, however, as the court noted, would be a second arbitration proceeding, not a court proceeding to vacate the award.[46]

Of particular significance is the footnote to the court's opinion emphasizing the wife's financial condition. If the wife had been a likely candidate for the welfare rolls, the dispute over support might not have been considered a purely private one. To the extent that a husband may not by express agreement relieve himself of the obligation to support his destitute wife, that same result ought not to be achieved through the medium of an agreement to arbitrate. A persuasive argument can thus be made that an arbitration award relieving a husband of the responsibility of supporting his destitute wife contravenes public policy and ought not to be enforced.

Although the New York Court of Appeals was hardly explicit about its rationale, the decision in *Hirsch* was a reasonable one. An arbitration clause in a separation agreement is intended by the parties to facilitate a just and speedy resolution of the dispute. So long as only the parties have a stake in the outcome of the dispute, there is no reason not to enforce an arbitration agreement. By permitting spouses to enter into a binding agreement fixing any reasonable level of support, a state indicates that the public has no interest in any particular resolution of a support dispute,[47] and that its interests are implicated

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[45] Hirsch v. Hirsch, 37 N.Y.2d 312, 316, 333 N.E.2d 371, 374, 372 N.Y.S.2d 71, 74 (1975).

[46] Apparently the separation agreement did not provide for a second arbitration in case of changed circumstances. The court's dictum, therefore, appears to expand the scope of the arbitration clause agreed to by the parties. *Id.* at 316-17, 333 N.E.2d at 372, 372 N.Y.S.2d at 72.

[47] There is, apparently, a state interest in ensuring that the agreement is reasonable. *See* notes 38-40 *supra*. This state interest must emanate from one of two sources. Either the state's interest is in protecting the state's coffers from the responsibility of caring for a destitute spouse, or the state's interest is merely in ensuring a just and equitable resolution of the dispute between the parties. If the state's interest is in its coffers, permitting arbitration between the parties to bind the state may be inappropriate because no one will be representing the state's interest and the state did not authorize arbitrators to decide questions affecting its pecuniary interests. *See* text accompanying notes 49-50 *infra*. If, however, the state is interested in ensuring a just

only when it may be required to foot the bill in support of a destitute spouse.[48] Thus, only when the public coffers are threatened, either by an explicit support agreement or an arbitration award, is the propriety of dispute resolution by arbitrators subject to question.

Arbitration of support disputes, however, may threaten the public fisc. An arbitrator might find it just and appropriate to relieve a nearly destitute husband from the obligation to support an equally impoverished wife. Between the two, this might be a most equitable arrangement. It might even, in some cases, increase the total funds available to the now separated couple by ensuring the wife's eligibility for public assistance. An arbitrator seeking the best resolution of a dispute between parties might well take this factor into account.

When the public coffers are involved the matter is no longer solely one between husband and wife. The public has become involved in the dispute; yet no one has signed an agreement to arbitrate on behalf of the public. No representative of the state appears before the arbitrators, and even if that could be arranged, the state has not delegated to arbitrators the right to decide, in effect, whether it is more appropriate for the state to support the wife than it is for the husband to do so. In fact, by statute, the legislature may have indicated, as it had at the time of the *Hirsch* case in New York,[49] that one

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resolution between the parties, and provides for review of separation agreements between the parties out of a fear of imposition by one spouse upon the other, arbitrators are equally equipped to guard against that evil. Arbitrators are charged with the responsibility of doing justice between the parties, and there is little reason to assume they perform that task less successfully than do courts.

[48] *See* McMains v. McMains, 15 N.Y.2d 283, 206 N.E.2d 185, 258 N.Y.S.2d 93 (1965), where the court said:

> We hold that a separation agreement valid and adequate when made and which contains a nonmerger agreement continues to bind the parties when its terms as to support have been written into a subsequent divorce judgment but that this does not prevent a later modification increasing the alimony *when it appears not merely that the former wife wants or by some standards should have more money but that she is actually unable to support herself on the amount heretofore allowed and is in actual danger of becoming a public charge.*

Id. at 284-85, 206 N.E.2d at 186, 258 N.Y.S.2d at 95 (emphasis added). It must be recognized, however, that where, as in the *McMains* case, the support terms of the separation agreement have been written into a divorce judgment, there has already been some judicial review of the reasonableness of the terms. More flexibility might be permitted a spouse seeking to avoid the support terms of a separation agreement if they have not been written into the divorce judgment and if the agreement itself has not been merged into the divorce judgment.

[49] *See* N.Y. FAM. CT. ACT § 414 (McKinney Supp. 1980) (repealed). *See also* N.Y. GEN. OBLIG. LAW § 5-311 (McKinney Supp. 1980). Of course, this exception to the general rule that support of a spouse should be freely arbitrable exists only if the legislature has dictated, as it had at the time of the *Hirsch* case in New York, that one spouse may never be entirely relieved of the obligation to support the other. If a legislature were to revoke this restriction, as it has now done in New York, *see* N.Y. FAM. CT. ACT § 414 (McKinney Supp. 1980) (repealed), no public policy would remain to prevent arbitration of disputes over spouse support. As has already been noted,

spouse retains upon divorce a primary support obligation when the other is threatened with becoming a public charge. Where the legislature has so indicated, to permit arbitrators to resolve finally the dispute between husband and wife would be to ignore the reality that the dispute is a tripartite one among husband, wife, and public. Public policy, therefore, may appropriately be invoked to vacate an arbitration award when the public has asserted its interest in protecting its coffers, and there is a danger that a spouse denied support will become a public charge.[50]

B. *Child Support*

New York courts that have dealt with the enforceability of agreements to arbitrate child support disputes have recognized that the children involved were not parties to the arbitration agreement. Yet those same courts have permitted arbitration of child support questions, even without representation of the children, on the assumption that only the parents, but not the children, would be bound by the arbitration award.

The leading case is *Schneider v. Schneider*,[51] decided by the New York Court of Appeals in 1966. There, the parents' separation agreement provided for continued support of the child upon the wife's remarriage and for arbitration of disputes over the amount of child support. Upon her remarriage, the wife petitioned the New York Supreme Court for an order restraining arbitration as improper in child support cases.[52]

Although the New York Court of Appeals sanctioned arbitration of the dispute, it did so with important qualifications. Because the *Schneider* case came to the court before an arbitration award had been rendered, the court noted that "[t]o affirm here we need not hold

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however, there might remain a policy requiring some review of support agreements executed by the parties to ensure that one party has not somehow imposed upon the other. *See* note 47 *supra*. That policy is one designed to ensure that justice is done between the parties, and there is no reason to assume that arbitrators could not perform the function as well as courts.

[50] It bears mention that in these circumstances, if the arbitrators have reached a solution that is optimal between husband and wife, that is, a solution that minimizes contribution of both husband and wife and maximizes that of the state, it is possible, although not likely, that there will be no one with an interest in having the award vacated.

A more basic question is whether arbitration should be permitted at all in this situation. If the state has an interest in the outcome of the arbitration, and if the award is freely subject to vacatur, it would be wasteful of time and resources to have the arbitration proceed as a mere preliminary to the eventual litigation.

[51] 17 N.Y.2d 123, 216 N.E.2d 318, 269 N.Y.S.2d 107 (1966).

[52] The New York Court of Appeals affirmed an Appellate Division order reversing Special Term's grant of the wife's motion.

that an award made by an arbitrator is final and beyond court review."[53] The court further indicated, by quoting an influential appellate division opinion,[54] that an arbitration award in a child custody case is not due the finality usually accorded arbitration awards,[55] and that such an award could be binding only so long as it did not adversely affect the child.[56]

The *Schneider* case treats arbitration less as a mechanism for speedy and efficient dispute resolution than as an intermediary step inserted before the courts finally resolve the issue. Whether or not this is an effective use of the arbitration process, and it may well be, it is a recognition that child support disputes present issues of public policy not suitable for private resolution by the child's parents. As the courts have noted, the children involved are not parties to the agreement; hence, they may not be bound by it, and may bring suit for child support notwithstanding its terms.[57]

It bears emphasis that it is not because they work injustice between the parties that express provisions for child support, or for final arbitration of child support disputes, are not binding on the courts. The child's welfare—the central concern of the law[58]—is at stake, and the child has never relinquished his right to redress in the courts. The child is not a party to the arbitration agreement, and can no more be bound by the agreement or a subsequent arbitration award than any third party can be bound by an agreement between two others. Parents alone do not have the capacity to agree to arbitration of child support disputes because the issues involved affect not only the parents themselves, but the child as well. The issues, then, transcend justice between the parties, and may not be finally determined by arbitrators.[59]

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[53] 17 N.Y.2d at 127, 216 N.E.2d at 320, 269 N.Y.S.2d at 110.

[54] Sheets v. Sheets, 22 A.D.2d 176, 178, 254 N.Y.S.2d 320, 324 (1964). Analysis of the merits of this limited use of arbitration is not within the scope of this Article. *See* note 34 *supra*.

[55] 17 N.Y.2d at 127, 216 N.E.2d at 320, 269 N.Y.S.2d at 110.

[56] *Id.* at 128, 216 N.E.2d at 320-21, 269 N.Y.S.2d at 111.

[57] *See, e.g.*, Boden v. Boden, 42 N.Y.2d 210, 212, 366 N.E.2d 791, 793, 397 N.Y.S.2d 701, 703 (1977) (citations omitted), where the court said:

> A husband and wife, in entering into a separation agreement, may include in that agreement provisions pertaining to the support of the children of their marriage. The terms, like any other contract clauses, are binding on the parties to the agreement. The child, on the other hand, is not bound by the terms of the agreement . . . and an action may be commenced against the father for child support despite the existence of the agreement. . . .

[58] *See, e.g.*, Finlay v. Finlay, 240 N.Y. 429, 433-34, 148 N.E. 624, 626 (1925) (Cardozo, J.); N.Y. DOM. REL. LAW § 70 (McKinney 1977).

[59] Note that the problem here is not that child support statutes are not designed to work justice between the parties. The problem instead is that the statutes are intended to adjust the rights of three or more parties, only two of whom are parties to the arbitration agreement. It is a

C. *Child Custody*

Custody matters do not provide courts with the alternative, sometimes favored in child support cases, of permitting arbitration so long as the award is not binding on the child. The child's interest is primary in custody matters, and a custody determination not binding on the child would therefore be a rather peculiar concept. Indeed, it would be disastrous if the effect were to permit the parents to agree to arbitrate custody disputes, subject to review only if the minor child, unrepresented at the arbitration proceedings, should see fit to bring a court proceeding to challenge the award.[60] Such a rule would, in effect, often permit private arbitrators to determine finally custody questions.

This would be unacceptable, as the courts have recognized, because the child is not a party to the agreement to arbitrate. Justice between the parties thus may not be in the best interests of the child.[61] But there is yet another reason why arbitration of child custody disputes would be unacceptable. Not only are arbitrators under no obligation to consider the best interests of the child, but they are in fact unable to further the child's best interest when neither parent is a suitable custodian. A court retains the discretion to deny custody to either parent.[62] So long as the parents alone are parties to the arbitration agreement, the arbitrator is in no position to award custody to a third party. This limitation on the power of an arbitrator to fashion a suitable award renders the process unsuitable for final custody determinations.

The two leading appellate cases in New York have taken somewhat different approaches to the incompatibility of arbitration and custody disputes, but each has recognized that arbitrators may not be permitted the final word in custody matters. In *Sheets v. Sheets*,[63] the court suggested that where a separation agreement provides for arbi-

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basic arbitration principle that a party whose interests are implicated in the dispute, and who has not agreed to arbitration cannot be deprived of his day in court. That principle suffices to justify the rule permitting judicial review in support cases despite an arbitration agreement between the parents. It is also true that arbitrators earnestly seeking to do justice between the parents may not adequately consider the child's welfare, because the interests of the parents and those of the child do not necessarily coincide.

[60] This is especially true in child custody cases because an award placing a child in the custody of the "wrong" parent may result in harm to the child, or to the parent denied custody, that is enduring and not compensable in monetary terms. In contrast, in child and spouse support cases, where the amount of support alone is at issue, a limited use of arbitration, with subsequent judicial review, may be justifiable.

[61] *See* note 58 *supra*.

[62] *See, e.g.*, Agur v. Agur, 32 A.D.2d 16, 20, 298 N.Y.S.2d 772, 777 (1969).

[63] 22 A.D.2d 176, 254 N.Y.S.2d 320 (1964).

tration of custody disputes, the agreement should be enforced, subject however to review by the courts to determine if the award is in the best interests of the child. In elaborate dictum, the court analogized an arbitration of child custody to an award of custody by a sister state court, which the New York courts would not consider binding.[64] Thus, in effect, a potentially two-step procedure would be created. First, arbitration between the parents; and second, a court proceeding to determine whether the arbitration award is in the best interests of the child. Because the arbitration award, if it adequately reflects the interests and desires of the parents, will most likely also reflect the best interests of the child, the second step of the procedure might not be a lengthy one.

In *Agur v. Agur*,[65] the court declined to mandate the two-step procedure of the *Sheets* case, and instead refused to permit arbitration at all. In intended compliance with Jewish religious law, the separation agreement in *Agur* granted custody to the wife until the child's sixth birthday, and to the husband thereafter. Any disputes were to be resolved by a panel of arbitrators applying Jewish law. Just before the child reached the age of six, the wife brought a court proceeding seeking custody. The husband countered by seeking a stay of the proceeding pending arbitration. The appellate division, in reversing a stay of the court proceeding, emphasized the court's role as *parens patriae*. Justice Hopkins cogently articulated the difficulties with arbitration of custody disputes:

> [T]he setting of arbitration stresses the settlement of a private dispute: the award ends the dispute by declaring that one or the other parent is granted custody. Under judicial standards, the court is not bound to grant custody to either parent, but may decide that in the child's best interests neither should have custody. In short, the judicial process is more broadly gauged and better suited to reach the ultimate objective.[66]

Rejected too, as already noted, was the potentially two-step procedure advanced in the *Sheets* case, partly on the ground that the delay attendant to such a procedure would, itself, not be in the best interests of the child.

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[64] Bachman v. Mejias, 1 N.Y.2d 575, 580-81, 136 N.E.2d 866, 868-69, 154 N.Y.S.2d 903, 907 (1956). The status of sister state custody decrees under the full faith and credit clause of the United States Constitution has not been definitively resolved by Supreme Court precedent. Compare the various opinions in May v. Anderson, 345 U.S. 528 (1953).

[65] 32 A.D.2d 16, 298 N.Y.S.2d 772 (1969).

[66] *Id.* at 20, 298 N.Y.S.2d at 777.

The *Agur* court did not justify its decision solely by adverting to the narrow range of inquiry and action available to arbitrators in an area that requires more than simply justice between the parties. The court also questioned the qualifications of arbitrators to decide such matters, and stressed the "immeasurable and intangible elements" involved in custody determinations.[67] These objections to arbitration, however, do not withstand analysis. Arbitrators, like courts, may compensate for their lack of "qualification" by the use of expert witnesses—social workers, psychologists, and psychiatrists—supplied by the parties to the custody dispute.[68] The willingness of courts to rely on expert witnesses to enlighten the arbitrators reflects not a lack of confidence in the capacity or judgment of arbitrators, but a recognition that the disputing parties themselves cannot be expected to provide all the information necessary to make a determination in the best interests of the child.[69] It is the inability to represent properly the interests of the child, who, of course, never consented to arbitration in the first place, that makes arbitration an inappropriate forum for resolution of custody disputes. Because justice between the parties to the arbitration agreement is an insignificant factor in making a custody award, arbitrators should not be permitted to make such determinations.

D. *Conclusions*

So long as domestic disputes may be resolved by agreement of the parties, there is every reason to enforce agreements to arbitrate such disputes. However, most domestic disputes may not be resolved in that manner. Children, who never agreed, and could not have agreed, to arbitrate, may be at the center of the dispute. The public at large, either through its treasury or derivatively through its concern for minor children whose interests may be different from those of their parents, may be concerned that the dispute be resolved in a manner

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[67] *Id.*

[68] In general, "[a]rbitrators have discretionary power to admit and hear any evidence that the parties may wish to present through witnesses or documents." M. DOMKE, *supra* note 2, at 235. In addition, they are not strictly bound by evidentiary rules. *See id.*

[69] Thus, in New York, § 249 of the Family Court Act permits the family court judge to appoint a law guardian for a minor child when "such representation will serve the purpose of this act, if independent legal counsel is not available to the child." N.Y. FAM. CT. ACT § 249 (McKinney 1975). As an additional protection, some states permit courts to order their own investigations in custody cases. *See* Gozansky, *Court-Ordered Investigations in Child Custody Cases*, 12 WILLAMETTE L.J. 511 (1976). These procedures permit the court to see the entire picture in a custody case if the court fears that the parents themselves would provide only an edited version.

having little or no connection to doing justice between the parties to the dissolving marriage. Arbitration has proven to be an effective and timesaving means of dispute resolution, but the primary purpose of child support and custody laws is not to resolve disputes. Paramount instead is the disposition and care of the child, the object of, but not a party to, the dispute. The arbitration process is designed not to further the child's best interest, but rather to resolve the dispute between the parents. Of course, in many, if not most, support and custody cases the best interests of the child and justice between the parents will coincide. There is, however, no assurance that they will, and so long as the arbitration process is one to which the child has not agreed, permitting private arbitrators to determine questions of support and custody without court review is inappropriate.

III. Antitrust Law

A. *The Rule and Its Rationale*

In 1968, two cases, one in the Second Circuit[70] and the other in the New York Court of Appeals,[71] held that public policy prohibits the enforcement of agreements to arbitrate all future disputes when the disputes that arise involve claims and defenses founded on the antitrust laws.[72] The doctrine is now well established. Succeeding cases have differed only as to its scope and application.[73] Many reasons have been advanced for the doctrine, both in judicial opinions and in scholarly journals. The most convincing one, often articulated but perhaps not sufficiently highlighted when combined with a plethora of less persuasive arguments, is simply that the antitrust laws are designed not to protect either of the contracting parties from overreaching by the other, but instead to promote competition in the economic system.[74] Arbitrators cannot be expected to sacrifice the

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[70] American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968).

[71] Aimcee Wholesale Corp. v. Tomar Prods., Inc., 21 N.Y.2d 621, 237 N.E.2d 223, 289 N.Y.S.2d 968 (1968).

[72] Not involved in either case was an agreement to arbitrate. Such agreements pose somewhat different problems. *See* text accompanying notes 92-96 *infra*.

[73] Other appellate cases applying the public policy doctrine to antitrust issues are Applied Digital Technology, Inc. v. Continental Cas. Co., 576 F.2d 116 (7th Cir. 1978); Sam Reisfeld & Son Import Co. v. S.A. Eteco, 530 F.2d 679 (5th Cir. 1974); Buffler v. Electronic Computer Programming Inst., Inc., 466 F.2d 694 (6th Cir. 1972); Helfenbein v. International Indus., Inc., 438 F.2d 1068 (8th Cir.), *cert. denied*, 404 U.S. 872 (1971); Power Replacements, Inc. v. Air Preheater Co., 426 F.2d 980 (9th Cir. 1970); A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710 (9th Cir. 1968).

[74] *See, e.g.*, Cobb v. Lewis, 488 F.2d 41, 47 (5th Cir. 1974) (Wisdom, J.); American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821, 826-27 (2d Cir. 1968); Aimcee Wholesale

most equitable resolution of the dispute between the parties in favor of the economic needs of society as expressed in the antitrust laws. This is not because arbitrators are any less capable or unbiased than judges or because they have fewer resources at their disposal, but because the task of arbitration is inconsistent with the purposes and functions of the antitrust laws. Arbitrators are entrusted with the responsibility of working justice between the parties as it appears to them and without explaining their conclusions. Antitrust laws, by contrast, have little to do with justice between the parties.[75] Thus, there is a choice to be made. Either arbitrators should be permitted to resolve disputes that implicate antitrust issues as they do other disputes—unbound by rules of law and at the possible sacrifice of antitrust policies—or they must be prohibited entirely from arbitrating such disputes. There is no middle ground consistent with the arbitration process as it has developed in this country.[76]

The choice has not been a difficult one for courts confronted with the problem. The Second Circuit, in *American Safety Equipment Corp. v. J.P. Maguire & Co.*,[77] was faced with a dispute over a license agreement. Hickok Manufacturing Company had agreed to grant American Safety an exclusive license to use the "Hickok" trademark with respect to certain automobile safety products, and had authorized American Safety to grant a sublicense for foreign territories, subject to Hickok's approval and so long as the sublicensee did not compete with Hickok or any of its licensees. Each company also agreed not to engage in the other's principal activity: Hickok would

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Corp. v. Tomar Prods., Inc., 21 N.Y.2d 621, 627, 237 N.E.2d 223, 225, 289 N.Y.S.2d 968, 971 (1968); *cf.* Pitofsky, *Arbitration and Antitrust Enforcement*, 44 N.Y.U. L. REV. 1072, 1079 (1969) (binding referral to arbitration of future antitrust violations analogous to agreement to waive rights to collect for future violations, which have been held void as against public policy).

[75] Antitrust disputes, not unlike child custody and support disputes, are tripartite. The public generally, in addition to the private parties to a contract, is an interested and unrepresented party in private antitrust disputes, and it is protection of the public, through promotion of competition, that is the objective of the antitrust laws.

[76] Of course, this may not be true of arbitration as it has developed in other countries, or, indeed, as it might have developed here. *See* note 10 *supra*.

Given the development of arbitration in this country, the courts could, as some New York courts have done in family law cases, *see* text accompanying notes 51-65 *supra*, create a potentially two-step procedure with full judicial review of all antitrust issues. Whatever the merits of this approach in custody and child support cases, it is not suited for antitrust disputes. If a dispute does involve antitrust issues, preliminary resolution of contract issues as if the antitrust laws were not involved would be a senseless waste of effort. Much more than in custody and support disputes, a fair resolution of the dispute between the parties is likely to frustrate public policy. Judicial review would of necessity have to be more comprehensive than in custody and support cases, where courts could approve arbitration awards so long as the awards provided adequately for the child.

[77] 391 F.2d 821 (2d Cir. 1968).

not sell safety equipment, and American Safety would not sell apparel and accessories. After operating for several years under the agreement, the parties had a falling out. American Safety sought a declaratory judgment that the agreement was illegal because in violation of the antitrust laws, and that no royalties were due. Hickok sought a stay of the action pending arbitration.

In reversing an order staying the declaratory judgment action pending arbitration, the court advanced four reasons for its conclusion that arbitration is an unsuitable forum for resolution of antitrust disputes. First, the court noted the effect of antitrust violations on the public at large.[78] Second, the court reasoned that an arbitration clause may represent the attempt of a monopolist, through contracts of adhesion, to choose the forum for trying antitrust disputes with its customers.[79] Third, the "complicated" issues in antitrust cases were deemed "better suited to judicial than to arbitration procedures."[80] Fourth, the court questioned the wisdom of permitting commercial arbitrators, often businessmen, to enforce policies designed to regulate the business community.[81]

The court's second argument is unpersuasive. Whenever an arbitration clause is involved, a court may decide, as a preliminary matter, whether there has been a valid agreement to arbitrate. If the court concludes that no valid agreement to arbitrate was reached or that the arbitration clause was itself a product of illegally exercised monopoly power, the court may then decide the dispute.[82] This applies whether or not antitrust claims are involved, and it provides no reason for treating antitrust claims specially.[83]

Similarly unpersuasive is the argument that antitrust cases are too complicated for arbitrators. It has not been suggested that complex commercial cases are unsuitable for arbitration, and there is little reason to expect arbitrators drawn from the antitrust bar and business community to be any less competent than judges to evaluate antitrust claims.[84]

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[78] *Id.* at 826-27.

[79] *Id.* at 827.

[80] *Id.*

[81] *Id.*

[82] *See* Prinze v. Jonas, 38 N.Y.2d 570, 577, 345 N.E.2d 295, 300, 381 N.Y.S.2d 824, 829-30 (1976); *cf.* Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402, 411 (2d Cir. 1959) (if party arguing illegality shows there is substance to the argument, there must be a judicial trial).

[83] *See* text accompanying note 133 *infra*.

[84] In fact, such arbitrators could conceivably be more competent because of their acquaintance with the economic consequences of antitrust violations.

Less easily dismissed is the difficulty of using businessmen, the subjects of antitrust regulation, to decide disputes involving antitrust issues. The court's uneasiness at this prospect seems, on the surface, to be merited. Were antitrust enforcement merely a matter of doing justice between businesses, however, there would be little reason to believe that businessmen could not be neutral or even vigilant enforcers of the law. Were the legal prohibition involved designed to prohibit overreaching by one business against another, there would be little reason to expect other businessmen to be less than adequate arbitrators.

The only remaining justification for the court's conclusion, and it is a strong one, is the effect of antitrust violations on the competitive economy as a whole. The court noted the function of nongovernment antitrust plaintiffs as private attorneys general, and concluded that matters of such public import are inappropriate for arbitration.[85] This reason alone would support the court's holding. Antitrust laws protect the public generally by prohibiting practices deemed inimical to the competitive system. The public has not consented to arbitration, and would not be represented in an arbitration proceeding. If antitrust violations "can affect hundreds of thousands—perhaps millions—of people and inflict staggering economic damage,"[86] the agreement of two parties is an insufficient basis for permitting arbitration to supplant the judicial system.

In the other trailblazing case involving the incompatibility of antitrust law and arbitration, *Aimcee Wholesale Corp. v. Tomar Products, Inc.*,[87] the New York Court of Appeals held that enforcement of the Donnelly Act, a state antitrust law, could not be left to arbitration. Judge Keating, writing for the court, raised some of the same arguments discussed in *American Safety Equipment*, decided after the *Aimcee* case was argued. In a particularly perceptive paragraph, he observed:

> [W]e cannot overlook the fact that many undeserving litigants are awarded damages in antitrust cases. Arbitrators are more likely to give more consideration to equitable notions such as waiver, estoppel and *in pari delicto*. Every time this is done, however, the deterrent effect of the law on antitrust violations is severely diminished.[88]

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[85] 391 F.2d at 826-28.

[86] *Id.* at 826.

[87] 21 N.Y.2d 621, 237 N.E.2d 223, 289 N.Y.S.2d 968 (1968).

[88] *Id.* at 629, 237 N.E.2d at 227, 289 N.Y.S.2d at 973.

Thus, the court explicitly recognized that the antitrust laws do not reflect ideas of justice between the parties, and that arbitrators seeking, as they should, to do justice would necessarily frustrate the goals of the antitrust laws.

Moreover, the court identified an additional dimension of the problem. The mere knowledge that a private antitrust suit could be brought serves as a deterrent to potential antitrust violators who may be concerned that damages unrelated to the just deserts of the antitrust plaintiff will be awarded. Successful implementation of antitrust policy depends heavily on this fear, instilled by the prospect of treble damage actions.[89] If potential antitrust violators are permitted to eliminate the danger by agreeing in advance to arbitrate all disputes with a potential antitrust plaintiff, antitrust enforcement will be jeopardized. The knowledge that an antitrust plaintiff will receive just compensation is not likely to have the same deterrent effect as the prospect that an undeserving plaintiff will receive a treble damage award.[90]

Subsequent cases have added little to the analytical framework built in the *American Safety Equipment* and *Aimcee Wholesale* cases.[91] Those cases have been cited with approval, but no additional reasons for prohibiting arbitration of antitrust claims have been advanced. Instead, as will appear in the next two sections, analysis has focused on an exception to the rule and applications of the rule when antitrust and other issues are involved in the same dispute.

B. *Agreements to Arbitrate Existing Disputes*

As noted, public policy prevents enforcement of an agreement to arbitrate future disputes in situations when the future dispute turns on the antitrust law. The issue is somewhat different, however, when the parties agree to arbitrate the dispute after, rather than before, it arises. By analogy to the parties' right to settle antitrust disputes, the courts have sanctioned agreements to arbitrate existing disputes.[92]

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[89] *See, e.g.*, Pitofsky, *supra* note 74, at 1073-75.

[90] Thus, there are two classes of third parties, not parties to any arbitration agreement, that the antitrust laws are intended to affect. First, the public is supposed to benefit from antitrust enforcement. Second, the laws attempt to deter potential antitrust violators from future violations.

[91] The leading appellate cases are cited in note 73 *supra*. Even the most thoughtful of these opinions, the one by Judge Wisdom in Cobb v. Lewis, 488 F.2d 41 (5th Cir. 1974), relies heavily on the analysis in the *American Safety Equipment* case.

[92] Coenen v. R.W. Pressprich & Co., 453 F.2d 1209, 1215 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *see* Cobb v. Lewis, 488 F.2d 41, 47-49 (5th Cir. 1974); Power Replacements, Inc. v. Air Preheater Co., 426 F.2d 980, 984 (9th Cir. 1970).

As Professor Robert Pitofsky has noted in an influential article, so long as the parties to an antitrust dispute are permitted to settle the dispute out of court, "arbitration may simply be a convenient mechanism to assist the parties in disposing of the controversy."[93] Complexities arise when no express agreement to arbitrate is reached after the dispute arises, but the parties implicitly agree to arbitrate by proceeding to arbitration under the terms of a preexisting agreement. The Fifth Circuit has asserted that even in that situation, arbitration should be permitted if a party's conduct indicates that an "informed, deliberate, and explicit decision to have his antitrust claims arbitrated"[94] has been made.

It can be argued that arbitration even of existing antitrust disputes is inappropriate. After all, arbitrators would be no less likely to ignore antitrust considerations in dealing with disputes that arise before than those that arise after the parties agree to arbitrate. If antitrust concerns are more important than justice between the parties, arbitration should not be permitted whenever antitrust claims are involved.

The difficulty with that argument is that by permitting settlement of private antitrust disputes without any intervention by the government, Congress has indicated that antitrust considerations may be subordinated to just resolution of the dispute between the parties. There would seem to be little reason, therefore, not to permit the parties to submit to private arbitrators those disputes that they could settle by private agreement. Whatever inconsistency there might be in thus differentiating agreements to arbitrate future and existing disputes, and there might be none,[95] is not in the exception to the general rule prohibiting agreements to arbitrate antitrust claims, but rather in the right of parties to frustrate antitrust policy by settling private antitrust cases without judicial intervention.[96]

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[93] Pitofsky, *supra* note 74, at 1079 & n.31.

[94] Cobb v. Lewis, 488 F.2d 41, 49 (5th Cir. 1974).

[95] This Article has argued that where the public has asserted its interest in the resolution of a particular type of dispute, and has not agreed to arbitrate, the dispute should not go to arbitration. Whatever inconsistency there may be in differentiating agreements to arbitrate future and existing disputes in terms of the public policy doctrine, evaporates when it is recognized that Congress, the public's representative, has delineated the scope of the public's interest in private antitrust enforcement. Regardless of when a court might properly protect a public interest that has not been expressed by the public representative in a statute—a question that pertains more to who may assert the public interest than to the scope of that interest—it would not be appropriate for a court to contradict a limit on the public's interest clearly expressed in a statute. For the reasons behind the limit, see note 96 *infra*.

[96] The congressional decision to permit settlement of private antitrust disputes is a rational one. It is important to recognize that in most cases, permitting private settlement of existing antitrust disputes is unlikely to frustrate the public interest in enforcing the antitrust laws. Even

C. *Arbitration of Claims Involving Both Antitrust and Other Issues*

Relatively few cases involve exclusively antitrust issues. Frequently, for instance, an antitrust defense may be the response to a claim for breach of contract. If the parties have entered into a valid agreement to arbitrate contract disputes, there is no public policy that would prevent arbitration of those disputes.[97] Yet, if arbitration of related antitrust disputes is prohibited, either the dispute resolution procedure must be bifurcated—with the court determining antitrust claims and arbitrators resolving other contract disputes—or the court must determine all the issues in disregard of the parties' agreement to arbitrate. This last alternative is particularly unappealing because it

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when private antitrust disputes proceed to litigation, the court does no more than adjust the rights of the parties. It is true that the rights are adjusted to comport with the public policy expressed in the antitrust statutes, not to achieve a just resolution of the dispute between the parties. But the public policy is effectuated by adjusting the rights of the disputing parties without directly involving financial or other tangible obligations of the public or any nonparties. (In this respect, antitrust litigation is different from the support and custody problem already discussed. *See* note 49 *supra* & accompanying text. In the support situation, a court can, by resolving the dispute between the parties, require the state to provide a greater or smaller contribution to the support of a needy spouse. In the custody situation, a court will affect the status of a child by resolving the dispute between the parents.)

Because the parties know the criteria that will be applied if the antitrust dispute proceeds to litigation, that is, they know that their rights will be adjusted in accordance with antitrust policies, not notions of justice, a rational settlement will reflect that knowledge. A rational party who believes a settlement offer to be unjust, but who also believes that he will do no better in litigation because the court is deciding on bases other than justice, is unlikely to resist the settlement offer. In other words, so long as the parties can evaluate their alternatives should the dispute proceed to litigation, and those alternatives reflect antitrust policy rather than justice, any settlement, too, is likely to be based on antitrust policy.

This indicates that an agreement to arbitrate an existing antitrust dispute is likely to frustrate no public policy. If both parties are willing to arbitrate, it probably means that neither party believes he will be appreciably worse off if the matter is decided by arbitrators seeking to do justice instead of judges bound by the antitrust laws. In such cases, it seems likely that the antitrust policies involved would, perhaps coincidentally, reflect justice between the parties. If not, one party would have good reason to resist arbitration in favor of litigation. Thus, if antitrust litigation is likely to produce a treble damage remedy as a deterrent to future violators, the likely beneficiary of that award would not rationally choose to arbitrate if he believed the arbitrators would do no more than make him whole.

If the litigation alternative is removed before the dispute arises, on the other hand, as it would be if a preexisting arbitration clause were held enforceable, neither party would be able to resist arbitration in the belief that the result in arbitration would differ greatly from the terms of a judicial adjudication. There is, in this situation, no reason to believe that the arbitrator's award, based on justice between the parties, will accurately reflect public policy. This difference, it is submitted, justifies both the rule that agreements to arbitrate future antitrust disputes are not enforceable, and the exception that existing antitrust disputes may be arbitrated if the parties so agree.

[97] *See* notes 20-24 *supra* & accompanying text.

raises the possibility that one party might assert frivolous antitrust claims or defenses to defeat the arbitration provisions in a contract.[98]

More commonly at issue, however, since the courts have assumed that it is appropriate to permit arbitration of related contract issues, is whether the arbitration of those issues should take place before or after the antitrust issues have been adjudicated.[99] Each approach has advantages and drawbacks. If arbitration precedes adjudication of the antitrust issues, the court will be able to decide those issues with the benefit of whatever factual determinations have been made by the arbitrators. Arbitrators, however, are not normally obliged to make findings of fact and conclusions of law, and even if they were, it cannot be assumed that they would address the same issues that will be of interest to the court faced with an antitrust problem. Moreover, "censoring" the arbitrators by instructing them which issues they may or must resolve, is disfavored because of the restrictions it would place on a process designed to remove the restrictions of judicial adjudication.[100] Arbitration may be preferred over judicial resolution because arbitrators are permitted to reach an equitable resolution of the dispute as a whole rather than by breaking down the dispute into discrete legal problems and then taking the sum of the legal resolutions. For this reason, forcing the arbitrators to focus on particular issues in the manner of a court may deprive arbitration of one of its advantages. Furthermore, even if the arbitrators were instructed to segregate the issues, this would be difficult or impossible in many cases because the antitrust and contract issues are so closely intertwined.

On the other hand, if the antitrust issues are adjudicated first, this might result in a considerable duplication of efforts. In order to make its determination on antitrust matters, the court is likely to make findings of fact and conclusions of law about the contractual relationship between the parties which, should an antitrust violation ultimately be found, will later be duplicated in the arbitration proceeding.[101]

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[98] *Cf.* Sam Reisfeld & Son Import Co. v. S.A. Eteco, 530 F.2d 679, 681 (5th Cir. 1976) ("We find no abuse of discretion in the court's refusal to allow Reisfeld's conclusory antitrust allegations to operate to defeat arbitration of the major part of this case.").

[99] *See, e.g.*, N.V. Maatschappij Voor Industriele Waarden v. A.O. Smith Corp., 532 F.2d 874, 876-77 (2d Cir. 1976); Helfenbein v. International Indus., Inc., 438 F.2d 1068, 1070 (8th Cir.), *cert. denied*, 404 U.S. 872 (1971); A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710, 716 (9th Cir. 1968).

[100] *See, e.g.*, Paver & Wildfoerster v. Catholic High School Ass'n, 38 N.Y.2d 669, 677, 345 N.E.2d 565, 570, 382 N.Y.S.2d 22, 26 (1976).

[101] Moreover, to the extent that the court expresses its findings and conclusions, the arbitrators may feel constrained, out of deference, to follow them.

The courts that have struggled with this problem have generally taken a flexible approach, evaluating both the strength of the antitrust claims advanced and the ease with which the antitrust issues may be separated from other issues in the case.[102] In addition, it has been held that the district courts have considerable discretion to determine the order in which issues are heard.[103] Since the problem admits of no entirely satisfactory solution, perhaps this accommodation is the best one possible, permitting arbitration to proceed when the antitrust issues appear inconsequential or when they are easily separable from other issues. Although it may be difficult to determine which fact patterns fit that category, such cases clearly provide the weakest arguments for prohibiting arbitration.

D. *Conclusions*

Courts will not enforce agreements to arbitrate future disputes when those disputes raise antitrust issues. So much is settled doctrine. What is less settled is the rationale for the doctrine. Many explanations have been advanced, but as has been demonstrated, most do not justify judicial unwillingness to permit arbitration of antitrust disputes. That unwillingness may be justified, however, because to permit arbitration of such disputes would require arbitrators either to ignore antitrust policy or to cease acting like arbitrators seeking to do justice between the parties in the individual case.

At the same time, agreements to arbitrate existing antitrust disputes are enforceable. Because parties who agree to arbitrate existing disputes most likely do so with their litigation prospects in mind, an agreement to arbitrate is likely to be made only if neither party believes that he will benefit significantly from choosing litigation over arbitration. So long as the parties are well-informed and rational, there is unlikely to be an agreement to arbitrate unless it is also likely that the arbitration award will be a rough equivalent of the likely court result. Permitting arbitration of existing antitrust disputes is thus unlikely to frustrate antitrust policy significantly.

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[102] *See* Applied Digital Technology, Inc. v. Continental Cas. Co., 576 F.2d 116, 117-18 (7th Cir. 1978); N.V. Maatschappij Voor Industriele Waarden v. A.O. Smith Corp., 532 F.2d 874, 876-77 (2d Cir. 1976); Cobb v. Lewis, 488 F.2d 41, 49-50 (5th Cir. 1974); Buffler v. Electronic Computer Programming Inst., Inc., 466 F.2d 694, 699-701 (6th Cir. 1972); Allied Van Lines, Inc. v. Hollander Express & Van Co., 29 N.Y.2d 35, 43, 272 N.E.2d 70, 74, 323 N.Y.S.2d 693, 698 (1971); *cf.* Varo v. Comprehensive Designers, Inc., 504 F.2d 1103, 1104 (9th Cir. 1974) (arbitration of contract claims stayed pending resolution of antitrust dispute).

[103] N.V. Maatschappij Voor Industriele Waarden v. A.O. Smith Corp., 532 F.2d 874, 876-77 (2d Cir. 1976); A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710, 716 (9th Cir. 1968); American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821, 828-29 (2d Cir. 1968).

IV. Patent Law

Licensing agreements between a patent owner and a patent user frequently contain arbitration clauses. On occasion, disputing patent owners and licensees have agreed to arbitrate the issue of patent validity. The courts, citing the public policy doctrine, have refused to enforce such agreements.[104]

Unlike the antitrust laws, which are designed to prevent monopoly in the economic system, the patent laws promote monopoly, albeit for a limited time, in the exploitation of a patented invention.[105] This limited monopoly is designed to encourage research and innovation by providing the inventor with an advantage over those who would seek to benefit only from the final product. The underlying assumption is that the economy as a whole will benefit if such incentives are provided.[106]

When an idea or invention is not sufficiently novel to justify the award of a patent there is, almost by definition, no reason to permit even a limited monopoly of its use. The anticompetitive effects of monopoly power in these circumstances would run afoul of antitrust policies with no commensurate gain to the economic system.

The procedure for obtaining a patent nevertheless involves only a limited adversary proceeding designed to vindicate the public's interest in competition. The Patent Office serves more as a clearinghouse for patent applications than as an advocate for the public at large.[107] The public interest in challenging invalid patents is left almost entirely to private litigation.[108] In this respect, enforcement of the patent laws differs significantly from enforcement in the antitrust area.

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[104] *See* N.V. Maatschappij Voor Industriele Waarden v. A.O. Smith Corp., 532 F.2d 874, 876 (2d Cir. 1976); Hanes Corp. v. Millard, 531 F.2d 585, 593-94 (D.C. Cir. 1976); Beckman Instruments, Inc. v. Technical Dev. Corp., 433 F.2d 55, 63 (7th Cir. 1970), *cert. denied*, 401 U.S. 976 (1971); Diematic Mfg. Corp. v. Packaging Indus., Inc., 381 F. Supp. 1057, 1061-62 (S.D.N.Y. 1974), *appeal dismissed*, 516 F.2d 975 (2d Cir.), *cert. denied*, 423 U.S. 913 (1975).

[105] *See* 35 U.S.C. § 154 (1976): "Every patent shall contain . . . a grant to the patentee, his heirs or assigns, for the term of seventeen years, . . . of the the right to exclude others from making, using, or selling the invention throughout the United States . . . ."

[106] *See* Sinclair & Carroll Co. v. Interchemical Corp., 325 U.S. 327, 330-31 (1945); United States v. Univis Lens Co., 316 U.S. 241, 250 (1942). *See also* 4 H. Toulmin, Patents and the Antitrust Laws § 2.1 (1950).

[107] The process has been described as follows: "The Patent and Trademark Office holds pending applications in confidence and conducts the examination 'ex parte' with the applicant pressing his claims and the examiner impartially judging the merits of those claims." 3 D. Chisum, Patents § 11.03(3) (1980) (footnote omitted).

[108] *See* 4 *id.* § 19.01. It is true that the public is not represented in private antitrust litigation, either, but enforcement of the antitrust laws is not left to private litigation alone—the government is actively involved.

Heavy reliance on private litigation to vindicate the policies that underlie the patent laws could indicate a weaker public concern for those policies than for the policies of antitrust. In *Lear, Inc. v. Adkins*,[109] however, the Supreme Court dispelled any such notion by overruling a prior case,[110] and striking down, as inconsistent with the patent laws, the doctrine of licensee estoppel, which had prevented licensees from attacking the validity of the licensed patent. In *Lear*, the licensee estoppel doctrine was disapproved not because of any unfairness to licensees, but because of the public stake in the dispute. As the Court stated:

> Surely the equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute to would-be monopolists without need or justification. We think it plain that the technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued.[111]

In other words, even if contract principles, developed to work justice between the parties, would result in an estoppel of the licensee, the public interest in challenging invalid patents must prevail.[112]

The holding in *Lear* establishes definitively that where a question of patent validity is involved, justice between the parties to the dis-

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[109] 395 U.S. 653 (1969).

[110] *Id.* at 671. *See* Automatic Radio Mfg. Co. v. Hazeltine Research, Inc., 339 U.S. 827, 836 (1950).

[111] 395 U.S. at 670-71.

[112] *See* Blonder-Tongue Labs., Inc. v. University of Ill. Foundation, 402 U.S. 313, 329 (1971). The Court noted that litigants who had not appeared in an earlier litigation, could not be estopped by any adjudication in that litigation, despite an identity of issues. The *Blonder-Tongue* case involved the opposite problem: the preclusive effect of prior adjudication of patent invalidity on a patentee who had been a party to the earlier litigation. In *Blonder-Tongue* the Court abandoned the doctrine of mutuality of estoppel and held that a patentee who brings a patent infringement suit in which it is adjudicated that his patent is invalid is estopped from asserting the patent's validity in a subsequent infringement suit. Justice White's opinion for the Court left open both the preclusive effect of an adjudication of patent invalidity in which the patentee had been a defendant rather than a plaintiff and the permissibility of offensive use of an adjudication of invalidity against the patentee. *Id.* at 329-30, 332. There has been some discussion of according weight in a subsequent suit against a different party even to an adjudication of patent validity. *See* Kidwell, *Comity, Patent Validity, and the Search for Symmetry: Son of* Blonder-Tongue, 57 J. PAT. OFF. SOC'Y 473 (1975) (citing Columbia Broadcasting Sys., Inc. v. Zenith Radio Corp., 391 F. Supp. 780, 786 & n.11 (N.D. Ill. 1975), *aff'd in part and rev'd in part*, 537 F.2d 896 (7th Cir. 1976)). *See also* Comment, 49 N.Y.U. L. REV. 343, 351 (1974).

pute must be subordinated to the public interest. Although patent law policies are vindicated largely through the litigation of private parties,[113] the *Lear* decision, in its emphasis on the public interest in patent cases, has furnished a basis for analogy to the antitrust area and a consequent refusal of the courts to enforce arbitration clauses in patent licensing agreements.

Beckman Instruments, Inc. v. Technical Development Corp.[114] was the first case decided after *Lear* to involve the enforceability of an arbitration clause in a patent licensing agreement. The principal issue involved the extent to which *Lear* eliminated the licensee estoppel doctrine. Also at issue was the propriety of the licensee's demand, under a term of its sublicense agreement, for arbitration of disputes with its sublicensee. The Seventh Circuit, in agreement with the district court, held that the patent validity issue was not within the scope of the arbitration clause. In dictum, however, the court went further and concluded that patent validity questions, even when they are within the scope of agreements to arbitrate, should be resolved only by the courts.[115] Citing *Lear* and quoting from the district court's opinion, Chief Judge Swygert noted that decisions in patent cases are of importance not only to the parties, but also to the general public.[116]

Subsequent cases have yielded similar results. In *Diematic Manufacturing Corp. v. Packaging Industries, Inc.*,[117] the court, by analogy to the antitrust cases, concluded that "[t]he grave public interest in questions of patent validity and infringement renders them inappropriate for determination in arbitration proceedings,"[118] and, there-

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[113] *See* note 108 *supra*.

[114] 433 F.2d 55 (7th Cir. 1970), *cert. denied*, 401 U.S. 976 (1971).

[115] *Id.* at 63. The court did not expressly distinguish between enforcement of arbitration agreements in existing licensing agreements and enforcement of agreements to arbitrate patent disputes once the disputes have arisen. Analogy might, however, be drawn to the antitrust principles discussed in note 96 *supra* & accompanying text.

[116] 433 F.2d at 63.

[117] 381 F. Supp. 1057 (S.D.N.Y. 1974), *appeal dismissed*, 516 F.2d 975 (2d Cir.), *cert. denied*, 423 U.S. 913 (1975).

[118] *Id.* at 1061. Although the court lumped together "questions of patent validity and infringement," *id.*, it is not clear that the two are best treated as a unit. Questions of patent validity, for the reason articulated in Lear, Inc. v. Adkins, 395 U.S. 653 (1969), transcend the interests of the disputing parties. Assuming, however, that the issues of patent validity and scope are resolved, the infringement issue would theoretically appear to be a dispute merely between the parties. Because the infringement issue is almost inevitably dependent on resolution of questions of patent scope and validity, the distinction has little practical significance. So long as arbitration is inappropriate to determine validity or scope, it is senseless to permit arbitration to decide questions of infringement. In fact, it might be dangerous to do so, since arbitrators bent on doing justice might well disregard judicial findings as to patent scope and validity.

fore, granted the stay sought by the patentee of arbitration proceedings begun under a broad arbitration clause in the licensing agreement.

Reluctance to enforce an arbitration clause in a patent licensing agreement was also expressed in *Hanes Corp. v. Millard*,[119] in which a licensee sought a declaratory judgment that a patent was either entirely invalid or inapplicable to the products in question. Because the Court of Appeals for the District of Columbia Circuit ultimately concluded that a potentially dispositive statute of limitations issue could appropriately be submitted to arbitrators, it denied the declaratory judgment.[120] The court indicated in dictum, however, that absent that issue, "the district judge would not have acted improperly" had he resolved the issue in dispute rather than submitting it to arbitrators.[121] In reaching this conclusion, the court placed more emphasis on the complexity of patent issues than on the public interest in patent litigation.[122] However, since the patent in *Hanes* had expired before the litigation was instituted, the public interest in the outcome was undoubtedly diminished.[123]

Thus, while only in the *Diematic* case has there been a square holding that an arbitration clause in a patent licensing agreement is not enforceable, other courts have expressed similar views. The conclusions that have been reached are consistent with and may be explained by the thesis of this Article: The public policy doctrine is appropriately invoked to prohibit arbitration when the legal principles implicated in a dispute are designed to serve goals other than achieving justice between the parties. The *Lear* case, in its repudiation of the contract principle of licensee estoppel, has indicated that the patent laws are not designed to do justice between the parties, but rather to protect the economic interests of the public, which is not made a party to the private litigation. So long as that is the case, it

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[119] 531 F.2d 585 (D.C. Cir. 1976).

[120] *Id.* at 600. As reasons for finding the statute of limitations issue arbitrable, the court cited first, the federal policy in favor of arbitration and second, the need to provide certainty in international commercial transactions where "unfamiliar and contrasting choice of law rules and statutes of limitations" would be troublesome. The court cited *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), in support of its conclusion. In addition, statutes of limitation are imposed out of fairness considerations—the need to provide repose against long-dormant claims, and the desire to protect courts and litigants from a decisionmaking process based on stale evidence. Arbitration is unlikely to frustrate these interests. Moreover, to the extent parties rely on statutes of limitation, justice between the parties may require arbitrators to abide by existing statutes. *See* text accompanying note 8 *supra*.

[121] 531 F.2d at 594.

[122] *Id.* at 593.

[123] *Id.* at 592.

would be inappropriate to enforce an arbitration clause in a patent licensing agreement.[124]

V. Securities Law

In 1953, the Supreme Court decided *Wilko v. Swan*,[125] and held invalid an arbitration clause in an agreement by a customer to purchase securities from a securities brokerage firm. The Court rested its decision on a statute—the provision of the Securities Act of 1933 that declares void "any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter . . . ."[126] An agreement to arbitrate, it was held, is a stipulation to waive the securities buyer's right to select the forum in which to litigate Securities Act disputes.[127]

Because the invalidity of an arbitration clause in securities cases has a direct statutory source, it is in a category distinct from other public policy prohibitions of agreements to arbitrate future disputes. The definitive holding in *Wilko* undoubtedly stifled judicial analysis of the issue well before the public policy doctrine had developed in other areas. Absent the statute, and especially the now entrenched statutory interpretation, the issue would not be free of difficulty.

In *Wilko v. Swan*, the Supreme Court advanced two principal reasons for treating an agreement to arbitrate as a stipulation to waive a securities buyer's rights under the 1933 Act. The second of these reasons, that judicial direction is necessary to ensure that the Act is correctly applied,[128] is of little merit. As has already been noted, the possibility that an arbitrator will misapply the law is present in every arbitration proceeding, and the nature of arbitration generally insulates such errors from judicial review.[129] So long as both the arbitrators and the underlying law are working to achieve justice between the parties, the risk of error is not, and should not be, particularly disturbing. Arbitration has been recognized as an acceptable mechanism for the resolution of disputes despite the risk of errors of law, and no persuasive reason has been advanced for treating differently the possibility of legal error in securities law cases.[130]

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[124] No reported cases have yet ruled on the enforceability of an agreement to arbitrate an existing patent dispute. By analogy to antitrust cases, such agreements should probably be enforced. *See* note 96 *supra* & accompanying text.

[125] 346 U.S. 427 (1953).

[126] 15 U.S.C. § 77n (1976).

[127] 346 U.S. at 434-35.

[128] *Id.* at 435-37.

[129] *See* notes 26 & 27 *supra* & accompanying text.

[130] *See* Fallick v. Kehr, 369 F.2d 899, 903 (2d Cir. 1966), where Judge Feinberg, writing for the court, noted: "Logically, if the possibility that an arbitrator may make an unreviewable

The first reason for the Court's holding, however, may not be disposed of so summarily. The Court stressed the potential inequality of bargaining power between buyers and sellers of securities, noting that "the Securities Act was drafted with an eye to the disadvantages under which buyers labor."[131] To compensate for these disadvantages, one of the rights provided the buyer is a nonwaivable right to a wide choice of courts. An agreement to arbitrate future disputes between buyer and seller would, the Court held, amount to a waiver of this right, and thus frustrate the congressional desire to redress the inequalities between the parties.[132]

It is beyond the scope of this Article to assess the Supreme Court's construction of Congress's intent in enacting the Securities Act. The suggestion that inequality of bargaining power requires invalidation of an arbitration clause in a contract, however, has implications that extend beyond the Supreme Court's reading of the Securities Act in *Wilko v. Swan*.

If inequality of bargaining power provides sufficient reason for invalidating arbitration agreements, little reason appears for limiting the doctrine to cases arising under the Securities Act. Countless commercial contracts containing arbitration clauses are made by parties with unequal bargaining power, frequently on standard forms. Perhaps these arbitration agreements also should not be enforced. In general, however, this approach has not been taken,[133] much as contracts of adhesion have not been held invalid as a matter of general contract law. A special exception for securities law cases, then, appears questionable.

That exception may be justified, however, on the ground that securities agreements as a class tend to involve inequality of bargaining power. The inequality stems in large measure from the much greater frequency with which securities sellers—typically professionals—as compared to securities buyers, enter into securities transactions. As a result, it is likely that an agreement will be memorialized in the seller's standard form, and the buyer is unlikely to pay much

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error of law alone justifies enjoining one arbitration, it requires enjoining all." *See also In re* Revenue Properties Litigation Cases, 451 F.2d 310, 313-14 (1st Cir. 1971).

[131] Wilko v. Swan, 346 U.S. at 435.

[132] *Id.*

[133] *See* Weinrott v. Carp, 32 N.Y.2d 190, 199, 298 N.E.2d 42, 48, 344 N.Y.S.2d 848, 856 (1973), where the court said of arbitration clauses: "[W]here a form contract is involved . . . a court should give the provision and the circumstances surrounding its inclusion in the contract great scrutiny." The court did not, however, indicate that arbitration clauses in form contracts or contracts between parties of unequal bargaining power would automatically be invalid. *See generally* M. Domke, *supra* note 2, at 41-44.

heed to matters as apparently trivial as arbitration clauses. It will not be worth the buyer's while to consider the benefits of an arbitration clause in an isolated agreement to purchase securities; it will be worth the seller's while to consider the benefits of arbitration in connection with the many similar transactions conducted by the seller each day. By treating securities agreements as a class and concluding that, for the most part, arbitration clauses involved in those agreements are not the product of free negotiations between the parties, case-by-case adjudication of the issue can be avoided. The treatment of clauses in contracts generally can be understood as exemplifying the contrary assumption that the parties are in a position to negotiate freely over the clause, even if in fact they do not do so in each individual case. Although neither assumption is universally true, each rule is tailored to the more common situation, thus avoiding the need for case-by-case inquiry into the process that led to inclusion of the arbitration clause.

The public policy involved when one party is in a position to impose an arbitration clause on the other is a basic one: No one should be deprived of access to the courts unless that party has satisfactorily demonstrated a willingness to give up such access. It bears emphasis that the rationale just articulated for refusing to enforce agreements to arbitrate securities law disputes has no relationship to the content of the securities laws. The same argument could be made, with equal or greater persuasiveness, to forbid enforcement of arbitration clauses in, for example, residential leases. The argument is not that freely negotiated agreements to arbitrate Securities Act issues should not be enforced, but instead that arbitration clauses in agreements to purchase or sell securities are unlikely to be freely negotiated.

Enforcement of arbitration clauses that are the product of unequal power presents two problems. First, as stated, potential litigants ought not to be deprived of access to judicial redress without adequate demonstration of a willingness to forego the judicial process. Second, parties with greater bargaining power, by insertion of an arbitration clause naming the arbitrators or providing for a favorable means of selecting them, may be able to ensure that the arbitrators will be predisposed toward a particular result.[134] Although arbitrators are generally required to be impartial,[135] there are few checks on arbitra-

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[134] *See, e.g.*, text accompanying note 166 *infra*.

[135] Some arbitration agreements provide for each party to select one arbitrator with the third to be selected by the other two. In such arbitrations, the arbitrators selected by the parties need not be strictly neutral, although they may not "act prejudicial to the interests of the other party." M. DOMKE, *supra* note 2, § 20.03, at 197. As the New York Court of Appeals has stated:

> Our decision that an arbitrator may not be disqualified solely because of a relationship to his nominator or to the subject matter of the controversy does not,

tors who are less than neutral decisionmakers. The concern of courts with the partiality of arbitrators, however, could be alleviated somewhat by enforcing arbitration agreements between parties of unequal bargaining power only when the method of selecting the arbitrators is unlikely to place the weaker party at a disadvantage.[136]

Another public policy might be asserted in support of the result in *Wilko*. It can be argued that the securities laws were enacted not merely to protect securities buyers from imposition by sellers, but also to reestablish public confidence in the securities market. This would appear to be a policy designed to do more than work justice between securities buyers and sellers. To the extent that the securities laws are so designed, however, they achieve that purpose by protecting buyers from imposition by sellers, most often by adjusting the legal rights of the parties in a manner that better works justice between them.[137] Similarly, to the extent that the securities laws are designed to preserve public confidence in the markets by deterring potential violators, they generally do so by working justice between buyers and sellers—unlike the antitrust laws, which deter violations by imposing penalties on violators beyond the damages actually incurred. There appears, then, to be no conflict of method between furthering the purposes of the securities laws and attempting to work justice between buyer and seller. This public policy furnishes no reason to refuse enforcement of arbitration clauses in securities sales agreements.

The conclusion that the rule of *Wilko* is based primarily on recognition that arbitration clauses in securities sales agreements generally are not freely negotiated is bolstered by the exceptions to the rule that have developed. It has been held that arbitration of disputes between stock exchange members pursuant to stock exchange rules

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however, mean that he may be deaf to the testimony or blind to the evidence presented. Partisan he may be, but not dishonest.

Astoria Medical Group v. Health Ins. Plan of Greater N.Y., 11 N.Y.2d 128, 137, 182 N.E.2d 85, 89, 227 N.Y.S.2d 401, 407 (1962).

[136] There would remain the concern that even when the selection process is neutral in appearance, the party with greater bargaining power or greater familiarity with the arbitration process would be better able to select favorably disposed arbitrators. *See also* note 9 *supra*.

[137] Rules of law are commonly designed to achieve public as well as private purposes. For example, contracts, while enforced primarily to work justice between contracting parties by satisfying the expectations created by the contract, may also be enforced to improve the economic health of society by encouraging mutually beneficial trade, which would be much more difficult to carry out without the security that contract law provides. But this secondary, public purpose can be achieved quite well by developing rules directed towards treating equitably the parties to an agreement. Such public purposes provide no occasion to refuse enforcement of arbitration agreements.

does not violate the Securities Act.[138] Member firms may also be bound, at the instance of nonmembers, to arbitrate disputes with nonmembers, also pursuant to exchange rules.[139] These exceptions have been supported by the underlying rationale of the *Wilko* decision—the need to compensate for the disadvantages borne by securities buyers as a class.[140] Stock exchange members labor under no such disadvantages, and the courts have responded to this difference by refusing to extend them special protection. It is significant, however, that the substantive Securities Act issues involved in disputes between stock exchange members may be no different from those held not arbitrable under the *Wilko* doctrine. There is nothing inherent in the laws regulating securities transactions or the policies behind them that makes arbitration inappropriate. Instead, the factual context within which those legal issues arise justifies application of the *Wilko* rule.

In *Scherk v. Alberto-Culver Co.*,[141] the Supreme Court carved yet another exception to the *Wilko* rule. At issue was an agreement by an American company to purchase European business entities from a German citizen. The agreement contained a broad arbitration clause providing for arbitration before the International Chamber of Commerce in Paris. Suit was brought in federal court by the American buyer alleging violation of the Securities Exchange Act of 1934. The Supreme Court declined to apply the *Wilko* rule, holding that in an international agreement raising potential conflict-of-laws problems, an arbitration clause should be enforced even if securities law issues may be involved.[142] The Court distinguished *Wilko* by noting that the advantage provided the securities buyer by the *Wilko* rule—the right to a wide choice of venue—would be chimerical, because the foreign seller "may by speedy resort to a foreign court block or hinder access to the American court of the purchaser's choice."[143]

The Supreme Court in *Scherk* was thus willing to enforce an agreement to arbitrate a controversy arguably governed by American securities law. Both the inquiry into the applicability of the securities laws and the application of those laws were left to arbitrators. The

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[138] Coenen v. R.W. Pressprich & Co., 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972); *In re* Revenue Properties Litigation Cases, 451 F.2d 310 (1st Cir. 1971); Brown v. Gilligan, Will & Co., 287 F. Supp. 766 (S.D.N.Y. 1968).

[139] Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d 838 (2d Cir. 1971).

[140] *See* Coenen v. R.W. Pressprich & Co., 453 F.2d at 1213-14; Axelrod & Co. v. Kordich, Victor & Neufeld, 451 F.2d at 842-43; *In re* Revenue Properties Litigation Cases, 451 F.2d at 312; Brown v. Gilligan, Will & Co., 287 F. Supp. at 771.

[141] 417 U.S. 506 (1974).

[142] *Id.* at 515-20.

[143] *Id.* at 518.

Court appears to have recognized that in large international transactions, in contrast to domestic securities purchases, providing a mutually agreeable forum for dispute resolution is likely to be a carefully negotiated part of the agreement, and not the product of unequal bargaining power. The rationale for the *Wilko* rule is thus inapplicable.

The foregoing analysis demonstrates that nothing inherent in securities disputes makes them unsuitable for arbitration. The public policy that prevents enforcement of agreements to arbitrate future disputes over securities purchases is derived from the need to protect securities buyers from imposition of terms by securities sellers. The rule is a statutory one, and is applied with discrimination to enforce arbitration agreements in circumstances where it is likely that they are the product of negotiation rather than imposition. The wisdom of the blanket rule adopted in *Wilko* is not beyond question, but the disadvantages of a case-by-case approach to deciding whether an arbitration clause was a product of inequality of bargaining power, are significant. In any event, the doctrine of *Wilko* rests on a foundation fundamentally different from the other public policy prohibitions on enforcement of arbitration agreements.

VI. ERISA Claims

In two recent cases,[144] it has been contended that an agreement to arbitrate all disputes arising out of termination of employment is not binding on an employee who seeks to litigate issues arising under the Employee Retirement Income Security Act of 1974. In one case the contention was rejected; in the other, it was not.

Each case arose out of a dispute between Merrill Lynch, a New York Stock Exchange member, and a former employee of Merrill Lynch who left its employ to work for a competitor. The Merrill Lynch pension plan provided for forfeiture of benefits by participants who engaged in competition with Merrill Lynch. In each case, the employee had agreed to be bound by the Rules of the New York Stock Exchange, which at the time the dispute over pension benefits arose, contained a provision for arbitration of all disputes. In each case, plaintiff brought suit seeking damages for breach of obligations imposed by ERISA.[145]

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[144] Fox v. Merrill Lynch & Co., 453 F. Supp. 561 (S.D.N.Y. 1978); Lewis v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 431 F. Supp. 271 (E.D. Pa. 1977).

[145] In *Fox*, other claims were also advanced, 453 F. Supp. at 563, but they were stayed pending resolution of the arbitrable claims. *Id.* at 567.

In the first case, *Lewis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[146] the court emphasized the close analogy between ERISA and the securities laws, and concluded that, as with the securities laws, prospective agreements to arbitrate ERISA claims should not be enforced.[147] The court noted that ERISA contained a provision declaring void as contrary to public policy "any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part,"[148] and another section affording plaintiffs liberal jurisdictional and venue provisions.[149] The statutory scheme was thus compared to the scheme on which the Supreme Court based its decision in *Wilko*.[150] The court recognized that, as in *Wilko*, a prospective agreement to arbitrate might be held void under the statute because it relieves a fiduciary of the liability to answer a suit brought under the liberalized venue and jurisdiction provisions.[151]

At the same time, the court was unwilling to rely on the statutory provisions alone, because the statute voids only "any provision . . . which purports to relieve a *fiduciary*," and arbitration was sought in *Lewis* not only by fiduciaries, but by the plan itself and its administrators.[152] The court, therefore, invoked other cases, including antitrust and Civil Rights Act cases, which held unenforceable prospective agreements to arbitrate future disputes.[153] Particularly stressed was the purpose of ERISA, to protect pension plan participants and beneficiaries:[154] "[I]f ERISA claims were subject to arbitration agreements, employers could require such agreements as conditions to participation in the pension plan, thereby . . . frustrating the congressional purpose. . . ."[155]

In *Fox v. Merrill Lynch & Co.*,[156] the *Lewis* case was distinguished on the ground that in *Fox*, no claim was being asserted against any fiduciaries, and the statutory argument used in *Lewis* was therefore unavailable.[157] The court went on, however, to reject the

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[146] 431 F. Supp. 271 (E.D. Pa. 1977).
[147] *Id.* at 275-76.
[148] *Id.* at 276 (quoting Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1110(a) (1976)).
[149] *Id.*
[150] 346 U.S. 427 (1953).
[151] 431 F. Supp. at 276-77.
[152] *Id.* at 276 (emphasis added).
[153] *Id.* at 277.
[154] *Id.*
[155] *Id.*
[156] 453 F. Supp. 561 (S.D.N.Y. 1978).
[157] *Id.* at 565-66.

nonstatutory public policy argument advanced in the *Lewis* case, reasoning that, unlike the antitrust cases, the ERISA dispute involved only a private contractual obligation requiring the resolution of no complex issues, and presented no substantial risk that the arbitrators would be biased in favor of the pension plan or its administrators.[158] Arbitration was, therefore, permitted to proceed.

In a sense, the arguments advanced by both courts are persuasive. Judge Pollack, writing in the *Fox* case, was undoubtedly right in concluding that the reasons for refusing to enforce agreements to arbitrate prospective antitrust disputes are inapplicable to ERISA claims. ERISA is designed to work justice between the parties, much as the securities acts are so intended. Arbitrators, even when not bound by statute, can be expected to guard against injustice. ERISA is thus unlike the antitrust laws, in which justice between the parties will often be a secondary consideration.

At the same time, the result in the *Lewis* case can be justified on the same basis that has been applied to the Securities Act cases. Pension plans, even more than securities transactions, involve inequality of bargaining power and the grave potential for imposition of an arbitration clause by the stronger party on the weaker. An employee participating in a pension plan is not likely to know about, let alone object to, an arbitration provision included in his pension agreement. Again, however, it bears emphasis that this public policy rationale is quite different from the public policy used to refuse enforcement of arbitration agreements in other fields, since it does not relate to the substance of the law involved.

VII. Usury

In *Durst v. Abrash*,[159] a case decided before the public policy doctrine had been fully developed, the New York courts were faced with a motion to compel arbitration pursuant to an agreement to arbitrate disputes arising out of a contract to sell and repurchase stock. The seller of the stock brought a declaratory judgment action seeking a determination that the stock transaction was in fact a usurious loan agreement in disguise. Plaintiff resisted arbitration on the ground that the validity of the stock sale agreement was for the court to decide.

In refusing to compel arbitration, the court quickly distinguished issues of common law contract invalidity from issues involving public

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[158] *Id.* at 566.

[159] 22 A.D.2d 39, 253 N.Y.S.2d 351 (1964), *aff'd on opinion below*, 17 N.Y.2d 445, 213 N.E.2d 887, 266 N.Y.S.2d 806 (1965).

policy illegality.[160] The court did not hold that the arbitrators could not decide whether the agreement was binding. The analysis focused instead on the particular infirmity, usury, involved in the transaction at hand.

The court thus distinguished between most issues of contract validity—such as consideration and the Statute of Frauds—and the issue of usury. At first glance, the basic question in both appears to be the same: Have the parties entered into a binding contract? Differences emerge, however, when the reasons for treating an agreement as not binding are examined.

Many agreements are not binding because the parties have not complied with legal requirements designed to ensure that the parties did, indeed, agree to be bound. Various contractual requirements, including the requirements of a writing, of a seal, and of witnesses, are designed in large measure to ensure that the agreement was reached after due deliberation by the parties.[161] The requirement of consideration has been justified on similar grounds.[162] Such contractual requirements have little to do with the substance of the agreement, but instead provide the courts with reliable, objective indicia of agreement and of deliberation prior to the agreement. So long as the parties, by complying with the required formalities, could have bound themselves to the terms of the agreement, there is no reason for courts to prevent them from resolving any disputes over those terms by submitting to arbitration pursuant to a preexisting arbitration agreement that satisfies the requisite contract formalities. The parties may not, in fact, have agreed to be bound by the particular terms of the agreement at issue, but so long as they could have satisfied the requisite formalities of an enforceable agreement, the concern of the law in imposing such requirements is satisfied. The requirement of formalities does not extend beyond protecting one of the parties from the injustice of enforcing against him an agreement that was never intended by the parties to be enforced.[163] The interests involved in such rules are those of the parties themselves. Arbitrators are as equipped as judges to guard those interests.

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[160] *Id.* at 42, 253 N.Y.S.2d at 354.

[161] Professor Fuller labeled this the cautionary function of legal formalities. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 800 (1941). Professor Fuller also noted that these formalities perform an evidentiary function and a channelling function. *Id.* at 800-01.

[162] *See id.* at 816 & n.27 (quoting Austin, *Fragments on Contracts, printed in* 2 LECTURES ON JURISPRUDENCE 939, 940 (4th ed. 1873)).

[163] The situation is different of course, when there is no undisputed agreement to arbitrate. In that situation, even if the state has no interest in any particular resolution of the dispute at hand, there is no contractual basis for preventing either party from seeking redress.

Somewhat different issues are involved in legal rules that invalidate agreements, or terms of agreements, despite their conformity with all the requisite formalities. Thus, for example, an otherwise binding agreement will not be enforced if it is unconscionable. An argument could be made that since the parties cannot explicitly agree to an unconscionable agreement, they should not be permitted to evade a judicial declaration of unconscionability by inclusion of an arbitration clause in the agreement. The argument, however, is flawed. The unconscionability doctrine was developed to promote justice between two parties to an agreement, especially when the parties are of unequal bargaining power or of unequal ability to evaluate the terms of the agreement. Because arbitrators, too, are supposed to do justice, considerations of unconscionability are not likely to elude them.[164] No frustration of the legal system's efforts to control overreaching is likely to result from submission of such disputes to arbitration, at least so long as the agreement to arbitrate was not itself the product of overreaching.[165]

What, then, distinguishes usury from the typical contract case? First, borrowers as a class and small borrowers in particular are uniquely subject to imposition by potential lenders. A borrower in grave need of funds is unlikely to concern himself with the terms of an arbitration clause in a loan agreement drafted by the lender. As the *Durst* opinion warns, if arbitration clauses in usurious agreements were enforceable, "[a]ny one desiring to make a usurious agreement impenetrable need only require the necessitous borrower to consent to arbitration and also to arbitrators by name or occupation associated with the lending industry."[166] Even if the arbitration clause is not patently a device to subject the borrower to an unsympathetic decisionmaker,[167] the very position of the borrower and the probability

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[164] This situation should be distinguished from the concern about inequality in bargaining power expressed in the securities law section. *See* text accompanying notes 129-32 *supra*. There, the concern was that parties would be forced, as a result of inequality of bargaining power, to relinquish their right to resort to the courts. In the present context, there is a conceded agreement to arbitrate; the question is whether arbitrators are likely to consider whether the terms of the substantive agreement in dispute were imposed by one party on the other.

[165] Parties to arbitration have some statutory assurance that they will receive a fair hearing. Under the federal arbitration statute, an award may be vacated for, among other reasons, "evident partiality or corruption in the arbitrators," "misconduct . . . in refusing to hear evidence pertinent and material to the controversy," and any other arbitrator "misbehavior by which the rights of any party have been prejudiced." 9 U.S.C. §§ 10b-10c (1976). The vacation provisions of the New York statute appear in N.Y. CIV. PRAC. LAW § 7511 (McKinney 1980). *See generally* M. DOMKE, *supra* note 2, § 21.02.

[166] 22 A.D.2d 39, 44, 253 N.Y.S.2d 351, 355-56 (1964) (citation omitted), *aff'd*, 17 N.Y.2d 445, 213 N.E.2d 887, 266 N.Y.S.2d 806 (1965).

[167] In *Durst*, the court declined to decide whether the result would be the same were a usury issue to arise "with respect to a prior general agreement between parties to arbitrate all disputes

that he was unaware or unconcerned at the time of the agreement about waiving his rights to judicial recourse, might lead a court to refuse enforcement on much the same theory as that developed in *Wilko v. Swan* and subsequent Securities Act cases.

This hypothesis is bolstered by the memorandum opinion of the New York Court of Appeals in *Rosenblum v. Steiner*,[168] where the court refused, in a proceeding by the lender, to stay an arbitration proceeding instituted by the borrower. The court distinguished *Durst*, noting that usury prohibitions were designed to protect borrowers, not lenders.[169] If the court were principally concerned with ensuring a decision on the usury issue in accordance with the strict rule of law, it should not matter which party objects to arbitration. However, if protection of the borrowing class is the court's concern, the result in *Rosenblum* is unassailable.

There may be an additional reason for prohibiting arbitration of usury disputes. Usury is not always viewed solely as an offense against the borrower. As then Justice Breitel noted in the *Durst* case, "[t]he welter of legislation in this area makes clear that the concern is one of grave public interest . . . ."[170] Not only may a usurious loan be invalidated, but a usurer may be subject to criminal penalties in some states, including New York.[171] This tends to indicate a societal judgment that usury is an evil perpetrated not on the borrower alone, but on the society at large. The religious origins of usury prohibitions also

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which might arise between them. . . ." *Id.* at 43, 253 N.Y.S.2d at 355. The court treated the arbitration clause as subsidiary to and inseparable from the portions of the agreement that provided for usurious interest. Subsequent cases have treated separately the validity of an arbitration clause and the validity of other provisions in an agreement. Thus, if there is no question involving the validity of the arbitration clause, disputes over other provisions may be decided by arbitration rather than by courts, so long as the parties did not intend the arbitration clause to be inseparable from other provisions of the agreement. Prinze v. Jonas, 38 N.Y.2d 570, 576-77, 345 N.E.2d 295, 300, 381 N.Y.S.2d 824, 829-30 (1976); Weinrott v. Carp, 32 N.Y.2d 190, 198, 298 N.E.2d 42, 47, 344 N.Y.S.2d 848, 855 (1973); *see* Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 403-04 (1967). *Contra*, ILGWU v. Ashland Indus., Inc., 488 F.2d 641, 644 (5th Cir.), *cert. denied*, 419 U.S. 840 (1974). In other words, the arbitration clause can stand on its own. If it is valid, other disputes over the contract, even over the contract's validity, need not be litigated, but may be submitted to arbitration. On the other hand, if the arbitration clause is itself invalid, the courts may intervene.

[168] 43 N.Y.2d 896, 374 N.E.2d 610, 403 N.Y.S.2d 716 (1978).

[169] *Id.* at 898, 374 N.E.2d at 611, 403 N.Y.S.2d at 717. The difficulty with the argument, and with the analogy to the Securities Act cases, is the basic assumption of inequality of bargaining power between borrower and lender. While the assumption may be accurate with respect to some subset of loan transactions, particularly those involving consumers, it seems implausible to conclude that business borrowers as a class are at the mercy of lenders, although it is possible that the usury laws operate on that assumption. *But see* text accompanying notes 170-74 *infra*.

[170] 22 A.D.2d at 44, 253 N.Y.S.2d at 356.

[171] *See, e.g.*, N.Y. PENAL LAW § 190.40 (McKinney 1975).

indicate that overreaching by lenders is not the only evil against which usury law protects.[172]

Moreover, and perhaps more significantly, the usury laws, whatever their policy origins, do not always work justice between borrower and lender in a period of fixed usury rates and widely fluctuating interest rates. The would-be home buyer unable to obtain a mortgage, or the business borrower unable to finance an expansion, is unlikely to consider usury laws protective of his interests. Especially when usury ceilings are lower than or perilously close to market interest rates the "injustice" of usurious loans is likely to escape individual borrowers, lenders and the public at large. This is significant because so long as arbitrators attempt to promote justice between borrower and lender, they are unlikely to invalidate loans made at or near prevailing market interest rates, let alone enforce statutory penalties against usurers. Thus, to the extent the legal system is committed to imposing usury ceilings so low that they contradict justice between the parties, arbitration may be an inappropriate forum for resolution of usury claims. The public policy doctrine might properly be invoked because resort to arbitration is quite likely to frustrate the public policy against usury.

VIII. Liquidated and Punitive Damage Claims

Two New York cases have treated the problem of an arbitration award that provides damages conceded by the arbitrators to be more than compensatory. In *Associated General Contractors, New York State Chapter, Inc. v. Savin Brothers, Inc.*,[173] the New York Court of Appeals confirmed an arbitration award of treble liquidated damages pursuant to a liquidated damages clause in the agreement between the parties. In a subsequent case, *Garrity v. Lyle Stuart, Inc.*,[174] the same court, citing public policy considerations, vacated the portion of an arbitrator's award imposing punitive damages. The *Associated* case was distinguished, in one paragraph, on the ground that in that case the award of treble liquidated damages, characterized by the court in *Garrity* as a penalty, was expressly authorized by the agreement of the

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[172] *See* Deut. xxiii:20. *See also* Leviticus xxv:35-37. Implicit in the religious prohibition is the judgment that lending money at interest is morally wrong, whether or not such a loan would benefit the borrower. *See, e.g.*, Commonwealth v. Donoghue, 250 Ky. 343, 352, 63 S.W.2d 3, 7 (1933). To the extent that prohibition of usurious agreements, or gambling or prostitution agreements, for example, is based on a desire to maintain a moral code that extends beyond the interests of the parties to the transaction, enforcing arbitration agreements covering such transactions is likely to frustrate public policy.

[173] 36 N.Y.2d 957, 335 N.E.2d 859, 373 N.Y.S.2d 555 (1975).

[174] 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976).

parties.[175] The distinction is unpersuasive, however, and the *Garrity* case appears to be an unwarranted application of the public policy doctrine, although the decision might be supportable on other grounds.

The *Associated* case involved an arbitration clause in the membership agreement of a trade association that conducted collective bargaining negotiations on behalf of its members. The arbitration clause provided that damages for violations of membership obligations were to be assessed by the arbitrators in an amount, for each day the member was in violation, of no less than three times the daily liquidated damage amount provided in certain construction contracts to which the member was a party.[176] Savin Brothers, a member of the trade association, violated its membership obligations by withdrawing from the association during collective bargaining negotiations and negotiating a separate contract. The parties proceeded to arbitration, and the association received an award based on the treble liquidated damage clause in its membership agreement.[177] The arbitrators specifically determined that the damage clause was not a penalty.[178] The award was confirmed by the supreme court, and the judgment was affirmed in the appellate division and the court of appeals.

In *Garrity v. Lyle Stuart, Inc.*, publishing agreements between the author and the publisher of two books contained broad arbitration clauses. The agreements provided for neither liquidated nor punitive damages. After a dispute arose, the author brought an action, and then, three years later, brought a second action, which contended that an additional $45,000 in royalties had been wrongfully withheld since the initiation of the first action.[179] Defendant received a stay of the second action pending arbitration, and plaintiff served a demand for arbitration requesting $45,000 plus punitive damages for defendant's malice in withholding royalties, allegedly to coerce the plaintiff to withdraw the earlier action.[180] The arbitrators awarded plaintiff $45,000 in compensatory damages and $7,500 in punitive damages. The award was confirmed by the supreme court, and the appellate division affirmed. In this case, however, the court of appeals modified

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[175] *Id.* at 357, 353 N.E.2d at 795, 386 N.Y.S.2d at 833. For a general discussion of these cases, see Note, *Punitive Damages in Arbitration: The Search for a Workable Rule*, 63 CORNELL L. REV. 272 (1978).

[176] 36 N.Y.2d at 958, 335 N.E.2d at 859, 373 N.Y.S.2d at 555.

[177] *Id.* at 958, 335 N.E.2d at 859, 373 N.Y.S.2d at 556.

[178] *Id.*

[179] 40 N.Y.2d at 356, 353 N.E.2d at 794, 386 N.Y.S.2d at 832.

[180] *Id.*

to vacate the award of punitive damages. As in the *Associated* case, the decision was four to three.

It is important to recognize that in both *Associated* and *Garrity*, the issue was not whether arbitration should be stayed, but rather whether an existing arbitration award should be confirmed. In *Garrity*, in particular, no ground had existed upon which arbitration could have been stayed before award. At issue was an ordinary contract claim, albeit with a demand for punitive damages; but if such a demand could, standing alone, avoid enforcement of an arbitration clause, almost every arbitration of a contract dispute would be subject to at least some form of stay upon request of a party seeking to avoid the effect of his agreement or to delay resolution of the dispute. The *Garrity* case does not stand as authority for such a broad proposition.

The issue in *Garrity* arose not from the nature of the dispute, but from the nature of the arbitrator's award. The court concluded that the award of punitive damages contravened public policy. Unless the court intended no more than to encourage arbitrators to award punitive damages silently rather than explicitly, it could not have been the "punitive damages" label that required vacation of the award. Instead, it seems plausible that the court in *Garrity* was indicating that arbitration awards may be reviewed to ensure that a gross disparity does not exist between the injury suffered and the relief awarded. Neither in New York nor elsewhere in this country do arbitration statutes provide for such review; yet there have been cases dating back almost twenty years stating that arbitration awards may be vacated for "irrationality."[181] Perhaps that is the basis for the result in *Garrity*, despite its use of "public policy" language. The *Garrity* case cannot otherwise be distinguished convincingly from *Associated*. The question still remains, however, whether the result in *Associated* represents an appropriate reconciliation of the advantages of arbitration with other societal demands.

In breach of contract actions, penalties typically are not enforced and punitive damages are not assessed principally because the purpose of contract damages is to make the injured party whole, and not to deter or punish those who would breach.[182] According to modern

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[181] *See, e.g.*, Lentine v. Fundaro, 29 N.Y.2d 382, 385-86, 278 N.E.2d 633, 635-36, 328 N.Y.S.2d 418, 422 (1972); National Cash Register Co. v. Wilson, 8 N.Y.2d 377, 383, 171 N.E.2d 302, 305, 208 N.Y.S.2d 951, 955 (1960).

[182] *See generally* 5 A. CORBIN, CONTRACTS §§ 1002, 1057-1058, 1077 (1964); 5 S. WILLISTON, CONTRACTS § 776 (1961); 11 *id.* §§ 1338, 1340.

A thoughtful and persuasive attack on the traditional rule that "penalty" clauses should not be enforced was launched in Goetz & Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient*

teaching, it may often be economically efficient and socially desirable for one party to breach a contract and pay compensatory damages.[183] If the injured party receives a damage award that compensates him fully for the breach, law and justice require no more. As the court stated in *Garrity*, "[i]t has always been held that punitive damages are not available for mere breach of contract, for in such a case only a private wrong, and not a public right, is involved."[184]

If a court's responsibility in a breach of contract action is simply to right a private wrong, there is no reason to prohibit arbitrators from undertaking the same task.[185] Particularly when private rights alone are at issue, arbitration is most useful. In both *Garrity* and *Associated*, the arbitrators were charged with adjusting the rights of the parties. True, in each case the arbitrators were asked to award more than compensatory damages. But they were under no obligation to do so. If they enforced a penalty or awarded punitive damages, presumably they did so on the theory that such an award was not unjust to the parties to the arbitration. The arbitration awards may not have been in accord with the prevailing legal theories about the appropriate measure of damages for breach of contract.[186] Neverthe-

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Breach, 77 COLUM. L. REV. 554 (1977). The author argues, in particular, that the prevailing rule denies fair compensation to the breach victim with nonprovable idiosyncratic wants, and creates significant costs either by requiring the purchase of inefficient insurance, or suffering exposure to inaccurate damage awards.

[183] *See, e.g.*, R. POSNER, *supra* note 30, at 49; Barton, *The Economic Basis of Damages for Breach of Contract*, 1 J. LEGAL STUD. 277, 291 (1972).

[184] 40 N.Y.2d 354, 358, 353 N.E.2d 793, 795, 386 N.Y.S.2d 831, 833 (1976).

[185] If the compensatory damage remedy for breach of contract were based primarily on considerations other than doing justice between the parties, that is, if contract actions were not viewed as essentially private disputes, the analysis might be different. Thus, one might hypothesize that compensatory damages are awarded for breach of contract not because they provide the most just remedy, but because a compensatory damages sanction for breach provides the greatest possible encouragement for each party to maximize his own economic opportunities without harming the other party. If this economic efficiency basis for contract damages were accepted, it might be important to the society at large that compensatory damages only, no more and no less, be awarded in each breach of contract case, regardless of justice between the parties. Perhaps, with such basis for contract law, arbitration of any contract dispute would be inappropriate. However, even if the basis for the compensatory damages remedy were economic efficiency, not justice between the parties, there would be little reason to decline to enforce arbitration agreements so long as the compensatory damages remedy does in fact provide a just remedy to the parties. The risk that enforcing arbitration agreements would frustrate the public interest in economic efficiency would be small so long as the arbitrators attempted to do justice between the parties. *See* note 9 *supra*.

[186] The New York rule prohibiting punitive damages in breach of contract actions is not universally accepted. *See* Simpson, *Punitive Damages for Breach of Contract*, 20 OHIO ST. L.J. 284 (1959), indicating that in a "growing minority of states, punitive damages are allowed in breach of contract cases where the breach is accompanied by a fraudulent act or some other intentional wrong, insult, abuse or gross negligence amounting to an independent tort, aggravated by malice, wantonness, or oppression." *Id.* at 284.

less, so long as the dispute is a private one, the award should not be subject for that reason to vacation by the courts.

Moreover, if every agreement providing for liquidated damages or a penalty were subject to judicial review either before or after arbitration, the potential for delay in resolving disputes would be great. Since liquidated damage clauses are relatively common, many agreements to arbitrate would be affected. This consideration, too, supports the result in *Associated.* A limited review of the arbitration award to ensure against "irrationality" could, perhaps, be instituted in extreme cases, but a general judicial review of questions involving penalties or punitive damages is unwarranted.

Emphasized should be the distinction between cases like *Garrity*, where punitive damages are awarded or penalties enforced contrary to the law in what is essentially a private dispute, and cases which require, for public policy reasons, an award of exemplary or punitive damages. Arbitration in the latter class of cases, which for example includes antitrust cases, is inappropriate because the arbitrators, seeking to do justice between the parties, would frustrate the public policy involved even if the disputes were resolved fairly to the parties. Successful and just arbitration of the dispute would thus fail to advance the more encompassing public policies and interests at stake in the dispute. By contrast, when the arbitrators of an essentially private dispute award damages that are more than compensatory, it is only because they are acting incorrectly, that is, because they are poorly assessing the just resolution of the dispute, that the award may be objectionable. But mere error of law by the arbitrators is no reason for vacating an arbitration award. If it were, there would be no finality to the arbitration process, and little incentive to arbitrate any disputes.

Some disputes, it must be recognized, are neither so private as an ordinary contract action nor so imbued with public policy as an antitrust case. For example, some contract disputes could possess elements which, depending on the proof offered, could lead a court to award punitive damages to serve as a deterrent against similar activity in the future. If deterrence is the basis for the rule sanctioning punitive damages, as it is likely to be, that basis has little to do with achieving justice between the parties. Consequently, it might appear that because of the possibility that punitive damages could be awarded in a court, the dispute should not be permitted to go to arbitration.

This solution is probably unwarranted. Most contract disputes, other than those involving statutory provisions requiring more than compensatory damages, will not warrant an award of punitive dam-

ages. The need for a punitive damage award, even in the comparatively rare instances in which it might be justified, is not likely to be established until the proof has been heard. To permit a party to a contract dispute to avoid an arbitration clause by seeking punitive damages would diminish the value of the clause in most cases, all for the sake of deterrence in the relatively few cases in which a punitive damages award would be appropriate. Especially since neither the public policy involved nor the deterrent effect of a punitive damage award are likely to be very strong, at least in the absence of a statutory command, these cases should probably not be withheld from arbitration.[187] Moreover, because a court award of punitive damages is unlikely to be made in the absence of some form of gross abuse by the breaching party, arbitrators, too, in such cases might be quite generous to the victim of the breach.[188] The arbitration award in the *Garrity* case itself serves to illustrate that arbitrators—even if for reasons other than the desire to deter similar conduct in the future—are not oblivious to the guile and malice of the breaching party.[189]

Because the court viewed the *Garrity* case as a purely private dispute, and one that should never have involved questions of punitive damages, these complexities were not involved. The chief difficulty faced in *Garrity*, then, was that the arbitrators, seeking to do justice between the parties to a purely private dispute, had awarded the injured party more damages than would have been available in an action at law. In agreeing to arbitration, however, the parties took the risk that the arbitrators might not adhere strictly to law, since arbitrators are under no obligation to do so.

The courts, following *Garrity*, may place some limits on the risk the parties may assume in agreeing to arbitration, by exercising the power to review arbitration awards for irrationality. But an award of punitive damages should not by itself require that the award be

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[187] *Cf.* text following note 133 *supra* (individual cases may be treated like the representative cases of the larger class to which they belong).

[188] A compensatory damages remedy may be viewed as just and economically efficient, because if one party encounters a more favorable economic opportunity that causes him to breach the contract, an award of compensatory damages will leave no one worse off. The victim of the breach is compensated for his losses, and the breaching party reaps the advantage of the favorable opportunity. If the breach is accompanied by other wrongful or malicious acts of the breaching party, an award of more than compensatory damages might also be viewed as just, and would still be economically efficient, so long as the breaching party is left no worse off than if he had not breached. This can be accomplished by awarding the victim of the breach not merely compensatory damages, but also the value, or some portion of the value, of the favorable economic opportunity taken by the breaching party. *See* Goetz & Scott, *supra* note 182, at 558-59. It would not be at all surprising to find that arbitrators, attempting to work justice between the parties, take such an approach.

[189] 40 N.Y.2d at 360, 353 N.E.2d at 797, 386 N.Y.S.2d at 835 (Gabrielli, J., dissenting).

vacated. So long as the dispute is a private one and the arbitrators seek to do justice, it is not for the courts to conclude that the arbitrators' conception of justice should be disregarded merely because it differs from their own. No public policy requires the evaluation of equities by a court to prevail over that of the arbitrators.

IX. Bankruptcy

The public policy doctrine has been invoked to avoid enforcement of arbitration clauses when one of the parties to the contract has become involved in bankruptcy proceedings. Two questions have arisen in such cases. The first is whether, after a personal bankruptcy, a creditor of the bankrupt may invoke an arbitration clause in a preexisting contract to seek a determination that the prebankruptcy debt has not been discharged. The second is whether a trustee in bankruptcy seeking to recover assets for the bankrupt's estate can be required to submit claims to arbitration because the parties against whom the claims are asserted had, before bankruptcy, entered into agreements to arbitrate all disputes with the bankrupt.

The Second Circuit addressed the first question in *Fallick v. Kehr*.[190] Kehr sued Fallick for misappropriation of partnership funds. Fallick moved to compel arbitration pursuant to a clause in the partnership agreement, and Kehr then abandoned the action and submitted to arbitration. Arbitration was stayed when Fallick filed a voluntary bankruptcy proceeding, but after Fallick was discharged in bankruptcy, Kehr attempted to reactivate the arbitration proceeding, asserting that his claim was not affected by the discharge. Fallick moved before the bankruptcy referee for a permanent stay of arbitration, and for a ruling that the claim was discharged; his motion was denied, as was his petition for review of the referee's order.

A divided panel of the Second Circuit affirmed, relying heavily, by analogy, on the limited discretion of the bankruptcy courts to enjoin suit in state court on a discharged debt only "under unusual circumstances."[191] The court declined to hold that as a matter of law, a threat of arbitration of the discharge issue requires the intervention of a bankruptcy court. Such a hard and fast rule, the court concluded, could be based only on "distrust of the arbitration process, or on an overriding policy of the Bankruptcy Act or on both."[192] Because state courts are permitted to determine the issue of dischargeability, the court reasoned, there can be no overriding bankruptcy

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[190] 369 F.2d 899 (2d Cir. 1966).

[191] *Id.* at 902.

[192] *Id.* at 903.

policy requiring adjudication by the bankruptcy court. And, of course, the court disclaimed any hostility towards the arbitration process. There could be no objection, therefore, to arbitration of the discharge issue.

The difficulty with the court's syllogism, as Judge Friendly recognized in dissent, is that, unlike a state court, an arbitrator is "possibly without knowledge of law and free in any event to 'fashion the law to fit the facts' before him."[193] Permitting arbitrators to decide the issue of dischargeability may frustrate bankruptcy policy in a way that permitting determination in a state court will not, because the state court is ultimately subject to review by the Supreme Court, while the arbitrator's determination is final.

The finality of the arbitrator's decision is not, of course, sufficient reason to prohibit arbitration. As the majority correctly stated, "[l]ogically, if the possibility that an arbitrator may make an unreviewable error of law alone justifies enjoining one arbitration, it requires enjoining all."[194] Because arbitrators are entrusted to reach just results in most cases, errors of law are tolerated.

The issue at stake in *Fallick*—the effect of a bankruptcy discharge on a preexisting claim—has, however, nothing to do with justice between the parties. There is no particular justice, as between debtor and creditor, in permitting a debtor to avoid his debt simply because he has incurred enough other debts that the prospect of repaying them all is slim. The bankrupt may be the recipient of some societal sympathy, but the arbitrator's view of justice might not include depriving a creditor of his due from one who has regained, or may regain in the future, the financial ability to repay his debts.

The Bankruptcy Act, however, "expresses a strong legislative desire that deserving debtors be allowed to get a fresh start."[195] The societal stigma long associated with bankruptcy would appear to indicate that not everyone has a charitable view of debtors, even "deserving" debtors, seeking relief from their justly acquired obligations. Indeed, attempts to avoid particular debts have raised the ire even of courts bound to enforce the bankruptcy laws.[196] Arbitrators charged with doing justice, and bound by rules of law, may be even less sympathetic to the purposes of the Bankruptcy Act, especially as applied in individual cases. To hold that discharge issues should not be

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[193] *Id.* at 905 (Friendly, J., dissenting).

[194] *Id.* at 903.

[195] *Id.* at 904.

[196] *See, e.g.*, State v. Wilkes, 41 N.Y.2d 655, 659-60, 363 N.E.2d 555, 558-59, 394 N.Y.S.2d 849, 852 (1977) (dischargeability of student loan).

determined by arbitrators should not require, as the majority in *Fallick* would have it, "[a] strong suspicion that an arbitrator would ignore the Act and thwart the purpose of discharging debtors."[197] It should be sufficient that the purpose of the Bankruptcy Act—the desire to provide debtors with a fresh start—has little to do with equitably adjusting the rights of debtors and creditors. So long as the aim of arbitration is to achieve such equitable adjustment, there is no reason to assume that an arbitration award will reflect the congressional intention to provide the debtor with a fresh start. For this reason, the issue of discharge is an inappropriate one for the resolution of arbitrators.

A different question was reached by the same court eleven years later in *Allegaert v. Perot*,[198] involving a scheme by H. Ross Perot, a controlling stockholder in duPont Glore Forgan Inc. (DGF), to transfer DGF's liabilities to duPont Walston Inc. (Walston), while using Walston's assets to pay DGF's expenses. Within a year, the scheme resulted in Walston's bankruptcy. The trustee in bankruptcy, alleging violations of duties imposed by the common law, federal securities and bankruptcy acts, and state statutes, brought suit against Perot, DGF, several other Perot-controlled entities, the Walston directors who voted in favor of implementing Perot's scheme, and the New York Stock Exchange. Most of the defendants moved to stay the action pending arbitration. Reliance was placed on three clauses requiring arbitration of disputes between Walston and the defendants. Two of the clauses were contained in stock exchange constitutions, and the third in one of the agreements realigning Walston and DGF. The motion to stay was granted in federal district court, and the trustee in bankruptcy appealed.

The Second Circuit reversed, concluding that the trustee could not be compelled to arbitrate the bankruptcy and securities claims. The analysis focused on the difference between the position of the bankrupt and that of the trustee in bankruptcy.[199] In particular, Judge Feinberg, speaking for the court, noted that the trustee's Bankruptcy Act claims "are statutory causes of action belonging to the trustee, not to the bankrupt, and the trustee asserts them for the benefit of the bankrupt's creditors, whose rights the trustee enforces."[200] The court emphasized the creditors' interest in the claims at issue, and noted that creditors were not parties to any of the

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[197] 369 F.2d at 904.
[198] 548 F.2d 432 (2d Cir.), *cert. denied*, 432 U.S. 910 (1977).
[199] *Id.* at 435-37.
[200] *Id.* at 436.

arbitration agreements. The court also observed that the nature of the evidence likely to be relevant made a judicial forum, with its greater assurance of the availability of discovery, preferable to arbitration. That argument, however, was given little prominence in the opinion.[201]

The crux of the matter is, as the court recognized, that the dispute was no longer solely between the parties to the arbitration agreement. As a result of Walston's bankruptcy, neither Walston as an entity nor its stockholders had any significant interest, let alone the only interest, in the outcome of the dispute. The possibility was remote that enough would be realized from the trustee's suit to satisfy creditor claims and leave a surplus for the stockholders. The real parties in interest were the creditors, even if the litigation was brought in the name of the trustee in bankruptcy, the successor in interest to the bankrupt corporation.[202] Under such circumstances, public policy is appropriately invoked to prevent enforcement of the arbitration agreement to the possible detriment of creditors who never agreed to arbitration.

Distinguished in the *Allegaert* case was *Fallick v. Kehr*, relied upon by the defendants.[203] The court noted that in *Fallick* the dispute over the effect of the discharge involved not the trustee in bankruptcy, acting on behalf of the bankrupt's creditor, but only the original parties to the arbitration agreement.[204] The distinction is sound in its recognition that the substitution of the trustee for the

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[201] *Id.* at 436-37.

[202] It is probably true in general that creditors will be better off if a debtor prevails in a lawsuit that brings the debtor more money. The more assets the debtor has, the more assurance a creditor has of payment. The creditor's benefit, however, is much more indirect than in the bankruptcy situation. For instance, the debtor has no obligation to use any particular assets for repayment of creditors, and the debtor is not obligated to take actions only in the creditors' best interest. The creditors, then, are not nearly so directly concerned with litigation involving an ordinary debtor as they are with litigation involving a trustee in bankruptcy.

A similar distinction was recognized in Knickerbocker Agency, Inc. v. Holz, 4 N.Y.2d 245, 149 N.E.2d 885, 173 N.Y.S.2d 602 (1958), in which debtors of an insurance company in liquidation sought unsuccessfully to compel arbitration of disputes with the company according to the terms of a preexisting arbitration agreement. The court said:

> As between Preferred [the insurance company] and petitioners [debtors], arbitration could have been compelled. With the onset of Preferred's insolvency and liquidation, however, the rights of creditors, indeed, the interests of policyholders, stockholders and the public, intervened. . . . It was at that time that the . . . contractual provision relating to arbitration became of no effect.

Id. at 251, 149 N.E.2d at 889, 173 N.Y.S.2d at 607 (citation omitted).

[203] 548 F.2d at 438.

[204] In addition, the court indicated that in *Fallick*, it had relied in part on the "Congressional lack of concern over use of a non bankruptcy court forum to decide" bankruptcy issues. The court noted that since the *Fallick* case, the Bankruptcy Act had been amended. *Id.* at 438 n.14.

bankrupt alters the nature of the dispute. Because the rights of another class of interested parties, the bankrupt's creditors, would be affected by the arbitration, the arbitrators would be deciding issues that extend beyond the scope of justice between the parties. Creditors who never agreed to arbitration should not lose their right to a judicial determination of their rights solely because the bankrupt himself had earlier agreed to submit future disputes to arbitration. Especially when, as in *Allegaert*, the trustee challenges the bankrupt's right to make the agreement in which one of the arbitration clauses appears, it would make little sense to bind the trustee, and consequently the creditors, to the bankrupt's agreement to arbitrate.

Because the parties to the arbitration agreement are not the parties whose rights would be determined in an arbitration proceeding seeking to recover assets for the bankrupt's estate, the arbitrators would be forced to determine questions that extend beyond the rights of the parties to the arbitration agreement. Public policy should, and does, forbid enforcement of the arbitration agreement in these circumstances.

At the same time, even when, as in *Fallick*, the parties to an arbitration agreement are the same parties whose rights would be affected by an adjudication of the discharge issue, public policy should prevent enforcement of arbitration agreements when at issue is a rule of law designed to effectuate some societal policy other than working justice between the parties to a dispute. Because the Bankruptcy Act provisions allowing discharge of a bankrupt's debt are designed not to promote just resolution of disputes between creditor and debtor, but instead to provide debtors with a "fresh start," even at the expense of just and deserving creditors, arbitration is an inappropriate forum for resolving the issue of discharge.

The common element in *Fallick* and *Allegaert*, then, is that the issues in each case transcend the need to work justice between the parties to the arbitration agreement. In *Allegaert*, the court recognized the problem; in *Fallick*, it apparently did not. Nevertheless, a footnote in *Allegaert* provides hope that with the current provisions of the Bankruptcy Act, the *Fallick* case might now be decided differently.[205] Certainly, the rationale of cases decided after *Fallick* in areas other than bankruptcy, even cases in the Second Circuit, indicate that *Fallick* was wrongly decided.[206]

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[205] *Id.*

[206] *See, e.g.*, American Safety Equip. Corp. v. J.P. Maguire & Co., 391 F.2d 821 (2d Cir. 1968).

X. Other Areas

Parties seeking to avoid the effect of an arbitration agreement have invoked the public policy doctrine in a variety of other areas, as well. Although beyond the scope of this Article because of the differences between commercial arbitration and arbitration pursuant to a grievance procedure in a collective bargaining agreement,[207] it bears mention that public policy has frequently been invoked, with considerable success, to prevent arbitration of certain disputes between public employers and employees.[208] These cases have been decided largely on the ground that a statutory policy exists forbidding the public employer, usually a school district, to delegate some of the authority vested in it by law.[209] Thus, in New York, because a school district may not delegate its authority to grant or deny tenure to a teacher, if a grievance arises over the denial of tenure, arbitrators will not be permitted to award tenure to a teacher, however aggrieved.[210]

Outside the labor arbitration context, public policy has been asserted, and rejected, to avoid arbitration in a variety of situations.[211] In *Sprinzen v. Nomberg*,[212] a union employee, when his employment began, had signed an agreement containing a covenant

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[207] *See* note 13 *supra*.

[208] *See, e.g.*, Cohoes City School Dist. v. Cohoes Teachers Ass'n, 40 N.Y.2d 774, 358 N.E.2d 878, 390 N.Y.S.2d 53 (1976) (teacher tenure); School Comm. of Hanover v. Curry, 369 Mass. 683, 343 N.E.2d 144 (1976) (abolition of a school position); Board of Educ., School Dist. No. 205 v. Rockford Educ. Ass'n, 3 Ill. App. 3d 1090, 280 N.E.2d 286 (1972) (selection or promotion of employees). The invocation has frequently failed, as well, depending upon the issue involved. *See, e.g.*, Port Jefferson Station Teachers Ass'n v. Brookhaven-Comsewoque Union Free School Dist., Inc., 45 N.Y.2d 898, 383 N.E.2d 553, 411 N.Y.S.2d 1 (1978) (size of specialist staff); Susquehanna Valley Cent. School Dist. v. Teachers Ass'n, 37 N.Y.2d 614, 339 N.E.2d 132, 376 N.Y.S.2d 427 (1975) (staff size).

[209] *See, e.g.*, Board of Educ., School Dist. No. 205 v. Rockford Educ. Ass'n, 3 Ill. App. 3d at 1093, 280 N.E.2d at 287 ("[A] board may not, through a collective bargaining agreement or otherwise, delegate to another party those matters of discretion that are vested in the board by statute.").

[210] Cohoes City School Dist. v. Cohoes Teachers Ass'n, 40 N.Y.2d 774, 358 N.E.2d 878, 390 N.Y.S.2d 53 (1976).

[211] There are a number of older cases in which "public policy" prohibition or illegality have been accepted as reasons for prohibiting arbitrations or vacating awards. *See* Black v. Cutter Labs., 43 Cal. 2d 788, 278 P.2d 905 (1955), *cert. dismissed*, 351 U.S. 292 (1956) (award reinstating employee accused of being a Communist vacated as against public policy); Franklin v. Goldstone Agency, 33 Cal. 2d 628, 204 P.2d 37 (1949) (illegality prevents unlicensed contractor from arbitrating dispute); AVCO Corp. v. Preteska, 22 Conn. Supp. 475, 174 A.2d 684 (Super. Ct. 1961) (award reinstating employee accused of gambling offenses vacated). *But see* Staklinski v. Pyramid Elec. Co., 6 N.Y.2d 159, 160 N.E.2d 78, 188 N.Y.S.2d 541 (1959) (award enforcing long-term employment agreement of corporate officer upheld). Because these decisions were made before judicial suspicion of the arbitration process had eased, it is submitted that they do not merit further analysis.

[212] 46 N.Y.2d 623, 389 N.E.2d 456, 415 N.Y.S.2d 974 (1979).

that restricted his right to "engage in organizing workers" for five years after termination of his employment, and provided for the arbitration of all disputes. When the employer-union sought arbitration of a dispute over an alleged violation of the restrictive covenant, the employee first challenged the impartiality of the arbitrator and, failing in that challenge, walked out of the proceedings. On the employee's motion to vacate an award in favor of the employer, the New York Court of Appeals held that public policy neither prevents arbitration of disputes involving restrictive employment covenants nor requires vacating an arbitration award specifically enforcing the covenant. The court concluded "that the arbitrator had the power to pass upon the issue of both the reasonableness and the necessity of the restrictions imposed upon the employee."[213]

As the New York Court of Appeals had earlier noted, "[s]ince there are 'powerful considerations of public policy which militate against sanctioning the loss of a man's livelihood,' the courts will subject a covenant by an employee not to compete with his former employer to an 'overriding limitation of "reasonableness." ' "[214] Whatever incidental public interest in competition might be furthered by invalidating restrictive covenants, it is concern for the covenantor's loss of a livelihood, not any generalized public interest, that is the principal factor in invalidating restrictive covenants.[215] The employee's right to practice his trade must be balanced against the employer's need to protect himself from diversion of business by an erstwhile employee using the contracts and good will established as a result of his employment. A "reasonableness" limitation is thus imposed to insure that an overzealous employer will not restrict forever an employee's right to earn a living. This is simply a matter of justice between the parties—a judicial creation to avoid overreaching which

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[213] *Id.* at 632, 389 N.E.2d at 460, 415 N.Y.S.2d at 979.

[214] Karpinski v. Ingrasci, 28 N.Y.2d 45, 49, 268 N.E.2d 751, 753, 320 N.Y.S.2d 1, 4 (1971).

[215] This is best illustrated by noting the judicial willingness to sustain restrictions on direct competition, but not on indirect competition. The public interest is undoubtedly greater in assuring direct competition and invalidating restrictions on it. *See also* Blake, *Employee Agreements Not to Compete*, 73 HARV. L. REV. 625 (1960):

> For many decades the rule for all covenants not to compete was stated in terms of their being reasonable if they were no broader in scope than was necessary to protect the covenantee, and if they caused no substantial injury to society. As applied to employee restraints, any consideration of the employee's interests had to be smuggled in under the second clause. Today, although this formulation is still occasionally repeated, the recognized method of decision is that of balancing the employer's claims to protection against the burden on the employee. Once the judgment is made, almost never does a court proceed to consider possible injury to society as a separate matter.

Id. at 686 (footnotes omitted).

might have disastrous consequences for an employee. Arbitrators seeking to do justice are likely to have the same considerations in mind. Because the rule of law and the process of arbitration are designed to achieve the same goals, public policy should not prevent arbitration of disputes over restrictive covenants.

In *Flower World of America, Inc. v. Wenzel*,[216] a franchisee brought an action asserting that his franchisor had violated the Arizona Consumer Fraud Act by engaging in deceptive practices and making misrepresentations during negotiation of the franchise agreement. The franchisor sought arbitration, but the franchisee resisted, arguing principally that public policy prohibited arbitration of claims based on the Consumer Fraud Act.[217] The court rejected the argument that all claims based on regulatory statutes must be litigated in the courts and not arbitrated, and noted that the dispute involved was essentially a private one.

The Arizona Consumer Fraud Act does not on its face provide for a private right of action. By its terms, the attorney general is to enforce the statute. Prior to the *Flower World* case, however, the Supreme Court of Arizona held that a private right of action was authorized.[218] In effect, as the court in the *Flower World* case noted,

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[216] 122 Ariz. 319, 594 P.2d 1015 (Ct. App. 1978).

[217] *Id.* at 321, 594 P.2d at 1017. In his complaint, the franchisee also requested punitive damages. *Id.* at 320, 594 P.2d at 1016. The court did not deal separately with the status of the punitive damage claim in arbitration. Because the Arizona Consumer Fraud Act, ARIZ. REV. STAT. ANN. §§ 44-1521 to -1534 (1967), does not treat explicitly private rights of action, save only to preserve any private claims arising out of acts prohibited, *id.* § 44-1533, punitive damages are not mentioned in the statute, either.

In Sellinger v. Freeway Mobile Home Sales, Inc., 110 Ariz. 573, 521 P.2d 1119 (1974) (en banc), however, the Supreme Court of Arizona had held both that the consumer fraud statute created a private right of action, and that punitive damages were available to plaintiffs "where the conduct of the wrongdoer is wanton, reckless or shows spite or ill will, Lufty v. R.D. Roper & Sons Motor Co., 57 Ariz. 495, 115 P.2d 161 (1941), or where there is a reckless indifference to the interests of others, McNelis v. Bruce, 90 Ariz. 261, 367 P.2d 625 (1961)." 110 Ariz. at 577, 521 P.2d at 1123. The *McNelis* opinion states that punitive damages are "not to compensate the plaintiff . . . but rather to punish the defendant." 90 Ariz. at 269, 367 P.2d at 630.

Were punitive damages to be awarded routinely for violations of the Arizona Consumer Fraud Act, there might be strong reason for refusing to enforce preexisting arbitration clauses when such violations are at issue. Then, the statute's usefulness, even in private actions, would largely be in enforcing obligations to the public at large and deterring antisocial behavior, not in adjusting private rights between the parties. This view of the Act, however, is inconsistent with the view of the Arizona court in the *Flower World* case: "This is essentially a private dispute arising out of a commercial transaction when the parties have agreed how to settle such disputes. . . ." 122 Ariz. at 323, 594 P.2d at 1019. To the extent that Arizona courts view the consumer fraud act as a mechanism for enforcing public rights, arbitration under the statute might be inappropriate.

[218] Sellinger v. Freeway Mobile Home Sales, Inc., 110 Ariz. 573, 521 P.2d 1119 (1974). The court relied upon § 44-1533 of the Act: " 'The provisions of this article shall not bar any claim against any person who has acquired any monies or property, real or personal, by means of any

the statute as interpreted codifies and expands common law fraud concepts.[219]

To the extent the statute is viewed as a substitute or supplement to common law fraud actions, no reason appears for prohibiting arbitration of disputes that fall within its purview. The statute redresses injustice inflicted upon one party by the deceptive practices of the other. An arbitrator would undoubtedly be similarly sensitive to that injustice. Only if the private right of action under the statute is viewed as a method of vindicating a more general public right, might there be a genuine question as to arbitrability. But, first of all, Arizona does not leave vindication of public rights solely to private lawsuits, but relies instead on the attorney general to redress whatever public grievances might arise.[220] More important, however, in this situation, whatever public interest there might be in preventing deception is similarly an interest of the deceived party. Unlike the antitrust situation, where the public interest protected by the regulatory statutes may be different from and antithetical to the interests of both parties, the interests of the public under the Arizona Consumer Fraud Act may be served by arbitration that does justice between the parties. Authorizing the attorney general, on behalf of the public, to act against deceptive practices does not change the underlying purpose of the statute—to prevent injustice by outlawing deceptive practices. Arbitration, if agreed to by the parties, should thus serve as an appropriate substitution for court adjudication.

Attempts have also been made, without success, to invoke the public policy doctrine to avoid enforcement of arbitration agreements

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practice declared to be unlawful by the provisions of this article.' " 110 Ariz. at 576, 521 P.2d at 1122.

[219] 122 Ariz. at 322 nn.1 & 2, 594 P.2d at 1018 nn.1 & 2.

[220] The Supreme Court of Arizona justified permitting a private right of action by citing a federal case authorizing a private right of action based on a penal statute. The court quoted from Wyandotte Transp. Co. v. United States, 389 U.S. 191, 202 (1967):

> In [cases that implied a private right of action from a penal statute] we concluded that criminal liability was inadequate to ensure the full effectiveness of the statute which Congress had intended. Because the interest of the plaintiffs in those cases fell within the class that the statute was intended to protect, and because the harm that had occurred was of the type that the statute was intended to forestall, we held that civil actions were proper.

110 Ariz. at 576, 521 P.2d at 1122. Emphasized, then, was the legislative desire to protect not only the public at large but wronged individuals as well. The Arizona court went on to note that "[w]ithout effective private remedies the widespread economic losses that result from deceptive trade practices remain uncompensable." 110 Ariz. at 576, 521 P.2d at 1122. At best, then, the private right of action, while primarily designed to compensate private plaintiffs, also serves as a supplement to, not a substitute for, proceedings by the attorney general to vindicate public rights.

in construction contracts covered by the Miller Act,[221] which requires contractors on most large federal government projects to post a payment bond for the protection of laborers and materialmen. It has been contended that the Act's provision conferring on the federal courts exclusive jurisdiction over Miller Act claims evidences a public policy forbidding enforcement of arbitration agreements between general contractors and subcontractors.[222] The courts have recognized, however, that the jurisdictional provision was designed not to protect subcontractor-plaintiffs, but to assure contractor-defendants a convenient forum—the federal district court in the district in which the contract was to be performed and executed.[223] The purpose of the Miller Act jurisdictional provision, then, unlike the jurisdictional provision in the Securities Act, is not to prevent overreaching by a stronger party against a weaker one. Instead, the provision conditions the rights granted by the Act to the weaker party, by affording the stronger party assurance of suit in a convenient forum. There is little reason to prevent the stronger party from waiving this protection; the rationale of *Wilko v. Swan*,[224] based on inequality of bargaining power, does not extend to this situation. The jurisdictional provision, then, provides no basis for failure to enforce an arbitration agreement between subcontractor and contractor.

Moreover, the Miller Act does not alter common law and contractual rights and liabilities between the parties except to make certain that funds are available to satisfy whatever liabilities the contractor incurs.[225] The Act thus expresses no intention to do anything other than to ensure that justice between the parties is achieved. If the parties have agreed to arbitrate disputes, that agreement is not inconsistent with the purposes of the Miller Act. The courts, therefore, have properly permitted arbitration of Miller Act claims.

Conclusion

"Public policy" should prevent enforcement of arbitration agreements only in two instances. First, in those limited instances in which

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[221] 40 U.S.C. §§ 270a-270c (1976).

[222] *See id.* § 270(b) (1976). *See generally* United States v. Electronic & Missile Facilities, Inc., 364 F.2d 705, 706 (2d Cir.), *cert. dismissed*, 385 U.S. 924 (1966).

[223] *See* United States v. Electronic & Missile Facilities, Inc., 364 F.2d 705, 707 (2d Cir.), *cert. dismissed*, 385 U.S. 924 (1966). *But cf.* Wilko v. Swan, 346 U.S. 427, 431 (1953) (Court concluded that jurisdictional provisions in Securities Act were designed to protect securities buyers, not sellers).

[224] 346 U.S. 427 (1953).

[225] The predecessor statute to the Miller Act was originally enacted to protect laborers and materialmen who would be protected by state lien laws but for the inapplicability of those laws to federal property. *See* United States v. Ansonia Brass & Copper Co., 218 U.S. 452, 471 (1910).

a statute is enacted to protect one class of contracting parties from imposition of contractual terms by another class of contracting parties with greater bargaining power, it may be that public policy should prevent enforcement of arbitration clauses in contracts between parties of the two classes. This public policy rests not on the legal nature of the dispute between the parties, but on the principle that arbitration agreements should not be enforced when there is substantial reason to believe that one party has never willingly agreed to relinquish the right to seek relief from the courts.

Second, and probably more important, public policy should prevent enforcement of arbitration agreements when the dispute involves statutes or other legal rules designed to achieve ends other than doing justice between the parties to a dispute. Because arbitrators are charged with promoting justice between the parties, there is little reason to prevent arbitration of disputes involving statutes similarly designed, albeit with greater particularity, to promote justice between the parties. Only when the dispute involves a statute or legal rule with a different purpose, focusing on interests other than those of the parties to the dispute, is arbitration inappropriate. An arbitrator cannot at the same time do justice between the parties and apply a legal rule that directs him not to do so.

The analysis in this Article does not answer all questions or solve all problems relating to the enforceability of arbitration agreements. In particular, it does not identify every public policy that could justify refusal to enforce agreements to arbitrate. In some cases, such as antitrust and child custody cases, the public policy behind the legal rules is strong, and the incompatibility of those rules with arbitration designed to work justice between the parties is clear. In other cases, it may be more difficult to identify the purposes of the legal rules, and thus to determine whether disputes involving those rules touch sufficient interests beyond those of the parties to a private dispute to contradict enforcement of an arbitration agreement. Certainly, not all legal rules have a component of public interest sufficient to preclude enforcement of arbitration agreements; if they did, arbitration agreements would be of little value.[226] Precisely where future lines will be drawn is uncertain. This Article attempts, at least, to suggest some guideposts.

The current statute retains the same purpose. *E.g.*, United States v. H.R. Morgan, Inc., 542 F.2d 262, 265 (5th Cir. 1976), *cert. denied*, 434 U.S. 828 (1977).

[226] Many rules of private law have some public component. *See, e.g.*, note 137 *supra*. If mere assertions of some public interest were enough to prevent enforcement of an arbitration agreement, few agreements would be immune from attack. Moreover, as has been noted, *see* note 137 & text following note 220 *supra*, in many instances, the public interest in the dispute can be given effect by working justice between the parties. In those instances, at least, there is no reason to prevent arbitration.