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United States Arbitration Act—Stay of Proceedings--Declaration of National Law—Fraud as an Arbitrable Issue.—Robert Lawrence Co., Inc. v. Devonshire Fabrics, Inc.

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be built into the declining balance method and need not be considered by the taxpayer.[12]

The Hertz Corporation has applied for and been granted certiorari in the United States Supreme Court.[13] It is submitted that the Third Circuit's interpretation of useful life could have been better substantiated by consideration of the fundamental concept of depreciation. The depreciation deduction should effect the distribution of the cost of a tangible capital asset over its estimated useful life in a systematic and rational manner. The deduction should seek to set off the cost of an asset against the income produced by it during its life. Actual physical life of an asset, if different from the holding period of the taxpayer, should be irrelevant.

The ability of the taxpayer to depreciate the asset below a reasonable salvage value is of great importance as a capital gain tax would be paid on any gain arising from the sale of the asset while depreciation is charged against ordinary income. The Supreme Court's problem in this issue will be to weigh the importance of the capital gain to the taxpayer on the sale of the depreciated property against the need for additional tax revenue. Whatever the final decision, it is probable that Congress has not spoken its last word on the subject.

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United States Arbitration Act—Stay of Proceedings—Declaration of National Law—Fraud as an Arbitrable Issue.—***Robert Lawrence Co., Inc. v. Devonshire Fabrics, Inc.***[1]—A Massachusetts buyer brought an action for damages in the United States District Court for the Southern District of New York, jurisdiction being grounded on diversity of citizenship, for alleged fraud in the inducement of a purchase agreement requiring interstate shipment of goods. The disputed contract, made in New York with a New York seller, contained an arbitration clause covering "any complaint, controversy, or question which may arise." The defendant seller moved to stay the legal proceedings pending arbitration, relying on § 3 of the United States Arbitration Act.[2] The District Court denied the motion,

[12] Sen. Rep. No. 1622, 83rd Cong., 2d Sess. 201 (1954) which in essence says that salvage value is not applicable because at the expiration of the useful life there remains an undepreciated balance which represents salvage value; Sen. Rep. No. 1622, 83rd Cong., 2d Sess. 203 (1954) which in substance states that the limitation of a three year life was placed on the declining method so that the asset could not be completely depreciated in the year of purchase.

[13] 361 U.S. 811 (1959).

[1] 271 F.2d 402 (2d Cir. 1959), cert. granted 28 U.S.L. Week 3259 (1960).

[2] 9 U.S.C. §§ 1-14 (1958). The legislation was first enacted in 1925; 43 Stat. 883 (1925), 9 U.S.C. §§ 1-15 (1946). It was enacted into positive law by Act, July 30, 1947, c. 392, 61 Stat. 670, without changing any of its provisions and designated officially as Title 9 U.S.C.

The heart of the Act is contained in §§ 2, 3, 4. § 2 makes "valid, irrevocable, and enforceable" written provisions for arbitration in contracts involving interstate commerce and maritime transactions; § 3 provides for a stay of action in federal courts

holding there could be no finding of an agreement to arbitrate until it was judicially resolved whether there was fraud in the inception of the contract as alleged. On appeal, the Court of Appeals for the Second Circuit reversed. HELD: § 2 of the Arbitration Act declaring arbitration agreements affecting commerce or maritime affairs "valid, irrevocable, and enforceable" is a declaration of national law equally applicable in state or federal courts, and questions as to validity and interpretation of arbitration agreements are substantive questions governed by federal rather than state laws. § 2 is to be construed as treating an agreement to arbitrate as a separable part of the contract. The arbitration clause was broad enough to encompass the issue of fraud in inducement, and since there was no allegation that the clause itself had been induced by fraud, arbitration must be had.

The court purports to answer questions left open by the Supreme Court in *Bernhardt v. Polygraphic Co. of America, Inc.*;[3] the "critical issue" for determination in the instant case being whether federal law, i.e. the rules fashioned by the federal courts under authorization of the United States Arbitration Act, or local law governs with respect to the validity and interpretation of the arbitration clause. The conclusion requiring the application of federal law is based primarily upon a determination that Congress intended to create a new body of substantive law relative to arbitration agreements affecting interstate commerce or maritime transactions.[4] It is especially true where the Act makes agreements to arbitrate "valid, irrevocable, and enforceable;" thus the Act creates federal rights which arise out of the exercise by the Congress of its constitutional power to regulate commerce, thereby precluding consideration in diversity cases of serious constitutional questions which might present themselves under the doctrine of *Erie R.R. v. Tompkins*.[5] Such a finding has hitherto never been precisely determined.[6]

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of issues referable to arbitration under those contracts; and § 4 provides motion proceedings to obtain a general order against a recalcitrant party to proceed to arbitration in compliance with the agreement.

[3] 350 U.S. 198 (1956).

[4] See statements to this effect in Local 205, United Electrical Radio & Machine Workers of America v. General Electric Company, 233 F.2d 85, 96 (1st Cir. 1956), aff'd, 353 U.S. 547 (1957), (where jurisdiction was grounded on § 301 of the Taft-Hartley Act [LMRA, 61 Stat. 156 (1947)] holding that federal substantive law applies not only to § 301 but also to Arbitration Act; however, the court's conclusions respecting the application of the Arbitration Act were later implicitly overruled); Wilson & Co., Inc. v. Fremont Cake & Meal Co., 77 F. Supp. 364 (D. Neb. 1948), (indicating that Congress has occupied the field where arbitration clause involves commerce or maritime matters); Jackson v. Kentucky River Mills, 65 F. Supp. 601, 603 (E.D. Ky. 1946), aff'd, 206 F.2d 111 (6th Cir. 1953), cert. denied, 346 U.S. 887 (1953), (holding that within the scope of § 2 [maritime, commerce] federal rather than state law is applicable). See also, Cox, Grievance Arbitration In The Federal Courts, 67 Harv. L. Rev. 591, 598 n.24 (1954); Sturges, Some Confusing Matters Relating To Arbitration Under The United States Arbitration Act, 17 Law & Contemp. Prob. 580 (1953).

[5] 304 U.S. 64 (1938); see, Pope & Talbot, Inc. v. Hawn, 346 U.S. 406, 410 (1953).

[6] Sturges, supra note 4; Kochery, The Enforcement Of Arbitration Agreements In The Federal Courts: Erie v. Tompkins, 39 Cornell. L.Q. 74, 78 (1953).

Formerly, the determination by the federal courts in diversity cases as to whether to apply local state law which might adhere to the common law rule of revocability and unenforceability of arbitration agreements,[7] or to apply the Arbitration Act appeared to depend upon the courts' characterization of the provisions of the Act as either "procedural and remedial" with the law of the forum controlling, or "substantive" in which case the law of the state would be applicable.[8] There appears to have been no comparable problem in the cases construing arbitration clauses in contracts entered into under specific federal statutes other than the Arbitration Act, the federal rule being almost automatically applied.[9] Prior to the decision in *Erie,* it was the prevailing rule that the means of enforcing an arbitration agreement properly fell in the category of remedy or procedure.[10] Subsequent to *Erie,* in diversity actions involving no federal question, the substantive law of the state in which the court sits must be applied.[11] Similarly, although remedial or procedural issues are for the forum's own law, questions otherwise classified as questions of remedy and procedure when they may "substantially affect the outcome" of the litigation must be determined in a diversity case according to state law.[12] *Bernhardt* declared that the Arbitration Act touched on substantive rights which *Erie* held were governed by local law, rather than a mere form of procedure within the power of the federal courts or Congress to prescribe. Thus, the procedure-substance dichotomy which has produced so much confusion in the federal courts[13] appeared resolved with respect to the enforceability[14] of an arbitration agreement, namely that the enforceability of an arbitration agremeent apart from the Arbitration Act "substantially affects the cause of action created by the State." *Bernhardt* also settled the question as to whether the pro-

[7] Vynior's Case 8 Co. Rep. 81b, 77 Eng. Rep. 597 (1609). Dictum enunciated by Lord Coke in 1609 to the effect that agreements for arbitration were specifically unenforceable, whereby the courts for two hundred and thirty-five years had sanctioned and attached the legal consequences of irrevocability to arbitration agreements.

[8] For a comprehensive examination of the substance-procedure dichotomy, see, Sturges, supra note 4, at 590-596; Kochery, supra note 6, at 76-78.

[9] Boston & Maine Transp. Co. v. Amalgamated Ass'n. 106 F. Supp. 334 (D. Mass. 1952); Voutrey v. General Backing Co., 39 F. Supp. 974 (E.D. Pa. 1941). Evolutionary development with respect to arbitration clauses in collective bargaining agreements under § 301 of the Taft-Hartley Act reaches its culmination in Textile Workers Union v. Lincoln Mills, 353 U.S. 448 (1957), where the court held that § 301 of the Taft-Hartley Act without the aid of the Arbitration Act authorized specific performance of arbitration agreements, and that federal substantive law is applicable under § 301. This fashioning of federal substantive law for the purpose of enforcing a federal act appears analogous to the instant case.

[10] E.g., California Prune & Apricot Growers' Ass'n v. Catz American Co., 60 F.2d 788 (9th Cir. 1932).

[11] Erie R.R. v. Tompkins, supra note 5.

[12] Guaranty Trust Co. v. York, 326 U.S. 99 (1945).

[13] Sturges, op. cit. supra note 4; Kochery, op. cit. supra note 6.

[14] The court in the instant case did not consider any tenable distinction existing between the enforceability of an arbitration agreement and questions of validity and interpretation of arbitration agreements with respect to their substantive effect. But see, e.g., The Silverbrook, 18 F.2d 144 (5th Cir. 1927).

visions of all sections of the Act extended to arbitration agreements covering controversies in addition to those arising out of "maritime transactions" or "commerce", concluding that the stay of proceedings provided in § 3 of the Arbitration Act reaches only those contracts covered by §§ 1 and 2, thereby narrowing the breadth of the Act to interstate commerce and admiralty matters.[15] The court in *Bernhardt* felt that the application of § 3 to diversity cases which do not involve commerce or maritime matters would raise the question as to whether under the *Erie* doctrine Congress has the constitutional authority to make the federal Act applicable to such cases.[16] Since the *Bernhardt* contract did not come within the two categories enumerated in the Arbitration Act, the court, fearing a head-on collision with *Erie*, left undetermined the questions whether in a diversity case involving commerce or maritime matters the newly characterized substantive feature of § 3 would preclude other than state law governing, or whether in its determination of the exclusiveness of the Act to commerce or maritime matters it intended to indicate the exercise of a congressional intent to create federal substantive law, under the commerce clause, applicable to arbitration agreements. The court's focus in *Bernhardt* on the possible substantive importance of arbitration might well lead to the conclusion that Congress intended the United States Arbitration Act to be applicable in state courts in cases involving arbitration agreements falling within the purview of the Act.[17]

An interpretation of the federal arbitration statute which involves the crucial problem of trying to determine whether a less than definitive exposition of law enumerated in the form of an act to require arbitration be given national substantive meaning by the courts necessarily hinges upon the judicial determination of a sufficient legislative intent that such exclusive meaning be given. The inquiry into the intent of Congress requires the courts to evaluate the necessity for federal law of national scope in light of state jurisdiction over arbitration agreements. Must Congress in the exercise of its vast powers under the Commerce clause, before it is free to employ the federal court system for the effectuation of the Arbitration Act, go the full length of displacing state substantive law? The process of evolution in the field of federal arbitration compels an affirmative response. Basically the result reached in the instant case merely flows as part of that evolutionary process favoring judicial recognition of arbitration agreements being made valid, enforceable, and irrevocable.

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[15] Prior to this determination a majority of courts had held that § 3 and other enforcement provisions of the Act were not limited by § 2 relating to commerce and admiralty, but that any arbitration agreement could be enforced if the federal court

[17] Bernhardt v. Polygraphic Co. of America, Inc., supra note 3, at 202-205; Cox, Cir. 1944).

[16] Sturges, op. cit. supra note 4; Kochery, op. cit. supra note 6.

[17] Bernhardt v. Polygraphic Co. of America, Inc., supra note 2, at 202-205; Cox, op. cit. supra note 4; see statements to this effect in the instant case at 405-406.