

**CASE NOTE: CONTRACTS—INTO THE VOID:
MINNESOTA LIMITS APPLICATION OF THE *PRIMA
PAINT* DOCTRINE—*ONVOY, INC. V. SHAL, LLC***

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*It is when merchants dispute about their own rules that they
invoke the law.*¹

I. INTRODUCTION

The observation of Justice Brett holds as true today as it did in the nineteenth century. During the course of contract negotiations, modern businesses frequently incorporate alternative dispute resolution (“ADR”)² provisions into their agreements as a

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1. *Robinson v. Mollett*, 7 App. Cas. 802, 817 (1875) (Brett, J., dissenting).

2. *ABC’s of ADR: A Dispute Resolution Glossary*, 10 ALTERNATIVES TO HIGH COST LITIGATION 115, 115 (1992) [hereinafter *Glossary*]. The most prevalent forms of ADR are the minitrial, mediation, med-arb, and arbitration. *Id.* at 115-16. The

way to settle conflicts without court involvement.³

One of the primary forms of ADR is arbitration. Arbitration is generally described as “[a] method of dispute resolution involving one or more neutral third parties who are usu[ally] agreed to by the disputing parties and whose decision is binding.”⁴ Parties prefer arbitration because it is less costly and less formal than litigation.⁵ Additionally, arbitration offers simpler rules, more flexible scheduling, and less disruption of dealings between parties.⁶

The arbitration process itself can take on a variety of forms.⁷ The most common are binding arbitration and non-binding arbitration.⁸ Binding arbitration involves selection by the parties of a neutral person or panel of three persons to hear the dispute and offer a final decision or award.⁹ During the process, the parties may establish their own rules of evidence and procedure.¹⁰ Under binding arbitration, awards are usually enforceable by the courts and not subject to appeal.¹¹ The process for non-binding arbitration is similar to that used in binding arbitration.¹² The major difference is that the neutral’s conclusion is merely advisory and may be used by the parties for future negotiations.¹³

However, inclusion of an arbitration provision in a contract does not guarantee the parties will use arbitration to resolve their

minitrial consists of two distinct processes. *Id.* at 116. First, parties exchange information and have an opportunity to hear the strong and weak points of their case and the cases of the other parties. *Id.* An attorney for each side then presents an abbreviated version of the case to representatives for each side who possess settlement authority. *Id.* The parties may then turn to negotiation, using a neutral advisor if desired. *Id.* Mediation is a voluntary and less formal procedure where the adversarial parties choose an impartial third party to help them reach a settlement. *Id.* Decisions reached in mediation are not binding, but rather serve to facilitate the process of negotiation. *Id.* Med-arb is an abbreviation for mediation-arbitration. *Id.* In med-arb, the parties pursue mediation, but agree to arbitrate any disputes not initially settled in mediation. *Id.* For a description of arbitration, *see* text *infra* Part I.

3. 4 AM. JUR. 2D *Alternative Dispute Resolution* § 1 (2000).

4. BLACK’S LAW DICTIONARY 79 (7th ed. 2000).

5. *Glossary*, *supra* note 2, at 115.

6. National Arbitration Forum, *Arbitration*, <http://www.arbforum.com/arbitration/index.asp> (last visited Nov. 12, 2004).

7. *Glossary*, *supra* note 2, at 115.

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

dispute. When a conflict arises over the use of arbitration, one of the parties will often turn to the judiciary for relief.¹⁴

In *Onvoy, Inc. v. SHAL, LLC*, the Minnesota Supreme Court recently examined an arbitration agreement in the context of a broader business lease.¹⁵ A specific provision in the lease provided for resolution of disagreements through arbitration.¹⁶ After a dispute arose under the contract, the parties argued over whether the conflict should be resolved under the arbitration clause or in court.¹⁷

Arbitration provisions are generally considered binding,¹⁸ and a significant body of authority exists supporting their enforcement.¹⁹ Minnesota courts also hold a strong presumption in favor of enforcing agreements to arbitrate.²⁰ However, a legitimate issue can be raised regarding these provisions. If the

14. See *Developments—The Paths of Civil Litigation*, 113 HARV. L. REV. 1851, 1863 (2000) [hereinafter *Developments*]. This type of dispute is common in business arrangements. Once a conflict arises, parties often argue over whether the problem should be handled by an arbitrator or heard in court. The answer depends on the wording of the arbitration clause, the type of dispute, and the jurisdiction that controls. See *infra* Part II.

15. 669 N.W.2d 344 (2003).

16. Fiber Optic Lease Agreement between Onvoy, Inc. and SHAL, LLC (Oct. 25, 1999) (on file with author) [hereinafter *Fiber Optic Lease*]. See also discussion *infra* Part III (explaining terms of the lease).

17. *Onvoy*, 669 N.W.2d at 347.

18. 9 U.S.C. § 2 (2000). Section 2 holds a written agreement to arbitrate a dispute involving commerce “shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.” *Id.* The U.S. Code is applicable here because the dispute between Onvoy and SHAL is governed under federal law. See discussion *infra* Part II.

19. See, e.g., 9 U.S.C. §§ 2-4 (2000); see also *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 64 (1995) (holding an arbitration award should be enforced “within the scope of the contract”); *Moses H. Cone Mem’l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983) (stating “questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration”); *David L. Threlkeld & Co. v. Metallgesellschaft Ltd.*, 923 F.2d 245, 248 (2d Cir. 1991) (noting “federal policy strongly favors arbitration as an alternative dispute resolution process”).

20. *Johnson v. Piper Jaffray, Inc.*, 530 N.W.2d 790, 795 (Minn. 1995). In *Johnson*, the supreme court noted that when considering a dispute over whether the parties agreed to arbitrate, Minnesota courts should resolve any questions in favor of arbitration “whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.” *Id.* at 795 (quoting *Moses H. Cone*, 460 U.S. at 24-25); see also *Heyer v. Moldenhauer*, 538 N.W.2d 714, 716 (Minn. Ct. App. 1995) (indicating where there is reasonable debate over the use of arbitration, the court should forward the issue to arbitration); 3 DUNNELL MINN. DIGEST *Arbitration and Award* § 1.00 (5th ed. 2000) (stating “[a]rbitration is a proceeding favored in the law”).

overall agreement itself does not exist, can a contract provision mandating arbitration still be valid? In *Onvoy*, the Minnesota Supreme Court crafted a solution that provides a balanced answer to this question.

This note first gives a brief overview of arbitration use in the United States.²¹ It then discusses the *Onvoy* decision²² and provides an analysis of the Minnesota Supreme Court's ruling.²³ Finally, the note concludes that the court's holding properly weighs Minnesota's strong presumption in favor of arbitration against the need to allow access to the courts.²⁴

II. HISTORY

A. Background

Many businesses now employ arbitration as a primary form of dispute resolution.²⁵ Arbitration is viewed as more streamlined and less costly than litigation.²⁶ Arbitration clauses are particularly common in commercial contracts involving construction, health care, entertainment, telecommunications, intellectual property, and technology.²⁷ However, arbitration as a form of dispute resolution has existed in America since the earliest days of settlement.²⁸ During both the Dutch and British colonial periods, merchants frequently resorted to arbitration as a faster and less expensive form of dispute resolution.²⁹ Use of arbitration also provided a less adversarial environment that favored continuing, mutually beneficial business relationships.³⁰ As early as the seventeenth century, businessmen in New York and Philadelphia

21. See *infra* Part II.

22. See *infra* Part III.

23. See *infra* Part IV.

24. See *infra* Part V.

25. See *Developments*, *supra* note 14, at 1855.

26. See 70 AM. JUR. *Proof of Facts* 3d § 379 (2003); Roger S. Haydock & Jennifer D. Henderson, *Arbitration and Judicial Civil Justice: An American Historical Review and a Proposal for a Private/Arbitral and Public/Judicial Partnership*, 2 PEPP. DISP. RESOL. L.J. 141, 179 (2002) (arguing that arbitration costs should be reasonable and proportional to the amount at stake to allow access to the system).

27. See *Developments*, *supra* note 14, at 1855-56.

28. Bruce L. Benson, *An Exploration of the Impact of Modern Arbitration Statutes on the Development of Arbitration in the United States*, 11 J.L. ECON. & ORG. 479, 481-82 (1995) [hereinafter Benson, *Development of Arbitration*].

29. *Id.* at 481.

30. *Id.* at 482.

began using arbitration as commerce developed between those cities.³¹ The New York Chamber of Commerce formed the country's first permanent independent board of arbitration in 1768.³²

As the nation continued to expand, so did the use of arbitration.³³ Mormons, as well as Chinese and Jewish immigrants, used arbitration instead of the courts as a response to perceived hostility from the broader community.³⁴ Minnesota acknowledged the existence of arbitration in its earliest state laws.³⁵

The U.S. Supreme Court first took a favorable view toward arbitration in *Hobson v. McArthur*.³⁶ *Hobson* involved a dispute over the appraisal of land.³⁷ The parties agreed to use three neutral appraisers as arbitrators to determine the value of a specific property.³⁸ When only two of the three arbitrators provided an estimate, the plaintiff brought suit.³⁹ The Court stated in interpreting the agreement, "we must look at what was the obvious intention of the parties. The parties clearly intended, that the valuation should, at all events, be made."⁴⁰ The fact that the third appraiser did not render an opinion was not sufficient to override the parties' intention to arbitrate.⁴¹

As a result, with *Hobson* the Court indicated arbitration provisions should be construed according to the intention of the parties.⁴² The ruling served notice on lower federal courts to stop searching for reasons to overturn arbitration awards on procedural grounds.⁴³

The Supreme Court's ruling in *Burchell v. Marsh* took things a

31. *Id.*

32. Ed Anderson & Roger Haydock, *History of Arbitration as an Alternative to U.S. Litigation*, WEST'S LEGAL NEWS, Aug. 12, 1996, available at 1996 WL 449743 [hereinafter Anderson & Haydock, *History of Arbitration*].

33. Benson, *Development of Arbitration*, *supra* note 28, at 481.

34. 4 AM. JUR. 2D, *supra* note 3, § 1.

35. MINN. STAT. ch. 96, § 1 (1851). "All controversies which might be the subject of personal action at law, or of a suit in equity, may be submitted to the decision of one or more arbitrators in the manner provided in this chapter." *Id.*

36. 41 U.S. 182 (1842).

37. *Id.* at 188.

38. *Id.*

39. *Id.* at 190.

40. *Id.* at 193.

41. *Id.*

42. *Id.* at 192-93.

43. Benson, *Development of Arbitration*, *supra* note 28, at 485-86.

step further.⁴⁴ In *Burchell*, a creditor sought reversal of an arbitration award favoring a debtor.⁴⁵ The Court upheld the award:

Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes, it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact. A contrary course would be a substitution of the judgment of the chancellor in place of the judges chosen by the parties, and would make an award the commencement, not the end, of litigation.⁴⁶

Burchell recognized that upholding the decision of an arbitrator respected the parties' intent under their contract.⁴⁷

B. *Modern Application*

Congress formally recognized arbitration when it passed the Federal Arbitration Act ("FAA") in 1925.⁴⁸ Prior to passage of the FAA, Federal courts had acknowledged arbitration agreements as an option, but viewed them as having no real force under the law.⁴⁹ Parties who wished to avoid agreements to arbitrate needed to merely refuse to proceed under the agreement, as courts would generally not order specific performance of the contract.⁵⁰ Additionally, the party obtaining an award under an arbitration clause was by no means guaranteed to receive it.⁵¹ The losing party would often contest the award in court through protracted litigation.⁵² Furthermore, courts in the United States continued to show reluctance toward private dispute resolution, even if the

44. 58 U.S. 344 (1854).

45. *Id.* at 346.

46. *Id.* at 349.

47. *Id.*

48. 9 U.S.C. §§ 1-16 (2000). "The FAA was Congress' response to the reluctance of federal courts to enforce arbitration agreements." Andre V. Egle, *Back to Prima Paint Corp. v. Flood and Conklin Manufacturing Co.: To Challenge an Arbitration Agreement You Must Challenge the Arbitration Agreement*, 78 WASH. L. REV. 199, 199 (2003).

49. Julius H. Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 270 (1926) [hereinafter Cohen & Dayton, *New Arbitration Law*].

50. *Id.*

51. *Id.*

52. *Id.* at 271.

parties had agreed on that course.⁵³ That all changed with passage of the FAA. The new law “reversed the hoary doctrine that agreements for arbitration are revocable at will and are unenforceable.”⁵⁴ The FAA solidified the validity of arbitration provisions and “place[d] arbitration agreements on par with other contracts.”⁵⁵

Also in the 1920s, several states passed arbitration statutes at the urging of arbitration groups and bar associations.⁵⁶ Interestingly, attorneys advocated passage of the laws in order to provide a place for themselves in the ADR process.⁵⁷ Many feared increasing use of arbitration would exclude them from their traditional dispute resolution activities, which would lead to reduced income.⁵⁸ Tailoring arbitration laws to facilitate attorney involvement guaranteed their continuing inclusion in the system.⁵⁹ In addition to encouraging attorney participation, the new statutes directed courts to recognize the validity of arbitration agreements and arbitration awards.⁶⁰ Minnesota followed this trend by adopting the Minnesota Arbitration Act (“MAA”) in 1957.⁶¹ Similar to the FAA, the MAA strongly advocates the use and validity of arbitration agreements.⁶²

With the development of arbitration statutes by so many jurisdictions, conflict between state and federal arbitration laws was inevitable. The U.S. Supreme Court addressed this issue in *Southland Corp. v. Keating*.⁶³ In *Southland*, several 7-11 franchisees

53. Anderson & Haydock, *History of Arbitration*, *supra* note 32.

54. Cohen & Dayton, *New Arbitration Law*, *supra* note 49, at 265.

55. Anderson & Haydock, *History of Arbitration*, *supra* note 32.

56. Benson, *Development of Arbitration*, *supra* note 28, at 481. The states included New York (1920), New Jersey (1923), Oregon (1925), Massachusetts (1925), Pennsylvania (1927), and California (1927). *Id.* Congress’ final version of the FAA nearly mirrors the New York and New Jersey arbitration statutes. Cohen & Dayton, *New Arbitration Law*, *supra* note 49, at 269.

57. Benson, *Development of Arbitration*, *supra* note 28, at 491-92.

58. *Id.*

59. *Id.*

60. *Id.* at 497.

61. MINN. STAT. § 572.08 (2002).

62. *Id.* The MAA states,

[a] written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable, and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Id.

63. 465 U.S. 1 (1984).

brought an action for fraud, misrepresentation, and breach of contract against their franchisor.⁶⁴ The California Supreme Court held the franchisees' claims could be heard under state arbitration law.⁶⁵ The U.S. Supreme Court reversed, and stated the FAA was controlling and served to preempt state laws that attempt to limit enforcement of arbitration provisions.⁶⁶

Nevertheless, a number of states continued to overlook *Southland* and apply their own laws to arbitration disputes.⁶⁷ Many jurisdictions looked to a loophole distinction of language in contracts either "involving" or "affecting" interstate commerce.⁶⁸ Inevitably, the Supreme Court provided the definitive jurisdictional solution in the 1995 case *Allied-Bruce Terminix Cos. v. Dobson*.⁶⁹ In *Terminix*, a homeowner sued an extermination company for inadequate termite removal and damage repair under their service contract.⁷⁰ The exterminator invoked the contract's arbitration clause, and asked for a stay to allow arbitration to proceed under Section 2 of the FAA.⁷¹ The lower court denied the stay, and the Alabama Supreme Court upheld the denial.⁷² The supreme court reasoned the FAA only would apply if the parties, at the time of contract formation, "'contemplated substantial interstate activity.'"⁷³

64. *Id.* at 1.

65. *Id.* at 2.

66. *Id.* at 15-16. In its opinion, the Court noted,

[t]he interpretation given to the [Federal] Arbitration Act by the California Supreme Court would therefore encourage and reward forum shopping. We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted. And since the overwhelming proportion of all civil litigation in this country is in the state courts, we cannot believe Congress intended to limit the Arbitration Act to disputes subject only to *federal*-court jurisdiction. Such an interpretation would frustrate congressional intent to place "[an] arbitration agreement . . . upon the same footing as other contracts, where it belongs."

Id. at 15 (internal citation omitted).

67. See discussion *infra* Parts II-III.

68. See *infra* note 75 and accompanying text.

69. 513 U.S. 265 (1995).

70. *Id.* at 268-69.

71. *Id.* at 269.

72. *Id.*

73. *Id.* (citing *Allied-Bruce Terminix Cos. v. Dobson*, 628 So. 2d 354, 355 (Ala. 1993) (quoting *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (2d Cir. 1961)), *cert. granted*, 510 U.S. 1190 (1994), *rev'd by* 513 U.S. 265 (1995)).

While Terminix was a multi-state firm, the court felt the parties anticipated a local and not an interstate transaction.⁷⁴ The U.S. Supreme Court disagreed. In its decision, the Supreme Court effectively preempted state law by holding the FAA applied to all transactions involving or affecting interstate commerce, regardless of whether the parties contemplated interstate commerce at contract formation.⁷⁵ From that point on, the FAA would govern any arbitration agreements relating to interstate commerce transactions throughout all fifty states.⁷⁶

A major issue that occurs in arbitration cases is interpretation of the arbitration clause as it relates to contract formation. Parties frequently clash over whether arbitration language aimed at resolving disputes “arising under” the agreement can be used to arbitrate questions regarding formation of the agreement itself. Several courts have stated the wording is in fact broad enough to

74. *Terminix*, 513 U.S. at 269.

75. *Id.* at 273-74. Specifically, the Court stated:

[W]e conclude that the word “involving” is broad and is indeed the functional equivalent of “affecting.” For one thing, such an interpretation, linguistically speaking, is permissible. The dictionary finds instances in which “involve” and “affect” sometimes can mean about the same thing. For another, the [FAA]’s legislative history, to the extent that it is informative, indicates an expansive congressional intent.

Id. (internal citations omitted).

The Court continued with:

[A] broad interpretation of this language is consistent with the Act’s basic purpose, to put arbitration provisions on “the same footing” as a contract’s other terms. Conversely, a narrower interpretation is not consistent with the [FAA]’s purpose, for (unless unreasonably narrowed to the flow of commerce) such an interpretation would create a new, unfamiliar test lying somewhere in a no man’s land between “in commerce” and “affecting commerce,” thereby unnecessarily complicating the law and breeding litigation from a statute that seeks to avoid it.

Id. at 275 (internal citation omitted). The Court had previously taken the position that states were required to apply the FAA when state law conflicted with federal law. See *Southland* discussion *supra* Part II. Many states disagreed with *Southland*, and in an effort to preserve state arbitration laws and limit the reach of the FAA, twenty state attorneys general joined respondent’s request to overturn the *Southland* decision in *Terminix*. *Terminix*, 513 U.S. at 272; Bryan L. Quick, *Keystone, Inc. v. Triad Systems Corporation: Is the Montana Supreme Court Undermining the Federal Arbitration Act?*, 63 MONT. L. REV. 445, 454 (2002).

76. Despite the *Terminix* ruling, both the district court and the court of appeals applied state law in reaching their decisions concerning the dispute between Onvoy and SHAL. *Onvoy, Inc., v. SHAL, LLC*, Nos. C7-02-621, C7-02-702, 2002 WL 31371961 (Minn. Ct. App. Oct. 22, 2002), *rev’d*, 669 N.W.2d 344 (Minn. 2003); see discussion *infra* note 132.

cover formation issues.⁷⁷ For example, in *Scherk v. Alberto-Culver Co.*, a manufacturer and a business owner entered into an agreement for the purchase of three business enterprises and their associated trademarks.⁷⁸ The parties then argued over whether their dispute involving an attempt to rescind the contract due to fraud should be heard in court or under the arbitration clause.⁷⁹ The Supreme Court determined the arbitration clause encompassed questions of formation.⁸⁰ The Third Circuit reached a similar conclusion in *Battaglia v. McKendry*.⁸¹ In *Battaglia*, a conflict arose between family members concerning settlement of a trust.⁸² Specifically, the parties disputed whether the arbitration provision contained in a settlement agreement was broad enough to cover questions concerning formation of the underlying agreement itself.⁸³ Again, the court determined the arbitration clause could address contract formation.⁸⁴

C. *The Prima Paint Doctrine*

Another issue can arise when one party seeks to use the courts instead of an existing arbitration agreement to settle a dispute. The most prominent example of this occurred in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*⁸⁵ In *Prima Paint*, two corporations from different states entered into a consulting agreement.⁸⁶ The consulting agreement contained an arbitration clause.⁸⁷ After a year of operating under the contract, Prima Paint

77. See cases cited *infra* notes 78, 81.

78. 417 U.S. 506, 507 (1974).

79. *Id.* at 506.

80. *Id.* at 519-20. The Court stated, “[W]e hold that the agreement of the parties in this case to arbitrate any dispute arising out of their international commercial transaction is to be respected and enforced by the federal courts in accord with the explicit provisions of the [Federal] Arbitration Act.” *Id.*

81. 233 F.3d 720 (2000).

82. *Id.* at 722-23.

83. *Id.* at 722.

84. *Id.* at 727. The court stated inclusion of phrases such as “arising under” and “arising out of” in arbitration provisions should be allowed “broad construction, and are generally construed to encompass claims going to the formation of the underlying agreements.” *Id.*

85. 388 U.S. 395 (1967).

86. *Id.* at 396.

87. *Id.* at 398. The clause stated “[a]ny controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration” in New York City and “in accordance with the rules then obtaining of the American Arbitration Association” *Id.*

contended that F & C had breached their agreement when Prima Paint discovered that F & C intended to file bankruptcy.⁸⁸ Prima Paint brought suit against F & C, alleging it had misrepresented its solvency, which in turn fraudulently induced Prima Paint to enter into the contract.⁸⁹

The case was originally heard in U.S. District Court.⁹⁰ Concurrent with filing of its complaint, Prima Paint also petitioned the district court for an order enjoining F & C from proceeding to arbitration.⁹¹ F & C filed a counter-motion asking the court to stay proceedings pending arbitration.⁹² The court granted F & C's motion, and held a charge of fraud in the inducement of a contract containing such a broad arbitration clause should be heard by an arbitrator, not the court.⁹³ Prima Paint appealed. The court of appeals affirmed, and indicated a claim of fraud in the inducement of the contract generally, as opposed to the arbitration clause specifically, should be heard by arbitrators, not the courts.⁹⁴ The court reasoned arbitration clauses are severable from the rest of the contract.⁹⁵ After considering the evidence, the Supreme Court affirmed.⁹⁶

The major impact of the Court's ruling in *Prima Paint* came in its reinforcement of the idea that arbitration clauses are severable from the rest of the contract under the FAA.⁹⁷ In considering the

88. *Id.*

89. *Id.*

90. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 262 F. Supp. 605 (D.C.N.Y. 1966).

91. *Id.* at 607.

92. *Id.*

93. *Id.*

94. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 360 F.2d 315, 317 (2d Cir. 1966).

95. *Id.* The court of appeals looked to the decision in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959), *cert. granted*, 362 U.S. 909 (1960), in which it was noted:

[t]hat the Arbitration Act envisages a distinction between the entire contract between the parties on the one hand and the arbitration clause of the contract on the other is plain on the fact of the statute. Section 2 does not purport to affect the contract as a whole. On the contrary, it makes "valid, irrevocable, and enforceable" only a "written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction"

Id. at 409-10.

96. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 400 (1967).

97. *Id.* at 403-04.

terms of the FAA, the Court stated:

Under § 4, with respect to a matter within the jurisdiction of the federal courts save for the existence of an arbitration clause, the federal court is instructed to order arbitration to proceed once it is satisfied that “the making of the agreement for arbitration or the failure to comply (with the arbitration agreement) is not in issue.” Accordingly, if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the “making” of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally.⁹⁸

Continuing with its opinion, the Court indicated, “[w]e hold, therefore, that in passing upon a § 3 application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate.”⁹⁹

As a result, in order to bypass an arbitration agreement and have a dispute heard in court, the party seeking court intervention must allege a problem with the arbitration provision itself, not the underlying contract.¹⁰⁰ This idea has become known as the “*Prima Paint* doctrine.”¹⁰¹

III. THE *ONVOY* DECISION

A. *Facts*

Onvoy, Inc. (“Onvoy”) is a privately held Minnesota telecommunications company.¹⁰² It was founded in 1988 by sixty-five local telephone providers for the purpose of supplying better access to long distance service.¹⁰³ SHAL, LLC (“SHAL”) is a Minnesota company comprised of three local telephone service providers who are each shareholders in Onvoy.¹⁰⁴ SHAL builds and

98. *Id.*

99. *Id.* at 404.

100. *Id.* at 403-04.

101. *See, e.g.,* Sandvik AB v. Advent Int’l Corp., 220 F.3d 99, 100 (3d Cir. 2000) (“[T]he arbitration clause is severable from the contested agreement under the doctrine announced by the Supreme Court in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*”).

102. *Onvoy, Inc. v. SHAL, LLC*, 669 N.W.2d 344, 347-48 (Minn. 2003).

103. *Id.*

104. *Id.* at 348.

maintains fiber optic telecommunications transport systems, primarily for SHAL companies.¹⁰⁵ SHAL is also a “segment provider” for Onvoy.¹⁰⁶ Segment providers supply one portion of the transmission capacity Onvoy needs to route long distance traffic from local providers to Onvoy.¹⁰⁷

In May 1999, Onvoy sought bids from fifty local telephone providers for a new fiber optic network running from Plymouth to Moorhead, Minnesota.¹⁰⁸ For cost purposes, Onvoy planned to lease the network rather than constructing and owning it.¹⁰⁹ Along with two other segment providers, SHAL submitted a bid for Onvoy’s project.¹¹⁰

The deep interconnection between Onvoy and SHAL was evident during formation of the deal. Three of the defendants, who were also respondents in this case, served on boards or committees at both companies, and were active in the negotiation of the agreement at issue.¹¹¹ Walter Clay served on both the boards of directors at Onvoy and SHAL, and served on the Finance and Audit Committee at Onvoy.¹¹² Robert Eddy served on both companies’ boards of directors, as well as Onvoy’s Network Committee.¹¹³ SHAL employee Darrell Westrum served on Onvoy’s Network Committee, as did Tom Dahl, the general manager of one of SHAL’s member service providers.¹¹⁴

During its negotiations with SHAL, Onvoy sought outside investors for the project.¹¹⁵ In September 1999, two investment companies of financier George Soros purchased 50,000 shares of Onvoy stock for \$50,000,000.¹¹⁶ As a result, Onvoy amended its articles of incorporation to allow the Soros shareholders to elect three Onvoy board members.¹¹⁷ Under the amended articles, at

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. Pl. Am. Compl. ¶ 28, *Onvoy* (Nos. C7-02-621, C7-02-702). The other two bidders, Val-Ed Joint Venture, LLP, and Central Transport Group, LLC, were also shareholders in Onvoy. Pl. Am. Compl. at ¶ 16.

111. *Onvoy*, 669 N.W.2d at 348.

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

least one of the Soros directors would have to approve transactions that involved contracting with an affiliate or entering or amending any material contract.¹¹⁸

In October 1999, Onvoy and SHAL executed a ten-year lease for construction and use of the fiber optic network.¹¹⁹ The lease contained the following provision:

Mediation and Arbitration. Any unresolved disputes arising under this Lease shall first be submitted to mediation. Unless the dispute is resolved after consultation between the liaisons of each party, a mediator shall be selected by agreement of the chief operation officers of each party. In the event that a dispute cannot be resolved by mediation, then the parties agree that the dispute shall be submitted to arbitration under the rules of the American Arbitration Association.¹²⁰

In November 2001, Onvoy sought rescission of the lease, claiming it was several times more expensive than the going market price.¹²¹ Onvoy also claimed that defendants Clay, Eddy, Westrum, and Dahl breached their fiduciary duties.¹²² Furthermore, Onvoy alleged that the defendants made material misrepresentations to induce Onvoy to enter the lease, as well as negligently

118. *Id.*

119. *Id.*

120. Fiber Optic Lease, *supra* note 16. SHAL argued the rules of the American Arbitration Association (“AAA”) should govern the arbitrability question under the terms of the contract. Respondent’s Brief at 5, *Onvoy* (Nos. C7-02-621 & C7-02-702). SHAL pointed out under AAA Rule R-8(b):

[T]he arbitrator shall have the power to determine the existence or validity of a contract of which an arbitration clause forms a part. Such an arbitration clause shall be treated as an agreement independent of the other terms of the contract. A decision by the arbitrator that the contract is null and void shall not for that reason alone render invalid the arbitration clause.

Id. The *Onvoy* court did not accept this argument. 669 N.W. 2d at 354; *see also* discussion *infra* Part III.

121. *Onvoy*, 669 N.W.2d at 349. In its Amended Complaint, Onvoy alleged, [t]he decisions and assumptions utilized in creating the benchmark cost resulted in overly high lease prices for the benefit of defendants, not Onvoy. The formula imposes on Onvoy the costs of ownership but does not give the benefit of ownership. Onvoy bore 100% of the cost of construction despite the fact that the lessors installed some of their own fibers and despite the fact that if Onvoy had constructed the facilities itself, it would not have done so without at least one partner to share the costs of construction with.

Pl. Am. Compl. ¶ 35(d).

122. *Onvoy*, 669 N.W.2d at 349.

misrepresented the lease terms and the bidding process.¹²³ In support of its position, Onvoy argued that the parties never formed an agreement because the actions of SHAL and its representatives constituted a prohibited interested-director¹²⁴ and ultra vires transaction.¹²⁵

An interested-director transaction is a form of conflict of interest.¹²⁶ A director is usually prohibited from “representing both himself and his principal in a transaction in which their interests are adverse and antagonistic.”¹²⁷ In Minnesota, courts can review a transaction if one party claims the other did not act in a “fair and reasonable” manner.¹²⁸

Ultra vires transactions are usually deemed invalid if they exceed the corporation’s authority to make an agreement.¹²⁹ However, an ultra vires transaction could be considered valid if it is within the power of the corporation, even though the transaction itself may be irregular or unauthorized.¹³⁰

B. *The Court’s Analysis*

Appellate courts’ standard of review for arbitrability questions

123. *Id.*

124. An interested director is one involved in a corporate transaction where he or she may have a personal interest. *See Possis v. Cont’l Machs., Inc.*, 425 N.W.2d 286, 288 (Minn. Ct. App. 1988).

125. BLACK’S LAW DICTIONARY 1235 (7th ed. 2000) (defining an “ultra vires transaction” as one that is “[u]nauthorized; beyond the scope of power allowed or granted by a corporate charter . . .”). Onvoy claimed an improperly constituted board approved the transaction with SHAL. *Onvoy*, 669 N.W.2d at 349.

126. In general,

a director may not pursue his own interests in a manner that is injurious to the corporation. Directors must use the authority given them solely for the benefit of the corporation and its stockholders and may not enter into contracts that will bargain away the independent judgment that they are bound to exercise in the interest of the corporation and all of the stockholders. Directors owe stockholders an active duty of honesty and good faith in the transaction of the business of the corporation and in their dealings with it.

9 DUNNELL MINN. DIGEST *Corporations* § 7.09 (5th ed. 2003).

127. 18B AM. JUR. 2D *Corporations* § 1732 (2000). Overall, a director does not have the right to work on behalf of the corporation in any transaction “in which he is . . . interested in obtaining any advantage at the expense of the corporation, and he cannot act as or for an adverse party to the transaction.” *Id.*

128. MINN. STAT. § 302A.255 (2002); *see also* discussion *infra* Part III.B.

129. 9 DUNNELL MINN. DIGEST *Corporations* § 6.00 (5th ed. 2003).

130. *Id.*

is de novo.¹³¹ The Minnesota Supreme Court examined the issues and determined that the FAA applied because the case involved interstate commerce.¹³² The court then addressed whether Onvoy's claims would make the lease void or merely voidable.¹³³ A void contract is not a contract at all; instead it is a "promise" or "agreement" that is void of legal effect.¹³⁴ A voidable contract is generally valid, but one of the parties has the power to avoid the agreement due to incapacity, breach of warranty, or fraud, duress, or mistake at formation.¹³⁵

SHAL argued that, under the *Prima Paint* doctrine, questions of contract validity could only be addressed by courts if they dealt with the arbitration clause itself, not the entire agreement.¹³⁶ SHAL pointed out that neither the Supreme Court nor the Eighth Circuit had adopted a distinction between void and voidable contracts, and therefore neither should the Minnesota Supreme Court.¹³⁷ The court disagreed, and stated that the question of whether a valid lease ever existed could be heard by a court and was sufficient to

131. *Indep. Sch. Dist. No. 88 v. Sch. Serv. Employees Union Local 284*, 503 N.W.2d 104, 107 (Minn. 1993) ("[T]his court's review of the determination of arbitrability is de novo.").

132. *Onvoy*, 669 N.W.2d at 350-351. The court cited *Terminix* in its reasoning. *Id.* at 351. *Onvoy* affected two Minnesota cases used by the lower courts: *Atcas v. Credit Clearing Corp.*, 292 Minn. 334, 197 N.W.2d 448 (1972), and *Thayer v. Am. Fin. Advisers, Inc.*, 322 N.W.2d 599 (Minn. 1982). *Atcas* held (1) a party would not be compelled to arbitrate if the arbitration clause did not cover fraud in the inducement, and (2) arbitration was not proper when one party sought rescission of the contract. 292 Minn. at 347-48, 197 N.W.2d at 456. *Thayer* stated federal law did not encompass the contract at issue, because the language of the FAA applied only to transactions "involving" and not "affecting" commerce. 322 N.W.2d at 603-04. *Onvoy* overruled *Atcas* to the extent it conflicted with *Terminix*. *Onvoy*, 669 N.W.2d at 351. *Onvoy* also vacated *Thayer*, because the Supreme Court in *Terminix* had removed the involving/affecting distinction and stated the FAA applied to all transactions in any way related to interstate commerce. *Id.*; see also text *supra* Part II (explaining *Terminix* decision).

133. *Onvoy*, 669 N.W.2d at 353-55.

134. See RESTATEMENT (SECOND) OF CONTRACTS § 7 cmt. a (1981).

135. *Id.* cmt. b.

136. *Onvoy*, 669 N.W.2d at 352-53 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967)); see also discussion *supra* Part II.C (describing the Supreme Court ruling in *Prima Paint*).

137. *Onvoy*, 669 N.W.2d at 353. The court stated it had previously considered the void/voidable distinction under Minnesota law. *Id.* In *Dvorak v. Maring*, the court indicated it had held on numerous occasions that "without the signatures of both spouses a conveyance of homestead property is not merely voidable but is void and the buyer acquires no rights whatsoever." 285 N.W.2d 675, 677 (Minn. 1979).

override the arbitration clause.¹³⁸ Specifically, the court held “parties may not be compelled to arbitrate claims if they have alleged that the contract at issue never legally existed.”¹³⁹ The court further indicated, “allegations that a contract is void may be heard by a court, even if not specifically directed to the arbitration clause, while allegations that a contract is voidable must be sent to arbitration.”¹⁴⁰

After resolving this issue, the supreme court turned to Onvoy’s specific claims. The court determined SHAL’s actions did not rise to the level of an ultra vires transaction.¹⁴¹ Minnesota recognizes an ultra vires transaction as one within the corporation’s powers, but with “some irregularity or defect in the actual exercise of power.”¹⁴² Onvoy claimed it did not properly approve the lease because a majority of the Onvoy board and one of the Soros directors did not vote on the transaction, thus making it ultra vires.¹⁴³ However, Minnesota law would presume the contract valid,¹⁴⁴ even if Onvoy approved the transaction with an improperly constituted board.¹⁴⁵ The court held the board’s actions would at most make the lease voidable, not void.¹⁴⁶ A voidable lease would be subject to arbitration under the arbitration clause; a void lease would require court involvement because no lease or arbitration clause would exist.¹⁴⁷ As a result, the court ruled Onvoy’s claim would be subject

138. *Onvoy*, 669 N.W.2d at 354.

139. *Id.*

140. *Id.* The court based its decision on *Sandvik AB v. Advent International Corp.*, 220 F.3d 99, 107-08 (3d Cir. 2000) (“[N]o arbitration may be compelled in the absence of an agreement to arbitrate.”); *see also* discussion *infra* Part IV.A.2 (explaining the *Sandvik* decision).

141. *Onvoy*, 669 N.W.2d at 355.

142. *Bell v. Kirkland*, 102 Minn. 213, 219, 133 N.W. 271, 273 (1907). *Bell* outlined two types of ultra vires transactions. *Id.* at 218, 113 N.W. at 273. The first type involved “a contract which is not within the scope of the powers of a corporation to make under any circumstances, or for any purposes.” *Id.* The second type related to contracts within the powers of the corporation, but with some problem or flaw in the use of the corporation’s power. *Id.* at 219, 113 N.W. at 273. The supreme court in *Onvoy* felt the dispute between the parties most closely resembled the second type of ultra vires transaction. 669 N.W.2d at 355.

143. *Onvoy*, 669 N.W.2d at 354; *see also supra* Part III.A (describing configuration of the board).

144. “The . . . performing by a corporation of an act . . . if otherwise lawful, is not invalid because the corporations was without the power to . . . perform the act.” MINN. STAT. § 302A.165 (2002).

145. *Onvoy*, 669 N.W.2d at 355.

146. *Id.*

147. *Id.* at 354.

to arbitration under the ultra vires theory.¹⁴⁸

Regarding the interested-director transaction, the court noted the burden was on SHAL to show the lease was not void from inception.¹⁴⁹ Under Minnesota law, SHAL would need to offer proof it satisfied one of four safe harbor provisions to demonstrate the transaction was in fact valid and not void as an interested-director transaction.¹⁵⁰ The *Onvoy* court indicated in order to prove the lease was valid, SHAL must show one of the following:

(1) that the transaction was fair and reasonable to the corporation at the time it was approved; (2) that material facts about the contract and the directors' interest were fully disclosed and the contract was approved in good faith by at least two-thirds of the disinterested corporate shareholders; (3) that material facts about the contract and the directors' conflicts were known by a board or committee who authorized the transaction without the vote of interested directors; or (4) that the contract is a distribution, merger, or exchange.¹⁵¹

If SHAL succeeded in showing the agreement met one of the safe harbor provisions, *Onvoy's* claims would be sent to arbitration.¹⁵² If SHAL failed, the lease would be considered void, and *Onvoy* would be allowed to litigate.¹⁵³ The court remanded this question to the district court for further consideration.¹⁵⁴

IV. ANALYSIS OF THE *ONVOY* DECISION

A. *Conflicting Views of the Circuits*

Two opposing schools of thought exist regarding application of the *Prima Paint* doctrine. Federal circuits are split over whether the question of contract formation invalidates an arbitration clause contained in the disputed agreement.¹⁵⁵ Understandably, the parties in *Onvoy* took opposite positions on this issue.

The crux of the conflict between *Onvoy* and SHAL hinges on

148. *Id.* at 355.

149. *Id.*

150. *See* MINN. STAT. § 302A.255 (2002).

151. 669 N.W.2d at 355-56.

152. *Id.* at 356.

153. *Id.*

154. *Id.*

155. *See* discussion *infra* Part IV.A.

the distinction between void and voidable contracts. SHAL, in following *Prima Paint*, argued the arbitration provision contained in the disputed contract applied in resolving the conflict.¹⁵⁶ Under SHAL's theory, the overall contract would be viewed as voidable.¹⁵⁷ A voidable contract allows one of the parties to rescind the agreement due to fraud, duress, or mistake at contract formation.¹⁵⁸ Disputes under a voidable contract remain subject to arbitration, however, because the existing contract, not the valid arbitration provision contained in the contract, would be the focus of debate.¹⁵⁹

Conversely, the decisions favoring Onvoy's position reflect a modified approach to *Prima Paint*. In those cases, questions of whether a contract was void would also affect the validity of the arbitration provision.¹⁶⁰ Under this theory, if no contract exists, neither does the arbitration clause contained in the contract.¹⁶¹ The Minnesota Supreme Court considered both positions in reaching its decision in *Onvoy*.

1. *Circuits Following Prima Paint*

Many courts consider the concept of severability of arbitration clauses controlling over disputes involving arbitration agreements.¹⁶² *Prima Paint* represents the primary reasoning behind this philosophy: unless specifically challenged on its own, the arbitration provision will control in any contract dispute.¹⁶³

Several federal circuits follow this reasoning and have ruled accordingly.¹⁶⁴ For example, the Fifth Circuit examined the

156. *Onvoy*, 669 N.W.2d at 352-53.

157. *Id.* at 353-54.

158. RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 134, at cmt. b.

159. *Onvoy*, 669 N.W.2d at 353-54.

160. *See* cases discussed *infra* Part IV.A.2.

161. *Id.*

162. *See* cases cited *infra* Part IV.A.1 and note 164.

163. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967).

164. *See* text *infra* Part IV.A.1; *St. Paul Fire & Marine Ins. Co. v. Courtney Enters.*, 270 F.3d 621, 624-25 (8th Cir. 2001) ("In deciding whether to compel arbitration," *Prima Paint* directs courts to "consider whether there was fraud in the inducement of the arbitration clause" but not the "underlying contract."); *Ferro Corp. v. Garrison Indus.*, 142 F.3d 926, 933 (6th Cir. 1998) (holding that, under *Prima Paint*, once the court determines "the agreement to arbitrate has not been fraudulently induced, all other issues falling within that agreement are to be sent to arbitration"); *Rojas v. TK Communications, Inc.*, 87 F.3d 745, 749 (5th Cir. 1996) ("Because [plaintiff's] claim relates to the entire agreement, rather than just

enforceability of an arbitration clause in *Robert Lawrence v. Comprehensive Business Services Co.*¹⁶⁵ Plaintiff Lawrence purchased a license allowing him to use the name of defendant Comprehensive, an accounting service.¹⁶⁶ The franchise agreement contained an arbitration clause.¹⁶⁷ After execution of the contract, Lawrence found out the Texas State Board of Public Accountancy had taken action against other Comprehensive franchisees for operating an accounting business under a trade name.¹⁶⁸ In fear of losing his license, Lawrence informed Comprehensive he could no longer perform under their franchise agreement.¹⁶⁹ Lawrence then brought suit to have the contract rescinded, claiming it was illegal under Texas law.¹⁷⁰ Comprehensive brought a motion to stay litigation and compel arbitration under terms of the franchise agreement.¹⁷¹ The district court ruled for Comprehensive and Lawrence appealed.¹⁷² The court of appeals affirmed, indicating the arbitration provision was binding despite Lawrence's claim the underlying contract was illegal.¹⁷³ The court also reinforced *Prima Paint*, and stated any challenges to arbitration must be directed at the legality of the arbitration provision itself, not the contract as a

the arbitration clause, the FAA requires that her claims be heard by an arbitrator.”); *R.M. Perez & Assoc., Inc. v. Welch*, 960 F.2d 534, 539 (5th Cir. 1992) (“If the fraud relates to the arbitration clause itself, the court should adjudicate the fraud claim.” However, if the fraud claim “relates to the entire agreement, then the Federal Arbitration Act requires that the fraud claim be decided by an arbitrator.”); *C.B.S. Employees Fed. Credit Union v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 912 F.2d 1563, 1567 (6th Cir. 1990) (*Prima Paint* mandates “[i]f the arbitration clause is not at issue, then the arbitrator will decide challenges to the contract containing the arbitration clause.”); *Jeske v. Brooks*, 875 F.2d 71, 75 (4th Cir. 1989) (holding when a party alleges defects in formation of a contract containing an arbitration provision, and the “alleged defects pertain to the entire contract, rather than specifically to the arbitration clause, they are properly left to the arbitrator for resolution”).

165. 833 F.2d 1159 (1987).

166. *Id.* at 1160.

167. *Id.* at 1161.

168. *Id.* at 1160.

169. *Id.*

170. *Id.* at 1161.

171. *Id.* The arbitration provision provided in part “[a]ny controversy arising out of, or relating to, this agreement . . . including any claim for damages or rescission . . . shall be settled by arbitration . . .” *Id.*

172. *Id.*

173. *Id.* at 1162; *see also* *Mesa Operating Ltd. P’ship v. La. Intrastate Gas Corp.*, 797 F.2d 238, 244 (5th Cir. 1986) (holding arbitration clause in gas sales contract enforceable despite claim contract was void from inception due to parties’ failure to follow state law concerning such sales).

whole.¹⁷⁴

The Sixth Circuit also examined this issue in *Burden v. Check Into Cash of Kentucky, LLC*.¹⁷⁵ *Burden* involved an action by a bankruptcy trustee for three estates against a creditor of those estates.¹⁷⁶ Plaintiffs in *Burden* claimed the defendant, under the guise of a check-cashing company, loaned money at usurious rates in violation of federal and state law.¹⁷⁷ Under the scheme, customers would provide the company with a check for a specified amount.¹⁷⁸ The company would then give the customer a sum of cash less than the amount of the check.¹⁷⁹ The company kept the difference as a “service fee” or “finance charge.”¹⁸⁰ The transaction required customers to execute a “loan agreement,” indicating the customer would pay back the cash to the company in two weeks.¹⁸¹ The loan agreement contained an arbitration clause.¹⁸²

After plaintiffs filed for bankruptcy, their trustee brought this action.¹⁸³ When plaintiffs sought class certification, defendant moved to compel arbitration of plaintiffs’ claims and stay litigation pending arbitration.¹⁸⁴ The district court denied defendant’s motion, and defendant appealed.¹⁸⁵ The court of appeals vacated the district court’s decision, and remanded on the question of arbitrability.¹⁸⁶ In explaining its decision, the court noted under *Prima Paint*, a dispute over fraud in the inducement of the entire contract is for an arbitrator, not a court, to decide.¹⁸⁷

174. *Robert Lawrence*, 833 F.2d at 1162.

175. 267 F.3d 483 (2001).

176. *Id.* at 486.

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.* at 487. The arbitration clause stated,

To pursue any claim, demand, dispute or cause of action . . . arising under this Agreement or the transaction in connection with which this Agreement has been executed, the claimant must submit to the other party in writing an explanation of the claim and a demand that the claim be resolved by arbitration.

Id.

183. *Id.* at 486.

184. *Id.*

185. *Id.*

186. *Id.* at 485-86.

187. *Id.* at 491. Specifically, the court indicated, “a challenge based on fraud in the inducement of the whole contract (including the arbitration clause) is for the arbitrator, while a challenge based on the lack of mutuality of the arbitration

The Fourth Circuit followed a similar course in *Snowden v. CheckPoint Check Cashing*.¹⁸⁸ In circumstances that paralleled *Burden*, Snowden, the plaintiff, executed several “deferred deposit” transactions with defendant check-cashing company.¹⁸⁹ The defendant provided cash to plaintiff, with the understanding plaintiff’s check would not be negotiated until a later date.¹⁹⁰ One of the agreements memorializing a specific deferred deposit transaction contained an arbitration provision.¹⁹¹ Snowden later brought suit against CheckPoint, claiming its deferred deposit transactions were in fact loans that violated state and federal statutes.¹⁹² CheckPoint moved to compel arbitration and stay any court proceedings.¹⁹³ The district court denied the motion, and CheckPoint appealed.¹⁹⁴ The court of appeals vacated the district court decision and remanded for further proceedings.¹⁹⁵ In a reference to *Prima Paint*, the court indicated a party seeking to avoid or stay arbitration must challenge the arbitration clause itself, not the underlying contract.¹⁹⁶

2. Circuits Taking a Modified Approach

Despite other jurisdictions’ decisions to the contrary, certain federal circuits have taken a modified approach to *Prima Paint*. Those circuits allow a court to decide the fundamental issue of whether the parties ever formed a binding contract, even if the contract at issue contains an arbitration provision.¹⁹⁷ Under this

clause would be for the court.” *Id.* (quoting *Matterhorn v. NCR Corp.*, 763 F.2d 866, 868 (7th Cir. 1985)).

188. 290 F.3d 631 (2002).

189. *Id.* at 633.

190. *Id.*

191. *Id.*

192. *Id.* at 634.

193. *Id.* at 635.

194. *Id.*

195. *Id.* at 637, 639.

196. *Id.* at 636. In its decision, the court noted,

The law is well settled in this circuit that, if a party seeks to avoid arbitration and/or a stay of federal court proceedings pending the outcome of arbitration by challenging the validity or enforceability of an arbitration provision on any grounds that “exist at law or in equity for the revocation of any contract” [under 9 U.S.C. § 2], the grounds “must relate specifically to the arbitration clause and not just to the contract as a whole.”

Id. (quoting *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933, 938 (4th Cir. 1999)).

197. See cases cited *infra* Part IV.2; see also *Camping Constr. Co. v. Dist. Council*

approach, challenging the existence of the overall contract would also bring the arbitration clause into question.

The Ninth Circuit issued one of the most prominent decisions on this issue in *Three Valleys Municipal Water District v. E.F. Hutton & Company, Inc.*¹⁹⁸ Plaintiffs in *Three Valleys* were comprised of several governmental entities.¹⁹⁹ Plaintiffs opened trading accounts with defendant E.F. Hutton, a securities investment firm.²⁰⁰ As part of the transaction, the parties executed a client agreement that contained an arbitration clause.²⁰¹ Two years after opening the accounts, plaintiffs brought suit against Hutton, claiming investment losses due to Hutton's wrongful conduct.²⁰² Hutton filed a motion to compel arbitration and stay court proceedings.²⁰³ Plaintiffs opposed the motion to compel and argued the client agreement with Hutton was void because the signatory did not have the power to bind plaintiffs.²⁰⁴ The district court ruled the question of whether the signatory had authority should be decided by an arbitrator, not the court.²⁰⁵ The court of appeals reversed.²⁰⁶ Hutton had argued *Prima Paint* applied to the making of the entire contract, not just the agreement to arbitrate.²⁰⁷ The court of appeals disagreed, and interpreted *Prima Paint* as restricted to "challenges seeking to *avoid* or *rescind* a contract—not to challenges going to the very existence of a contract" that one of the parties "claims never to have agreed to."²⁰⁸ Consequently, the court held

of *Iron Workers*, 915 F.2d 1333, 1340 (9th Cir. 1990) (stating "[t]he court must determine whether a contract *ever* existed;" otherwise, "there is no basis for submitting any question to an arbitrator"); *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51, 54-55 (3d Cir. 1980) (holding a trial is warranted "to determine whether or not an agreement was reached and, if so, whether said agreement properly included an agreement to arbitrate"); *Interocean Shipping Co. v. Nat'l Shipping and Trading Corp.*, 462 F.2d 673, 676 (2d Cir. 1972) (indicating "if the making of the [contract] was in issue . . . the district court should have proceeded to trial of this question" before compelling arbitration).

198. 925 F.2d 1136 (1991).

199. *Id.* at 1137.

200. *Id.*

201. *Id.* at 1138. The arbitration clause provided "all controversies which may arise between us concerning any transaction or . . . performance or breach of this . . . agreement between us . . . shall be determined by arbitration." *Id.*

202. *Id.*

203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.* at 1137.

207. *Id.* at 1140.

208. *Id.*

the party contesting the existence of a contract containing an arbitration clause “cannot be compelled to arbitrate the threshold issue of the *existence* of an agreement to arbitrate” because “[o]nly a court can make that decision.”²⁰⁹

The Third Circuit provided another significant decision on the arbitrability issue in *Sandvik AB v. Advent International Corp.*²¹⁰ *Sandvik* involved an attempt by an American equity investment firm to purchase subsidiaries of a Swedish manufacturing company.²¹¹ The parties executed a sales agreement that included an arbitration provision.²¹² When the equity firm, Advent, indicated it did not see itself as bound by the agreement, the manufacturer, Sandvik, sued for fraud, misrepresentation, and breach of contract.²¹³ Advent then moved to compel arbitration, arguing that under the *Prima Paint* doctrine, the arbitration clause contained in the sales agreement was severable from the rest of the contract.²¹⁴ Sandvik asserted it could not be forced into arbitration if no agreement to arbitrate existed.²¹⁵ The district court agreed with Sandvik, and the court of appeals affirmed.²¹⁶ In its holding, the court indicated “no arbitration may be compelled in the absence of an agreement to arbitrate.”²¹⁷

The Second Circuit also examined the question of arbitrability under a group of disputed contracts in *Sphere Drake Insurance Ltd. v. Clarendon National Insurance Co.*²¹⁸ Plaintiff, a reinsurer, and defendant, an insurance carrier, executed six reinsurance agreements through their agents.²¹⁹ The reinsurance agreements contained arbitration clauses that provided for arbitration of disputes.²²⁰ Sphere Drake became unhappy with the terms of the contracts and brought a declaratory judgment action.²²¹ To avoid

209. *Id.* at 1140-41.

210. 220 F.3d 99 (2000).

211. *Id.* at 100.

212. *Id.* at 101. The arbitration provision dictated mandatory arbitration for “[a]ny dispute arising out of or in connection with this Agreement” *Id.*

213. *Id.* at 101-02.

214. *Id.* at 100-01.

215. *Id.* at 101.

216. *Id.* at 100-01.

217. *Id.* at 107-08.

218. 263 F.3d 26 (2001).

219. *Id.* at 28.

220. *Id.* The arbitration clause in each contract provided, “[d]isputes between the parties arising out of this Reinsurance which cannot be resolved by compromise . . . shall be submitted to arbitration.” *Id.*

221. *Id.* at 27-28.

arbitration, Sphere Drake asked the district court to declare the agreements void because its agent had exceeded his authority.²²² The district court held the dispute was subject to the contracts' arbitration clauses because, under *Prima Paint*, a party seeking to avoid arbitration must allege a problem with an arbitration clause specifically, not the overall contract.²²³ The court of appeals reversed with respect to one of the contracts.²²⁴ In its holding, the court noted Sphere Drake had presented sufficient evidence that its agent did not have the authority to enter into the disputed contract.²²⁵ That evidence would show the contract was void, and would also put the entire contract, including the arbitration provision, "in sufficient issue as to warrant a trial on the question whether the arbitration clause in the [disputed] contract is enforceable."²²⁶

B. The Minnesota Supreme Court Has Taken the Proper Stance on Prima Paint with the Onvoy Decision

In addressing the fundamental question of contract formation, the Minnesota Supreme Court properly distinguished the issue in *Onvoy* from the issue in *Prima Paint*. In the *Prima Paint* decision, the U.S. Supreme Court operated from the presumption that an agreement already existed.²²⁷ By contrast, the *Onvoy* court took a step back and looked at the formation of the agreement itself.²²⁸

Prima Paint focused on fraud in the inducement of the contract.²²⁹ The Supreme Court reasoned that because the underlying contract was in question, not the validity of the arbitration provision contained in the agreement, the arbitration clause should govern in resolving the contract dispute.²³⁰ In reaching this decision, the Court determined the arbitration clause was severable from the rest of the contract.²³¹ Unless the arbitration clause itself was challenged, an arbitrator, not a court,

222. *Id.* at 28, 32.

223. *Id.* at 29.

224. *Id.* at 34.

225. *Id.* at 33.

226. *Id.*

227. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401-02 (1967).

228. *Onvoy, Inc. v. SHAL, LLC*, 669 N.W.2d 344, 352 (Minn. 2003).

229. 388 U.S. at 398.

230. *Id.* at 403-04.

231. *Id.*

would resolve any disputes arising under the agreement.²³²

As a general principle of contract, a claim of fraud in the inducement makes an existing agreement voidable, not void.²³³ If a contract is voidable, the aggrieved party can rescind at his or her discretion.²³⁴ Under *Prima Paint*, rescission of the contract itself would leave the uncontested arbitration clause intact and controlling over any disputes.²³⁵

Conversely, *Onvoy* presents a different fact situation. *Onvoy* argued it could not be bound by the arbitration provision because the underlying lease containing the provision was void.²³⁶ A void contract is an agreement with no legal effect.²³⁷ Consequently, any provision contained in the agreement, including an arbitration clause, would also have no effect.²³⁸ Accordingly, even if the parties initially intended to arbitrate, that intention would be based on a valid (i.e., not void from inception) agreement to arbitrate.²³⁹ Armed with this distinction, the court sought guidance from other jurisdictions. Notwithstanding broad arbitration clauses, several federal circuits have allowed disputes to proceed to trial if the plaintiff claims the original agreement is void.²⁴⁰ Specifically, the Second, Third, and Ninth Circuits, with their decisions in *Sphere Drake*, *Sandvik*, and *Three Valleys*, respectively, all support the position that a party cannot be compelled to arbitrate under a disputed contract containing an arbitration provision.²⁴¹ The court

232. *Id.*

233. JOSEPH M. PERILLO, 7 CORBIN ON CONTRACTS § 28.22 (rev. ed. 2002).

234. RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 134, at cmt. b.

235. *See* 388 U.S. at 403-04.

236. *Onvoy, Inc. v. SHAL, LLC*, 669 N.W.2d 344, 352, 354 (Minn. 2003).

237. RESTATEMENT (SECOND) OF CONTRACTS, *supra* note 134, at cmt. a.

238. As one prominent legal scholar noted, “[i]f a contract includes an arbitration agreement, and grounds exist to revoke the entire contract, those grounds would also vitiate the arbitration agreement.” RICHARD A. LORD, 21 WILLISTON ON CONTRACTS § 57:14 (4th ed. 2001); *see also* 1 DOMKE ON COMMERCIAL ARBITRATION § 11:2 (West Group rev. ed., 2002) (“[A] valid arbitration agreement cannot arise out of a broader contract if no broader contract ever existed.”).

239. The *Onvoy* court held “allowing courts to retain jurisdiction over credible claims that a contract is void, leaves room for [parties] to escape obvious abuses of power in contracting.” 669 N.W.2d at 352.

240. *See* cases cited *infra* note 241.

241. *Sphere Drake Ins. Ltd. v. Clarendon Nat’l Ins. Co.*, 263 F.3d 26, 32 (2d Cir. 2001) (if one party to a contract alleges the contract is void and can establish evidence supporting that position, then that party “need not specifically allege that the arbitration clause in that contract is void, and the party is entitled to a trial on the arbitrability issue”); *Sandvik AB v. Advent Int’l Corp.*, 220 F.3d 99, 107-08 (3d Cir. 2000) (stating that the non-existence of an underlying contract means a

found this rationale persuasive and adopted its holding based on those circuits' decisions.²⁴²

The ruling in *Onvoy* fits well with Minnesota's judicial principles. On the one hand, the strong presumption in favor of arbitration is retained.²⁴³ *Onvoy* will be compelled to arbitrate if, on remand, the district court finds the actions of the SHAL defendants did not constitute an interested-director transaction and thus did not render the lease void.²⁴⁴ On the other hand, as Justice Paul Anderson's concurrence points out, the *Onvoy* decision reflects the court's strong belief in the right of access to the judicial system.²⁴⁵ Here, because the parties disputed the very existence of the lease (and by extension, the arbitration clause contained in the lease), the supreme court properly held the district court should resolve the issue of contract formation.²⁴⁶

The Gilbert concurrence also acknowledges the Minnesota view of a balance between the role of the courts and the use of arbitration.²⁴⁷ However, Justice Gilbert also urges caution toward

valid arbitration provision does not exist; accordingly, "no arbitration may be compelled in the absence of a [valid] agreement to arbitrate."); *Three Valleys Mun. Water Dist. v. E.F. Hutton & Co.*, 925 F.2d 1136, 1140-41 (9th Cir. 1991) (a party challenging the "making of a contract containing an arbitration provision cannot be compelled to arbitrate the threshold issue of the *existence* of an agreement to arbitrate."). *Contra* cases cited *supra* note 164.

242. *Onvoy*, 669 N.W.2d at 353-54. The *Onvoy* court also examined other cases where courts have jurisdiction when one party disputes the existence of a contract. *Id.* In *Chastain v. Robinson-Humphrey Co.*, a securities trading company tried to compel arbitration under a customer agreement. 957 F.2d 851, 853 (11th Cir. 1992). The account holder claimed no agreement existed because she had never signed a contract with the securities company. *Id.* The court held the facts of the case were sufficient to put the making of the arbitration agreement at issue, which therefore required court involvement "to determine the validity of the customer agreements before compelling [plaintiff] to submit her securities claims to arbitration." *Id.* at 855. The Eighth Circuit considered a similar issue in *I.S. Joseph Co. v. Mich. Sugar Co.* 803 F.2d 396 (1986). A disagreement arose over whether one party to a commercial contract could be compelled to arbitrate with an assignee who was not the original party who agreed to arbitrate. *Id.* at 398-99. The court of appeals held the question of the existence of a contract between the parties must be decided by the district court, and remanded for a ruling on that issue. *Id.* at 400.

243. See sources cited *supra* note 20.

244. *Onvoy*, 669 N.W.2d at 356.

245. *Id.* at 358-59 ("[W]hen a right as fundamental as the right of access to the courts and trial by jury is at stake, waiver of that right is not to be lightly presumed.") (Anderson, Paul, J., concurring).

246. 21 LORD, *supra* note 238, § 57:14.

247. *Onvoy*, 669 N.W.2d at 359 (Gilbert, J., concurring in part, dissenting in part).

the use of ADR in general. The impartiality of mediators and arbitrators is often suspect, due to their close ties to the industries they serve.²⁴⁸ Additionally, arbitration decisions are not required to conform with the existing rule of law.²⁴⁹ To address these issues, and in support of the supreme court's overriding view of the primacy of the judiciary, Justice Gilbert recommends evaluation of both the state and federal arbitration systems "so that they may carry the same integrity that we require from our courts."²⁵⁰

All in all, the impact of *Onvoy* should not be overwhelming on the courts. Unless a major flaw in contract formation is alleged, most disputes will probably proceed to arbitration as agreed. However, the court did consider the possible effects of this decision, and offered guidance for those entering into future arbitration agreements. If the parties desire jurisdiction of a court rather than an arbitrator on specific issues, they should expressly state that intention in the contract.²⁵¹ That way, in the event of a dispute, additional disagreements can be minimized.

V. CONCLUSION

A number of jurisdictions now limit the application of *Prima Paint* when a conflict arises over contract formation.²⁵² With the *Onvoy* decision, Minnesota has joined these ranks. The reasoning behind this movement is solid and sounds in the very foundations of contract law: how can an arbitration provision be enforced if it's part of an agreement that may not exist?²⁵³ The Minnesota Supreme Court recognized this question, and provided a balanced solution in *Onvoy*. Arbitration is a significant part of the business landscape in Minnesota, but enforcement of arbitration provisions under all circumstances does not apply. Going forward from *Onvoy*, parties can expect their day in court if their contract dispute involving arbitration crosses the line from the voidable into the void.

248. *Id.* at 360.

249. *Id.*

250. *Id.* at 359.

251. *Id.* at 352.

252. *See* cases cited *supra* note 241.

253. *See* sources cited *supra* note 238.