PUTTING ARBITRATION BACK IN ITS PLACE:

HOW TO MAKE ARBITRATION WORK AS INTENDED BY THE CONTRACTING PARTIES

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Putting Arbitration Back in Its Place: How to Make Arbitration Work As Intended by the Contracting Parties

"Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."[1]

-United States Supreme Court

1. CURRENT STATE OF ARBITRATION

Today, arbitration can be, and frequently is, just as costly and time-consuming as are judicial proceedings. But the reason is not the arbitration process itself. Rather, the contracting parties are to blame. We often forget the basic idea behind an arbitration clause — it is a contract bargained for by the parties. Thus, arbitration is what the parties make it. The contracting parties have all the power — the power to mold their arbitration proceedings into a shape suitable for them, at that particular time and for that particular purpose.

A. Federal Arbitration Act

In 1921, the American Bar Association developed a draft of the Federal Arbitration Act ("FAA"), which became law in 1925.[2] The FAA provides for judicial facilitation of private dispute resolution through arbitration. [3] It applies in both state courts and federal courts, where the underlying transaction involves interstate commerce.[4] The FAA is predicated upon an exercise of the Commerce Clause powers granted to Congress in the United States Constitution. The United States Supreme Court has made it clear that the FAA "simply requires courts to enforce privately negotiated agreements to arbitrate, like other contracts, in accordance with their terms."[5]

B. State Arbitration Laws

For transactions not covered by the FAA, many states have adopted the 1955 Uniform Arbitration Act.[6] Specifically, 48 states, the District of Columbia, and Puerto Rico have adopted

[1] United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960).

[2] Pub.L. 68–401, 43 Stat. 883, enacted Feb. 12, 1925, codified at 9 U.S.C. § 1 et seq.

[3] *Id.*

[4] *Id.*

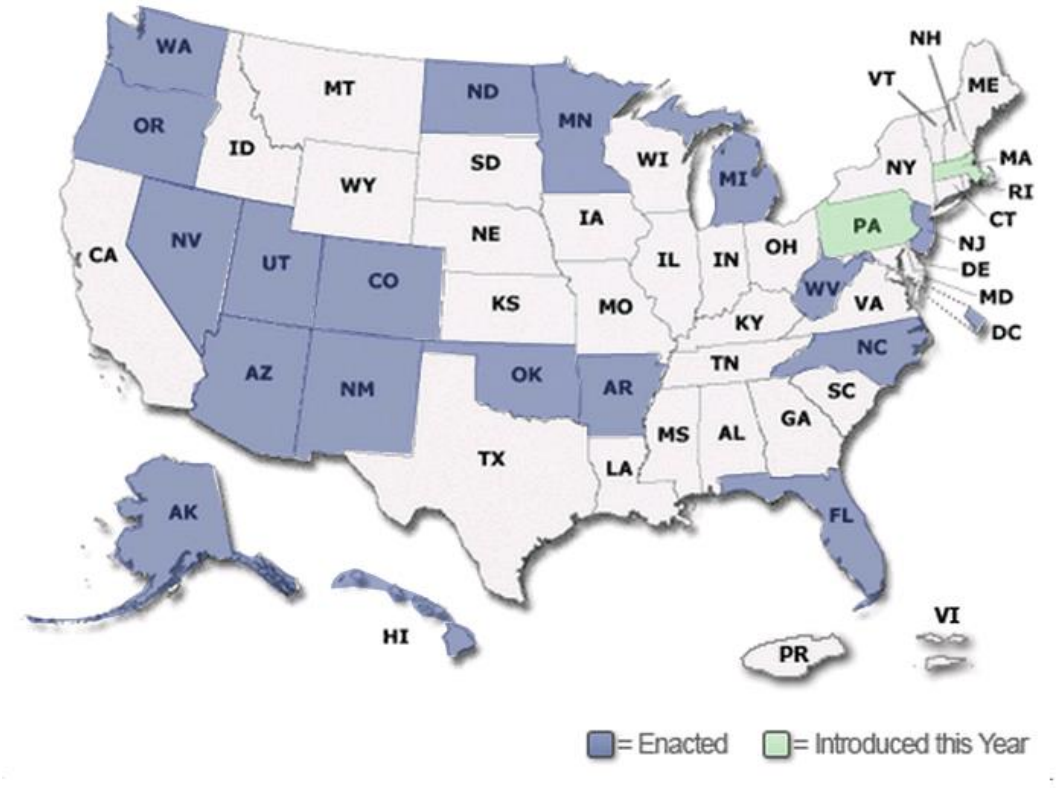
[5] Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 109 S. Ct. 1248, 1255 (1989).

[6] American Arbitration Association University, *Uniform Arbitration Act*, (April 9, 2015), https://www.aaau.org/media/5046/uniform%20arbitration%20act.pdf

some form of the Uniform Arbitration Act.[7] In some states that have not enacted their own version of the Uniform Arbitration Act, the common law supports the concept of arbitration.

The Revised Uniform Arbitration Act is a modified version of its 1955 predecessor and was introduced in 2000. The following depicts the enactment status of the Revised Act[8]:

Legislative Enactment Status
Arbitration Act (2000)



Legislative Tracking

2015 Introductions & Enactments

State	Bill	Sponsor	Status
Massachusetts	HB 37		Introduced
Pennsylvania	HB 34	Grell	Introduced
West Virginia	SB 37	Palumbo	Enacted

[7] *Id.*

[8] Legislative Enactment Status, http://www.uniformlaws.org/Act.aspx?title=Arbitration%20Act%20%282000%29 (last visited Apr. 7, 2015).

Whether proceeding under federal law, state law, or the common law, arbitration has the same fundamental concept — the parties contractually agree and determine what powers and duties to give to the arbitrator.[9] Importantly, the arbitrator has only those powers given to him or her by the parties.

2. HOW TO ACCOMPLISH YOUR ARBITRATION GOALS

An arbitration clause must be carefully designed to fulfill its intended purpose. What powers can be given to the arbitrator? The answer depends upon the parties' intentions. To make arbitration work the way the contracting parties intend for it to work, the arbitrator's powers must be appropriately limited. Similarly, the parties must be clear regarding what claims they intend to arbitrate, and how. An arbitration clause that includes "any and all controversies" between the parties may result in the unintended arbitration of tort claims.[10] Default American Arbitration Association ("AAA") rules are not suitable for every situation. An arbitration clause is a lawyer's only chance to "make up" rules.

The following are key issues that can (and probably should) be addressed in every arbitration clause:

1. Arbitrability
2. Venue
3. Choice of Law
4. Joinder of parties
5. Attorney's fees
6. Discovery
7. Number and qualifications of arbitrators
8. Form of decision
9. Injunctive relief
10. Statute of limitations
11. Damages
12. Right to appeal
13. Amount in controversy
14. Briefs and closings

This paper will examine how courts have reacted to some of the foregoing issues in the context of arbitration agreements.

[9] "[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit." United Steelworkers of Am. v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960).

[10] Gregory v. Electro-Mech. Corp., 83 F.3d 382 (11th Cir. 1996); Grektorp v. City Towers of Florida, Inc., 644 So. 2d 613 (Fla. 2d DCA 1994).

3. GENERAL LIMITS ON ARBITRATION CLAUSES

First, let's examine the general limits on "making up" arbitration rules. Generally applicable contract defenses, such as unconscionability, fraud, violation of public policy, and duress, may apply to invalidate arbitration agreements.[11] However, courts rarely find contracts unenforceable due to unconscionability. In determining whether an agreement may be voided as a "contract of adhesion," courts consider whether[12]: "there is unequal bargaining power as between the parties; the weaker party may opt out of arbitration; the arbitration clause is clear and conspicuous; an unfair advantage is obtained; the arbitration clause is negotiable; the arbitration provision is boilerplate; the aggrieved party had a meaningful choice or was compelled to accept arbitration; the arbitration agreement is within the reasonable expectations of the weaker party; and the stronger party used deceptive tactics."[13]

In addition to generally applicable contract defenses, limitations applicable to specific arbitration clauses must be considered.

4. ENFORCEMENT OF SELECTED ARBITRATION PROVISIONS

A. Arbitrability — Who Decides Whether the Dispute is Subject to Arbitration?

The first key question is whether the dispute is subject to arbitration. Who has the power to decide whether the dispute is subject to arbitration: the court or the arbitrator?

The answer is simple: it's up to the contracting parties. The United States Supreme Court has made it clear that the parties may contractually agree not only to arbitrate the merits of a dispute, but also who decides the question of arbitrability.[14] Similarly, the Supreme Court of Virginia has held that contracting parties may explicitly leave the question of arbitrability to the arbitrators, but in the absence of such an explicit agreement, the question of arbitrability is for

[11] Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 686–87, 116 S. Ct. 1652, 134 L. Ed. 2d 902 (1996).

[12] Harris v. Green Tree Fin. Corp., 183 F.3d 173 (3d Cir. 1999); We Care Hair Dev., Inc. v. Engen, 180 F.3d 838, 1999-1 Trade Cas. (CCH) P 72548 (7th Cir. 1999); Powers v. Dickson, Carlson & Campillo, 54 Cal. App. 4th 1102, 63 Cal. Rptr. 2d 261 (2d Dist. 1997), as modified, (May 23, 1997); Chor v. Piper, Jaffray & Hopwood, Inc., 261 Mont. 143, 862 P.2d 26 (1993); Buraczynski v. Eyring, 919 S.W.2d 314 (Tenn. 1996); Beldon Roofing & Remodeling Co. v. Tanner, 1997 WL 280482 (Tex. App.—San Antonio 1997); Sosa v. Paulos, 924 P.2d 357 (Utah 1996).

[13] Thomas H. Oehmke, J.D. & Joan M. Brovins, J.D., T*he Arbitration Contract—Making It and Breakin It*,83 Am. Jur. Proof of Facts 3d 1, § 70. Unconscionable or Adhesion Contracts (2005).

[14] First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 943, 115 S. Ct. 1920, 1923 (1995).

the court.[15] In Texas, the incorporation of AAA rules may be enough to allow the issue of arbitrability to be decided by the arbitrator.[16]

B. Venue for Motion to Compel Arbitration — Which Court Has the Power?

The parties may contractually agree upon a venue for the arbitration proceedings, but is that the proper venue to compel arbitration? Not always. Section 4 of the FAA contains conflicting directions to district courts regarding the proper venue to hear motions to compel arbitration.[17] It explicitly grants the power to compel arbitration to any district court with jurisdiction, but does not state whether district courts may compel arbitration outside of their own districts.

There is a three-way split between the courts on mandatory versus permissive venue provisions for a motion to compel arbitration:

(A) A district court may compel arbitration in any jurisdiction in the country,

(B) A district court may compel an arbitration in its own district regardless of the terms of the parties' arbitration agreement, and

[15] Waterfront Marine Constr., Inc. v. North End 49ers Sandbridge Bulkhead Groups A, B and C, 251 Va. 417, 468 S.E.2d 894 (1996). The court relied, in part, on Virginia Code § 8.01-581.02.

[16] Haddock v. Quinn, 287 S.W.3d 158, 172 (Tex. App.—Fort Worth 2009, pet. denied) ("The majority of courts have concluded that express incorporation of rules empowering the arbitrator to decide arbitrability (including ruling upon his or her own jurisdiction) clearly and unmistakably evidences the parties' intent to delegate issues of arbitrability to the arbitrator."); Burlington Res. Oil & Gas Co. LP v. San Juan Basin Royalty Trust, 249 S.W.3d 34, 41 (Tex. App.—Houston [1st Dist.] 2007, pet. denied) ("We are also mindful that, in certain circumstances, the incorporation of AAA rules may constitute clear and unmistakable evidence of an intent to allow an arbitrator to decide issues of arbitrability."); Qualcomm Inc. v. Nokia Corp., 466 F.3d 1366, 1368, 1373 (Fed. Cir. 2006) (concluding arbitration agreement containing broad arbitration clause and incorporating American Arbitration Rules allowing arbitrator to rule on own jurisdiction "clearly and unmistakably shows the parties' intent to delegate the issue of determining arbitrability to an arbitrator"); Contec. Corp. v. Remote Solution Co. Ltd., 398 F.3d 205, 208 (2d Cir. 2005).

[17] *See generally* Jarred Pinkston, Toward a Uniform Interpretation of the Federal Arbitration Act: The Role of 9 U.S.C.§208 in the Arbitral Statutory Scheme, 22 Emory Int'l L. Rev. 639, 651(As Pinkston writes: Section 4 contains "an internal conflict: it directs both that the court enforce an arbitration agreement in accordance with its terms and that it may direct arbitration only if it is to occur within the court's own district." A concrete example of this internal conflict would be if one party brings an action in the jurisdiction where the defendant is domiciled for breach of contract, there is a subsequent failure to arbitrate as per the terms of the contract, and the defendant then raises as a defense that the situs named in the arbitration clause is outside the district court's jurisdiction. Despite the fact that the arbitration clause is valid in all respects, a federal court would lack authority to compel arbitration outside its "district" under section 4, even if specific performance at the specified situs is the "manner provided for in such agreement" and is the only appropriate remedy under the contract in question.)

(C) A district court may compel an arbitration only in its own district, and lacks the authority to rule on a motion to compel when the parties' contract specifies that arbitration should proceed in another district.[18]

Each is addressed in turn.

A district court may compel arbitration in any jurisdiction in the country.

The first approach was developed by the Fifth Circuit and does not follow the text of Section 4 of the FAA.[19] Under the Fifth Circuit's approach, if a party who seeks to avoid arbitration files suit outside the district where the parties contractually agreed to hold arbitration, the district court has the power to compel arbitration in the contractually agreed-upon venue, even if that venue is outside its district.[20]

For example, in *Dupuy-Busching General Agency, Inc. v. Ambassador Insurance Co.*[21], the parties' contract called for arbitration in New Jersey. Dupuy-Busching received notice of an arbitration demand and filed suit in Mississippi state court, seeking to enjoin arbitration. The lawsuit was removed to federal court, whereupon Ambassador asserted a compulsory counterclaim seeking to compel arbitration pursuant to the parties' agreement. On appeal, the Fifth Circuit held that:

> *[W]here the party seeking to avoid arbitration brings a suit for injunctive relief in a district other than that in which arbitration is to take place under the contract, the party seeking arbitration may assert its Section 4 right to have the arbitration agreement performed in accordance with the terms of the agreement.*[22]

Later, in *Purdy v. Monex International Ltd.*, the Fifth Circuit clarified that the foregoing rule extends beyond a compulsory counterclaim scenario, reiterating: "[A] district court has the authority to order arbitration outside the district if the party seeking such a result has not waived

[18] Ansari v. Qwest Commc'ns Corp., 414 F.3d 1214, 1218–20 (10th Cir. 2005) (surveying cases). *See also* Jason W. Burge & Laura K. Richards, A Compelling Case for Streamlining Venue of Action to Enjoin Arbitration, 88 Tul. L. Rev. 773 (2004).

[19] Ashland Oil, 817 F.2d at 331 ("Apparently contrary to some other courts, we have not taken such a literal approach to the two part mandate of section 4.").

[20] See, e.g., Nat'l Iranian Oil Co. v. Ashland Oil, Inc., 817 F.2d 326, 331 (5th Cir. 1987) (construing § 9 of the FAA); *See also* Jason W. Burge & Laura K. Richards, A Compelling Case for Streamlining Venue of Action to Enjoin Arbitration, 88 Tul. L. Rev. 773 (2004).

[21] Dupuy-Busching General Agency, Inc. v. Ambassador Insurance Co., 524 F.2d 1275, 1276–78 (5th Cir. 1975).

[22] *Id*. at 1278.

his choice of forum."[23] However, the Fifth Circuit also noted that a waiver situation may exist where a party seeking to avoid arbitration initiated litigation.[24]

A district court may compel an arbitration in its own district regardless of the terms of the parties' arbitration agreement.

The second approach was developed by the Ninth Circuit and ignores the parties' intentions. In the Ninth Circuit, a district court may compel arbitration in its own district regardless of the parties' contractually agreed-upon venue.[25]

For example, in *Textile Unlimited, Inc. v. A..BMH & Co.*, the parties contracted to arbitrate in Georgia.[26] The seller submitted the matter to arbitration in Georgia, and the buyer filed suit in federal court in California, seeking to enjoin arbitration.[27] On appeal, the Ninth Circuit held that despite the parties' contractual agreement, "nothing in the [FAA] requires that [the buyer's] action to enjoin arbitration be brought in the district where the contract designated the arbitration to occur."[28]

Therefore, the district court where the suit is first filed has the power to compel arbitration, despite a contractual clause that states otherwise. Although such an approach leads to a race to the courthouse and forum-shopping, it follows the waiver logic of the Fifth Circuit. The Fifth Circuit found waiver of venue for a motion to compel if a party seeking to avoid arbitration initiated suit. The Ninth Circuit extended waiver to a motion to compel and right to conduct arbitration in the contractually agreed-upon venue.[29]

A district court may compel an arbitration only in its own district, and lacks the authority to rule on a motion to compel when the parties' contract specifies that arbitration should proceed in another district.

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[23] *Id.* at 1523; *See also* Ashland Oil, 817 F.2d at 331 ("Thus, Dupuy-Busching suggests that the language of section 4 need not be applied literally, that there may be some cases in which district courts are empowered to compel arbitration notwithstanding the parties' contractually established forum or outside of the district in which the courts sit.").

[24] Dealer Computer Servs., Inc. v. Red Hill Ford, Inc., No. H-08-2791, 2009 WL 2498483, at *2 n.1 (S.D. Tex. Aug. 11, 2009) (refusing to assert jurisdiction).

[25] See, e.g., Textile Unlimited, Inc. v. A..BMH & Co., 240 F.3d 781, 783 (9th Cir. 2001); Cont'l Grain Co. v. Dant & Russell, Inc., 118 F.2d 967, 968 (9th Cir. 1941).

[26] Textile Unlimited, Inc. v. A..BMH & Co., 240 F.3d 781, 783 (9th Cir. 2001).

[27] Textile Unlimited, 240 F.3d at 784.

[28] *Id.*

[29] *See* Jason W. Burge & Laura K. Richards, A Compelling Case for Streamlining Venue of Action to Enjoin Arbitration, 88 Tul. L. Rev. 773 (2004).

The third approach is the majority approach. The majority of federal circuit courts hold that venue under Section 4 of the FAA cannot be waived by either party. Under the majority approach, district courts have the power to compel arbitration only within their own district.

The issue was first addressed by the Third Circuit in *Econo-Car International, Inc. v. Antilles Car Rentals, Inc*.[30] There, the parties agreed to arbitrate in New York. [31] When Antilles refused to submit the parties' dispute to arbitration, Econo-Car filed suit in the district court for the Virgin Islands, seeking to compel arbitration in New York.[32] On appeal, the Third Circuit held that it could not compel arbitration in New York, and the case was dismissed.[33]

In addition to the Third Circuit, the other circuits that follow the majority approach include the Fourth Circuit[34], the Sixth Circuit[35], the Seventh Circuit[36], and the Tenth Circuit.[37] Courts in these circuits have stayed the action pending the outcome of arbitrability issue, dismissed the action, or transferred the action to the parties' contractually agreed-upon venue.

After one of the foregoing approaches is applied to determine which court has the power to compel arbitration, the next key issue is the reasonableness of the venue.

C. Venue After Motion to Compel — Is It Reasonable to Arbitrate in Your Back Yard or Across the Ocean?

The general rule is that forum-selection clauses are enforceable, even when the chosen forum is not reasonably related to the parties' commercial relationship. For example, in *McCain Foods Ltd. v. Puerto Rico Supplies, Inc.*, a company who contracted to distribute the plaintiff's goods in Puerto Rico was compelled to arbitrate in Ontario, Canada.[38] Similarly, in *Sam Reisfeld & Son Import Co. v. S. A. Eteco*, the court stayed litigation proceedings in the United States pending arbitration in Belgium, overruling one party's objection that the contractually agreed-upon forum was unreasonable.[39] A forum-selection clause is enforceable, unless it is fraudulent,

[30] 499 F.2d 1391 (3d Cir. 1974).

[31] *Id.*

[32] *Id.*

[33] *Id.* at 1394.

[34] See Elox Corp. v. Colt Indus., Inc., No. 90-2456, 1991 WL 263127, at *1 (4th Cir. Dec. 16, 1991) ("Further, if a court orders arbitration, the arbitration must be held in the same district as the court.").

[35] Mgmt. Recruiters Int'l, Inc. v. Bloor, 129 F.3d 851, 854 (6th Cir. 1997).

[36] 49 F.3d 323 (7th Cir. 1995).

[37] Ansari v. Qwest Commc'ns Corp., 414 F.3d 1214, 1219–20 (10th Cir. 2005).

[38] McCain Foods Ltd. v. Puerto Rico Supplies, Inc., 766 F. Supp. 58 (D.P.R. 1991).

[39] Sam Reisfeld & Son Import Co. v. S. A. Eteco, 530 F.2d 679, 1976-1 Trade Cas. (CCH) P 60851 (5th Cir. 1976).

unworkable, or revocable. Courts have gone so far as to compel domestic parties to arbitrate in foreign countries.[40]

D. Choice of Law — Who Is More Supreme?

An arbitration agreement may, and generally does, contain a choice-of-law provision. However, state laws sometimes conflict with the FAA. For example, the Florida Arbitration Code[41] was initially interpreted as prohibiting an award of attorney's fees by arbitrators, in conflict with the FAA.[42]

The United States Supreme Court settled the issue for contracts falling under the FAA by holding that, under the Supremacy Clause, the FAA preempts conflicting state statutes or state common law.[43] Generally speaking, a choice-of-law provision does not offend federal policy since there is no federal policy requiring arbitration "under a certain set of procedural rules."[44] Therefore, as the United States Supreme Court held in a case involving a payment dispute on a construction contract, federal law did not have preemptive effect on California law when the parties contracted to enforce California law.[45]

For contracts not falling under the FAA, state law governs as there is no issue involving the Supremacy Clause. However, a frequent issue in such cases involves the conflict between state laws and the contractually agreed-upon "make up" rules specified in the arbitration clause.

For example, Texas law provides that a mechanic's lien on real property "may be foreclosed only on judgment of a court."[46] May the parties agree to have the arbitrator decide the issue of lien validity, despite the statute? Yes, according to the Texas Supreme Court.[47] In *CVN Group, Inc. v. Delgado*, a contractor sought to confirm an arbitration award finding that its claimed statutory and constitutional mechanic's liens were valid.[48] The Texas Supreme Court ultimately held in favor of the contractor, concluding that the validity of the contractor's lien

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[40] Tennessee Imports, Inc. v. Filippi, 745 F. Supp. 1314 (M.D. Tenn. 1990); In re Hops Antitrust Litig., 655 F. Supp. 169, 1988-2 Trade Cas. (CCH) P 68121 (E.D. Mo. 1987).

[41] F.S. §682.01, et seq.

[42] FS 682.11; *See also* Michael A. Hanzman, Arbitration Agreements: Analyzing Threshold Choice of Law and Arbitratility Questions, The Florida Bar Journal, Volume LXX, No. 11, Dec. 1996, available at https://www.floridabar.org/divcom/jn/jnjournal01.nsf/Author/012DC56DB4F61A9B85256ADB005D60E2 (last visited April 9, 2015).

[43] Perry v. Thomas, 482 U.S. 483, 107 S. Ct. 2520, 2526 (1987).

[44] Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 109 S. Ct. 1248 (1989).

[45] *Id.*

[46] TEX. PROP.CODE § 53.154 ("A mechanic's lien may be foreclosed only on judgment of a court of competent jurisdiction foreclosing the lien and ordering the sale of the property subject to the lien.").

[47] CVN Group, Inc. v. Delgado, 95 S.W.3d 234, 46 Tex. Sup. Ct. J. 366. (2002).

[48] *Id.*

claim was within the scope of the parties' arbitration agreement, and that the arbitration award did not violate public policy.[49] The Court also cited two Texas cases that correctly decided the same issue.[50] Therefore, at least in Texas, it appears that the parties may contract to "override" state laws, subject to the limitations discussed in section 3 of this paper.[51]

Another issue arises when the contract's choice-of-law provision conflicts with the arbitration clause. For example, in *Mastrobuono v. Shearson Lehman Hutton, Inc.*, the parties' contract included a choice-of-law provision specifying that New York law would govern, while the arbitration clause required application of the rules of the National Association of Securities Dealers ("NASD").[52] Importantly, New York law allows courts (but not arbitrators) to award punitive damages, while NASD rules permit arbitrators to consider punitive damages as a remedy.[53] The United States Supreme Court offered the following solution to harmonize conflicting clauses within the contract:

> *We think the best way to harmonize the choice-of-law provision with the arbitration provision is to read "the laws of the State of New York" to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice-of-law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other. In contrast, respondents' reading sets up the two clauses in conflict with one another: one foreclosing punitive damages, the other allowing them. This interpretation is untenable.*[54]

Mastrobuono evidences courts' inclination to enforce arbitration clauses, even if they conflict with existing state laws. It appears that the Court even went so far as to favor the arbitration clause over another provision in the contract.

E. Attorney's Fees

The right to "make up" rules in an arbitration clause appears to also extend to attorney's fees. For example, the Supreme Court of Florida has held that parties may agree to allow the collateral issue of attorneys' fees to be decided in arbitration together with the underlying

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[49] *Id*. at 250

[50] Dalton Contractors, Inc. v. Bryan Autumn Woods, Ltd. ,60 S.W.3d 351, 354 (Tex. App.—Houston [1st Dist.] 2001, no pet.); Hearthshire Braeswood Plaza, Ltd. P'ship v. Bill Kelly Co., 849 S.W.2d 380, 390–91 (Tex. App.—Houston [14th Dist.] 1993, writ denied).

[51] Supra, General Limits on Arbitration Clauses

[52] Mastrobuono v. Shearson Lehman Hutton, Inc. 514 U.S. 52, 115 S. Ct. 1212 (1995).

[53] *Id.*

[54] *Id*. at 1219.

dispute.[55] However, the Court noted that an arbitrator has no authority to award attorney's fees absent an express waiver of "statutory right" to have the court decide the attorney's fee issue.[56] Therefore, with regard to contracts not covered by the FAA, it appears that the parties must specifically address attorney's fees in the arbitration clause.

In contrast, in cases involving contracts covered by the FAA, every arbitration agreement provides arbitrators with the authority to award attorney's fees as part of their broad power to fashion appropriate remedies, so long as the underlying statutory or common-law basis for the award of such fees exists.[57]

F. Confidentiality Clause — How Much Can You Hide?

Generally, an arbitration agreement may include a provision requiring confidentiality of the arbitration proceedings, but there are limits. For example, in *Longnecker v. American Express Co.*, the district court held that a confidentiality provision in an arbitration agreement between an employer and its employees was substantively unconscionable and, thus, unenforceable.[58] The provision recited that all arbitration proceedings were private and confidential, and required all parties to maintain the privacy and confidentiality of the arbitration hearing. The district court reasoned that the confidentiality provision was unfairly one-sided because it kept only the employees in the dark regarding prior arbitration decisions and, therefore, was only for the benefit of the employer.[59] The court ultimately severed the confidentiality provision from the arbitration agreement, and enforced the remainder of the agreement.[60]

G. Punitive Damages

An arbitration agreement may contain a provision limiting the arbitrator's power to award punitive damages. The United States Supreme Court has held that the FAA allows a party to explicitly exclude punitive-damage claims from the scope of agreement to arbitrate.[61]

The FAA is silent on the issue of whether arbitrators have the power to award punitive damages. After the United States Supreme Court issued its decision in *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, upholding choice-of-

[55] Turnberry Assocs. v. Service Station Aid, 651 So. 2d 1173 (Fla. 1995).

[56] *Id.*

[57] *See* Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); Prudential-Bache Securities, Inc. v. Depew, 814 F. Supp. 1081 (M.D. Fla. 1993).

[58] Longnecker v. American Exp. Co., 23 F. Supp. 3d 1099 (D. Ariz. 2014) (applying Arizona law).

[59] *Id.*

[60] *Id.*

[61] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614, 105 S. Ct. 3346 (1985).

law provisions not in conflict with FAA, clever parties began to "sneak in" a no-punitive-damages provision by specifying in their choice-of-law provision the law of a state that did not allow arbitrators to award punitive damages.[62]

However, the United States Supreme Court rejected such an attempt in at least one instance. In *Mastrobuono v. Shearson Lehman Hutton, Inc.*, the parties' contract did not expressly address punitive damages. However, the contract contained (1) a choice-of-law provision specifying that New York law would govern; and (2) an arbitration clause requiring application of the rules of the National Association of Securities Dealers ("NASD").[63] As noted above, New York law allows courts (but not arbitrators) to award punitive damages, while NASD rules permit arbitrators to consider punitive damages as a remedy. The United States Supreme Court ultimately held that, pursuant to NASD rules, the arbitrator had the power to award punitive damages. The Court reasoned that the choice-of-law provision introduced an ambiguity into the arbitration agreement, which otherwise allowed the award of punitive damages, and any ambiguity as to the scope of the arbitration clause is resolved in favor of arbitration.[64]

Therefore, if the parties intend to preclude an award of punitive damages, that should be made clear in the arbitration clause.

H. Joinder of Parties — Who Must Arbitrate?

Generally speaking, a contract binds only the parties thereto. Nevertheless, may an arbitration clause be enforced against a non-signatory? Yes, according to the Second Circuit[65]:

> Arbitration is contractual by nature. . . . It does not follow, however, that under the [FAA] an obligation to arbitrate attaches only to one who has personally signed the written arbitration provision. This court has made clear that a non-signatory party may be bound to an arbitration agreement if so dictated by the ordinary principles of contract and agency.[66]

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[62] Michael A. Hanzman, Arbitration Agreements: Analyzing Threshold Choice of Law and Arbitratility Questions, The Florida Bar Journal, Volume LXX, No. 11, Dec. 1996, available at https://www.floridabar.org/divcom/jn/jnjournal01.nsf/Author/012DC56DB4F61A9B85256ADB005D60E2 (last visited April 9, 2015).

[63] Mastrobuono v. Shearson Lehman Hutton, Inc. 514 U.S. 52, 115 S. Ct. 1212 (1995).

[64] *Id.* at 1218

[65] Thomson-CSF, S.A. v. American Arbitration Assoc. and Evans & Sutherland Computer Corp., 64 F.3d 773, 766 (2nd Cir. 1995).

[66] *Id.*

A non-signatory may be bound to arbitrate under the following principles: estoppel, incorporation by reference, assumption, agency, and alter ego/corporate veil piercing.[67]

Incorporation by reference is perhaps the most commonly used principle. For example, in *Frank J. Rooney, Inc. v Charles W. Ackerman of Florida, Inc.*, the parties' subcontract did not contain an arbitration clause. The subcontract did, however, incorporate by reference the general contract, which itself incorporated by reference the general provisions of the American Institute of Architects, including those providing for arbitration. Thus, the court held that the subcontractor was entitled to arbitrate its claims against the general contractor.[68] Some federal courts have taken a different approach by allowing incorporation by specific reference to the arbitration clause in a separate contract.[69] The Seventh Circuit has held that a wife was bound by an arbitration agreement that only her husband signed because she ratified the agreement by accepting services under it.[70]

The Texas Supreme Court has held that a non-signatory may be compelled to arbitrate if the non-signatory asserts one or more claims "based on a contract" containing an agreement to arbitrate, thereby subjecting itself to the contract's terms.[71] In *In re FirstMerit Bank*, the Court reasoned that by bringing their breach-of-warranty claims, the non-signatories sought benefits that stemmed directly from the terms of the contract, which included an arbitration clause. However, in a subsequent decision, the Court made an important distinction:

> *[U]nder "direct benefits estoppel," although a non-signatory's claim may relate to a contract containing an arbitration provision, that relationship does not, in itself, bind the non-signatory to the arbitration provision. Instead, a non-signatory should be compelled to arbitrate a claim only if it seeks, through the claim, to derive a direct benefit from the contract containing the arbitration provision.*[72]

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[67] *Id.*

[68] Frank J. Rooney, Inc. v Charles W. Ackerman of Fla., Inc., 219 So.2d 110 (Fla. 3d DCA 1969).

[69] Richard Bamforth and Irina Tymczyszyn, *Joining Non-Signatories to an Arbitration: Recent Developments*, Dispute Resolution 2007/08, Volume 2: Arbitration, available at http://www.olswang.com/pdfs/arbitration_jun07.pdf (last visited April 9, 2015).

[70] In re VMS Ltd. P'ship Sec. Litig., 26 F.3d 50, 52 (7th Cir.1994).

[71] In re FirstMerit Bank, 52 S.W.3d at 755, 44 Tex. Sup. Ct. J. 900 (2001) ("[A] litigant who sues based on a contract subjects him or herself to the contract's terms.").

[72] In Re Kellogg Brown & Root, Inc., Supreme Court of Texas, 166 S.W. 3d 732, 48 Tex. Sup. Ct. J. 678 (2004).

See Bailey, 364 F.3d at 268; MAG Portfolio Consult., GMBH v. Merlin Biomed Group LLC, 268 F.3d 58, 61 (2d Cir.2001) ("The benefits must be direct—which is to say, flowing directly from the agreement."); Int'l Paper Co., 206 F.3d at 417–18;Thomson–CSF, 64 F.3d at 778–79; In re FirstMerit Bank, 52 S.W.3d at 755.

The Court ultimately held that the non-signatory was not required to arbitrate its *quantum meruit* claim because the non-signatory did not seek, through that claim, to derive a direct benefit from a contract containing an arbitration provision.[73]

Another important issue is whether the parties may contractually agree that the arbitrator will decide the issue of joinder of parties. In Texas, the answer appears to be yes.[74]

I. Right to Appeal — None, Limited, or Full?

Generally, the parties to an arbitration agreement agree that the decision of the arbitrator is final, binding, and may be enforced by a judicial proceeding if necessary. Challenges to arbitration awards are allowed only in limited circumstances. The United States Supreme Court has held that the FAA lists the exclusive grounds upon which an arbitration award may be vacated (i.e., only if the award was procured by corruption, fraud, or undue means; there was evident partiality or corruption in the arbitrators; the arbitrators were guilty of misconduct in refusing to postpone the hearing for sufficient cause, in refusing to hear pertinent and material evidence, or of any other misbehavior by which a party's rights were prejudiced; or where the arbitrators exceeded their powers).[75] The United States Supreme Court further clarified that the statutory grounds for judicial review in the FAA are exclusive and may not be supplemented by contract. [76]

However, the Supreme Court of California appeared to disagree with the Supreme Court in Cable Connections, Inc. [77] The Cable Court examined the following clause providing a judicial review of the arbitrator's decision for legal error[78]:

> *"The arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error."*

The Cable Court held that the general rule of limited review issued by the United States Supreme Court "has been displaced by the parties' agreement."[79] The Cable Court noted the importance of an explicit judicial review clause and a clause stating state law should apply, rather than FAA. [80] Based on this California decision, these two factors appear crucial if the parties want to have a potential right to appeal an arbitration award for legal error.

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[73] In Re Kellogg Brown & Root, Inc., Supreme Court of Texas, 166 S.W. 3d 732, 48 Tex. Sup. Ct. J. 678 (2004).

[74] Saxa Inc. v DFD Architecture, Inc., 312 S.W.3d 224. (Dallas App.—2010).

[75] Hall Street Associates, LLC v. Mattel, Inc., 552 U.S. 576, 128 S.Ct. 1396 (2008).

[76] *Id.* at 587.
[77] Cable Connections, Inc. v. DirecTV, In., 44 Cal. 4th 1334 (2008).
[78] *Id.* at 1357.
[79] *Id.* at 1355.
[80] *Id.*

The Texas Supreme Court appeared to agree with the California Supreme Court.[81] The Texas Court examined whether: (1) the Texas Arbitration Act precludes the parties to contract for judicial review of an arbitration award for reversible error and, if not, (2) whether the FAA preempts enforcement of such right. Texas Supreme Court held that the TAA did not preclude parties from agreeing to limit an arbitrator's authority in a manner that effectively expanded the scope of judicial review of an arbitration award (i.e., for reversible error), and that the FAA did not preempt enforcement of such an agreement. [82]

Can the parties contractually agree to eliminate all appeal rights? No, according to the Ninth Circuit.[83] The Ninth Circuit Court was faced with a "binding, non-appealable arbitration" clause and ruled the clause was not enforceable. The court reasoned that permitting parties to contractually eliminate all judicial review of arbitration decisions would run counter to the FAA and frustrate the Congress's attempt to ensure a minimum level of due process for parties to an arbitration. [84]

Additionally, in 2013, AAA changed this process by allowing optional AAA appellate review of arbitrator's decisions on such limited grounds of fairness and integrity. The review is conducted by the AAA Appeal Tribunal and governed by Optional Appellate Arbitration Rules.[85]

J. Other Arbitration Clauses — How Far Can You Go?

Today, it appears that the parties may easily define the scope of the arbitrator's powers. For example, the parties may contractually agree on arbitration discovery limits, including specifying the number of depositions, requests for production, and interrogatories. The parties may also agree to preserve the applicability of a statute-of-limitations defense; preclude the award of injunctive relief; specify the expertise of the arbitrator, the number of arbitrators, or the form of decision; vary the arbitration rules to be applied according to the amount in controversy; and exclude the requirement of written briefs.

[81] *Nafta Traders, Inc. v. Quinn*, 339 S.W.3d 84, 87 (Tex. 2011), *cert. denied*, 132 S.Ct. 455 (Oct. 17, 2011).
[82] *Id.*

[83] In re Wal-Mart Wage & Hour Empl. Practices Litig. V. Class Counsel & Party to Arbitration, 2013 U.S. App. LEXIS 24948 (9th Cir. Nev. Dec. 17, 2013).
[84] *Id.*
[85] American Arbitration Association, Optional Appellate Arbitration Rules, 2013, available at https://www.adr.org/aaa/ShowProperty;jsessionid=hk8HS1hT2lhfKLq6F862y5J3YLHyGsmvb2rQd9n63chZrDJQytNp!1064099277?nodeId=/UCM/ADRSTAGE2016218&revision=latestreleased (last visited April 9, 2015).

5. SAMPLE ARBITRATION CLAUSES[86]

Injunctive relief

If injunctive relief is likely required, and you would rather have such relief available in court, delete any reference to inclusion of the Optional Rules for Emergency Measures of Protection and insert the following:

> Notwithstanding the foregoing, either party may immediately bring a proceeding seeking preliminary injunctive relief in a court having jurisdiction thereof which shall remain in effect until a final award is made in the arbitration.

Expertise

▪ The arbitrator shall be a certified public accountant.

▪ The arbitrator shall be a lawyer having at least ten years of experience in patent law.

▪ The arbitration panel shall consist of a lawyer having at least ten years of experience dealing with complex contracts, an accountant having experience in calculating lost profits, and a panel chair experienced in conducting complex arbitrations.

Form of decision

To ensure that the arbitrator issues a full decision, include a provision like the following:

▪ The arbitrator(s) shall issue a reasoned decision.

▪ The arbitrator(s) shall issue findings of facts and conclusions of law.

However, if you want to avoid any additional expense associated with a full decision, you may want to include the following provision:

▪ The arbitrator(s) shall provide a standard form of Award.

Discovery

Specify any particular forms of discovery you wish to utilize. You will want to be careful, however, that you do not provide for so much discovery that you sacrifice low cost and efficiency, two of the premier virtues of arbitration.

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[86] David Allgeyer, *Sample Arbitration Clauses with Comments*, Association of Corporate Counsel, http://www.acc.com/_cs_upload/vl/membersonly/SampleFormPolicy/409703_1.pdf (last visited April 9, 2015).

▪ The arbitrator shall require exchange by the parties of documents relevant to the issues raised by any claim, defense or counterclaim or on which the producing party may rely in support of or in opposition to any claim, defense or counterclaim, with due regard for eliminating undue burden and expense and the expedited and lower cost nature of arbitration. At the request of a party, the arbitrator may at his or her discretion order the deposition of witnesses. Depositions shall be limited to a maximum of three depositions per party, each of a maximum of four hours duration, unless the arbitrator otherwise determines.

▪ The arbitrator(s) shall only require the parties to disclose documents that they intend to rely on in presentation of their case at the hearing.

▪ The arbitrator(s) shall require the parties to disclose active electronic information maintained by only [specified number] custodians, from primary storage facilities (excluding backup facilities and tapes).

▪ The arbitrator(s) shall require disclosure of non-privileged materials, including electronic information, relevant to any parties' claim or defense, subject to limitations imposed by the arbitrator based on reasonable expense, duplication and undue burden.

Statutes of limitations

To preserve the applicability of a statute-of-limitations defense, you may want to include the following provision:

No demand for arbitration may be made after the date when the institution of legal or equitable proceedings based on such claim or dispute would be barred by the applicable statute of limitation.

Prohibition against punitive damages

To limit the arbitrator's authority to award punitive damages, include the following provision:

The arbitrator is not authorized to award punitive or other damages not measured by the prevailing party's actual damages.

Award of costs and attorney's fees

You may require such an award, forbid it, or leave it to the discretion of the arbitrator(s):

▪ If the arbitrator determines that a party has generally prevailed in the arbitration proceeding, then the arbitrator shall award to that party its reasonable out-of-pocket expenses related to the arbitration, including filing fees, arbitrator compensation, attorney's fees and legal costs.

▪ Each party shall bear its own costs, fees and expenses of arbitration.

▪ If the arbitrator determines that a party has generally prevailed in the arbitration proceeding, then the arbitrator may award to that party its reasonable out-of-pocket expenses related to the arbitration, including filing fees, arbitrator compensation, attorney's fees and legal costs.

Confidentiality

Arbitration proceedings are typically confidential, but confidentiality is not required unless the parties so agree. The following provision seeks to preserve confidentiality, while allowing necessary reports and steps to enforce the arbitration award:

▪ The arbitration proceedings and arbitration award shall be maintained by the parties as strictly confidential, except as is otherwise required by court order or as is necessary to confirm, vacate or enforce the award and for disclosure in confidence to the parties' respective attorneys, tax advisors and senior management and to family members of a party who is an individual.

Appeal

▪ An appeal may be taken to a separate panel of three JAMS arbitrators (or a single arbitrator if the parties so agree).

▪ The standard of review will be the "same standard . . . the first-level appellate court in the jurisdiction would apply to an appeal from the trial court decision."

▪ The decision will be rendered within 21 days of oral argument or service of final briefs, which will not exceed 25 double-spaced pages.

Additional sample clauses may be found on the JAMS website: http://www.jamsadr.com/clauses/.

6. CONCLUSION

Arbitration should be brought back in its place. Arbitration stemmed from a basic right to contract. Critics of arbitration often forget that arbitration is a contract bargained for by the parties. The contracting parties hold the power to mold an arbitration clause suitable for them, for that particular situation, at that particular time. As an attorney, its imperative to take advantage of any opportunity to "make-up" laws. Carefully drafting an arbitration clause gives exactly that opportunity. The courts put limits on "make-up" laws but the general inclination by all courts is the same: give as much weight as possible to the contracting parties' intentions. If the contracting parties' intentions are not explicit, the courts can not make arbitration work as intended by the contracting parties.

CHECKLIST[87]

The following items should be kept in mind when reviewing an arbitration clause:

Language

- Is there a written provision?
- What is the scope of the arbitration clause?
  — Is the arbitration clause narrow?
  — Is the arbitration clause broad?
  — Is there a “Future Disputes" clause?
- Are their successive contracts in which an arbitration clause may be affected by later agreements?

Type of Award

- Does the arbitration clause call for a final and binding award?

Form of Conflict Resolution

- Does the arbitration clause require mediation?
- Does the arbitration clause require a mini-trial?
- Does the arbitration clause require a summary jury trial?
- Is arbitration court-ordered?

Choice of Arbitrator

- Neutral decision-maker required?

Arbitration Rules

- Federal Arbitration Act
  — Transactions involving interstate commerce
  — Maritime transactions
- Uniform Arbitration Act

[87] Thomas H. Oehmke, J.D. & Joan M. Brovins, J.D., T*he Arbitration Contract—Making It and Breakin It,*83 Am. Jur. Proof of Facts 3d 1, § 70. Unconscionable or Adhesion Contracts (2005).