

DRAFTING ENFORCEABLE ARBITRATION PROVISIONS

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DRAFTING ENFORCEABLE ARBITRATION PROVISIONS*

I. INTRODUCTION

Many companies seek arbitration with the hope that it will result in more expeditious resolution of disputes than a traditional trial. In fact, a recent survey by the American Bar Association indicated that nearly 8 out of 10 litigators felt that arbitration was generally quicker than courtroom litigation.¹ On the other hand, depending upon the circumstances, many lawyers (and clients) might disagree with the attractiveness of arbitration based on their personal experience. As such, the drafting and enforcement of arbitration clauses is a common subject of concern among attorneys and their clients.

At a minimum, a well-drafted arbitration clause should set forth:

1. which disputes are covered;
2. the venue and place for the proceeding;
3. the procedure for selecting the decision-maker (e.g., the agreement can vest the ADR-provider (such as the American Arbitration Association, JAMS/Endispute) with discretion to select the adjudicator; or the parties can agree on a predetermined list; or the contract can describe the method by which an arbitrator will be selected;
4. a body to oversee the proceedings and resolve disputes;
5. applicable procedural rules and governing law;
6. the range of permissible remedies; and
7. the manner of enforcement of awards.

II. THE SCOPE OF THE ARBITRATION CLAUSE

In drafting an arbitration clause, the first consideration is the scope of the clause. The scope of the clause is important because it is the first thing that courts will look to in determining whether a particular dispute is subject to arbitration.² While a majority of clauses are drafted under broad terms as, at least initially, the parties generally desire any disputes that may arise to be arbitrated, the prudent practitioner will also consider whether his client's needs may be better served by a narrowly tailored clause.

A. Broad scope

If the arbitration clause is broad in scope, the court will generally defer to arbitration on any issues that "touch on" contract rights or contract performance.³ There is a presumption in favor of arbitration, and the presumption is particularly

powerful when the contract contains a broad arbitration clause.⁴

Avoiding arbitration when parties have agreed to a broad arbitration provision is extremely difficult. To do so, some courts have held that there must be an "express provision" excluding the particular dispute from the coverage of the arbitration clause, or "the most forceful evidence of a purpose to exclude" must be present.⁵

Courts have held that an arbitration clause will be considered broad in scope when phrases such as "all disputes or controversies" or "related to" are used.⁶ These broad phrases will extend to "all disputes between the parties having a significant relationship to the contract regardless of the label attached to the dispute."⁷

B. Narrow Scope

If the court is evaluating a narrow arbitration clause, some courts have determined arbitrability by asking if the cause of action pursued in court "directly relates" to a right in the contract.⁸ Other courts have asked "whether the dispute involves an agreement collateral to the agreement containing the arbitration clause."⁹ Whatever the exact test employed, it is clear that a party seeking to enforce a narrow arbitration clause will have a much higher burden than a party seeking to enforce a broad arbitration clause. Typically, language such as "arising from" has been used to determine a clause as narrow.¹⁰

In *Cornell University v. UAW Local 2300*,¹¹ the Second Circuit found an arbitration provision to be narrow and refused to compel arbitration. The provision defined arbitrable grievances as "any matter involving the interpretation or application of this Agreement which alleges a violation of the rights of an employee or the Union under the terms of this Agreement."¹² The agreement further stated that if Cornell changes the employee health care plan, it must notify the union prior to implementing the changes. During the negotiations leading up to the agreement, several proposals by the union were rejected. The proposals were incorporated into a letter of understanding, and included a clause stating that Cornell would establish a health insurance committee for reviewing plan information. The letter was silent on arbitration. Cornell subsequently took action in violation of the letter agreement and the union sought arbitration.

The union argued that the arbitration clause in the agreement applies because the letter supplemented the agreement and did not stand alone as a side agreement. Disagreeing, the court held that the arbitration agreement should be applied narrowly only to the disputes which directly relate to the terms of the agreement. As such, the court denied arbitration.

In *Lebanon Chem. Corp. v. United Farmers Plant Food, Inc.*, the Eighth Circuit found an arbitration clause to be narrow when the language of the provision required arbitration of all disputes “arising from a contract started or concluded under” the rules of the American Seed Trade Association.¹³ The court ultimately found that the dispute did not fall within the narrow clause and refused to compel arbitration.

Thus, in utilizing a narrow arbitration clause the practitioner should be aware that, despite a general policy favoring arbitration, courts will generally enforce arbitration claims as they are written.

III. POTENTIAL PITFALLS: MAINTAINING THE INTEGRITY OF AN ARBITRATION CLAUSE

When considering particular arbitration provisions, there are potential pitfalls to keep in mind that could render the dispute unarbitrable. As often occurs, one party may view it advantageous to proceed in arbitration while the opposing party believes it would be advantageous to proceed in court. When such a dispute arises, the party seeking to resolve the dispute in the courtroom typically attempts to have the arbitration provision deemed unenforceable.

A. Judging Arbitration Clauses

Arbitration clauses are subject to the same claims and defenses as any other agreement. Specifically, the Federal Arbitration Act puts arbitration clauses on the same footing as all contracts.¹⁴ In determining the contractual validity of an arbitration agreement, courts apply ordinary state-law principles that govern the formation of contracts.¹⁵ As such, any arbitration clause will be found unenforceable if the court finds that the agreement was procured by fraud, duress, or *unconscionability*.¹⁶ Unconscionability is by far the most litigated aspect regarding the enforcement of arbitration clauses.

B. Two types of unconscionability

Unconscionability, generally, includes two aspects: (1) procedural unconscionability, which refers to the circumstances surrounding the adoption of the arbitration provision, and (2) substantive unconscionability, which refers to the fairness of the arbitration provision itself.¹⁷

C. Types of procedural unconscionability

1. Amendment of agreement

An increasingly common event, especially in the credit card industry, is an amendment of the agreement between the parties where the amendment is mailed (usually to the consumer) and adds, for the first time, an arbitration provision. There has been

much litigation in recent years with consumers attempting to avoid the binding arbitration included in the amendments. Most courts have held that the amendments are enforceable.

In *Battels v. Sears National Bank*, a consumer opened a credit card account with Sears.¹⁸ The credit agreement was governed by a broad change-of-terms provision that allowed Sears to amend the agreement after providing written notice to the consumer.¹⁹ Sears amended the agreement by adding, among other things, an arbitration provision.²⁰ The consumer was given the chance to reject the agreement in writing, or accept the agreement by continued use of the card.²¹ The consumer continued to use the card.²²

Ultimately, a dispute arose and the consumer sought to avoid the arbitration clause on the grounds that he did not receive meaningful notice and that he did not assent to the new terms. The court rejected these arguments, stating that mailing the amendments constituted notice and continued use of the card indicated acceptance of the new terms.²³ As such, the consumer was bound to arbitrate.

The court in *Hoefs v. CACV of Colorado, LLC*, reached a similar result.²⁴ In *Hoefs*, a consumer entered into a credit card agreement with MBNA.²⁵ After entering the agreement, the consumer added her then-husband as an additional user.²⁶ The consumer and her husband divorced, and the consumer moved to a new address. After the divorce, MBNA sent the consumer an amendment to the agreement—the amendment included an arbitration clause.²⁷ The clause allowed the consumer to opt out of the agreement within thirty days.²⁸ The consumer failed to opt out.²⁹ The account ultimately went into default, and MBNA moved to compel arbitration, in accord with the amended agreement, so that it could collect the debt.³⁰

In her attempt to avoid arbitration, the consumer argued that there was no evidence that she ever received the amendment.³¹ The court was unsympathetic to her claim, noting that the “mailbox rule” controlled.³² The court found that the plaintiff did not rebut the presumption of the mailbox rule, and found that the amended agreement was enforceable.³³

The common thread between *Hoefs* and *Battels*, insofar as the enforceability of unilaterally mailed agreement, is that in both cases the consumer was given an opportunity to opt out of the amended terms. Thus, the prudent practitioner looking to amend an arbitration agreement via mail will include the opportunity for the consumer to opt out of the agreement.

2. Size of font

Many drafters of arbitration clauses and litigators alike may claim that an arbitration clause must be set off in contrasting type, either bold or underlined, so

that it may be more noticeable to the other party. While this belief is common in many legal circles, it seems to be unfounded.

The United States Supreme Court has held that the Federal Arbitration Act actually prohibits states from passing statutes requiring arbitration clauses to be displayed with special prominence.³⁴ Specifically, the Supreme Court held that the FAA precludes states from “singling out arbitration provisions for suspect status, requiring instead that such provision be placed upon the same footing as other contracts.”³⁵ As such, an arbitration clause will likely avoid being found unconscionable due to print size as long as the print is uniform throughout the contract.

In *Webb v. Investacorp, Inc.*³⁶, the plaintiff entered into an agreement with Investacorp whereby he became a contract representative for the company.³⁷ The agreement was governed by a “Principal Agreement,” which contained an arbitration clause.³⁸ When a dispute between the parties arose, Investacorp moved to arbitrate while Webb attempted to avoid it.³⁹ Webb argued, among other things, that the arbitration clause was unconscionable because it was “in fine print in the Principal Agreement.”⁴⁰ The Fifth Circuit rejected Webb’s argument, noting that the arbitration provision in the agreement could not be unconscionable because the size of print used for the arbitration provision was the same size as the print used throughout the agreement.⁴¹

3. Contract of adhesion

Courts scrutinize adhesion contracts and generally find them to be unconscionable. An adhesion contract is defined as a “standardized contract, which imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.”⁴²

In California, the state supreme court has found pre-employment arbitration agreements to be adhesive where the agreement is made a condition of employment.⁴³ In *Little v. Auto Stiegler Inc.*, an employee of an automobile dealership was terminated for investigating and reporting warranty fraud. During his employment, the employee signed three arbitration clauses, the most-recent of which read: “I agree that any claim, dispute, or controversy (including, but not limited to, any and all claims of discrimination and harassment) which would otherwise require or allow resort to any court or other governmental dispute resolution forum between myself and the Company (or its owners, directors, and officers, and parties affiliated with its employee benefit and health plans) arising from, related to, or having any relationship or connection whatsoever with my seeking employment with, employment by, or other association with, the Company, whether

based on tort, contract, statutory, or equitable law, or otherwise, shall be submitted to and determined exclusively by binding arbitration under the Federal Arbitration Act, in conformity with the procedures of the California Arbitration Act.”

The employee filed claims of wrongful termination, among others, in court and the dealership moved for arbitration. In discussing procedural unconscionability, the court stated “[I]n the case of preemployment arbitration contracts, the economic pressure exerted by employers on all but the most sought-after employees may be particularly acute, for the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement.” As such, the court noted that the employer had imposed an adhesive arbitration agreement on the employee and found the clause procedurally unconscionable.

However, the Ninth Circuit has repeatedly held that parties can avoid such an outcome by giving the employee an opportunity to opt out of the unconscionable provisions.⁴⁴

D. Types of substantive unconscionability—shocking the conscience

Courts have held that substantive unconscionability centers on whether the terms of the agreement are so one-sided as to “shock the conscience.”⁴⁵

1. Waiver of class action suits

The implementation of provisions that purport to waive the right to sue in the form of a class action are used largely in the consumer context. These provisions predominantly benefit the corporation, rather than the consumer, even if the clause is drafted in a manner that waives the rights of the both parties to sue as a class. Corporations rarely, if ever, sue consumers as a class, while the inverse is not true. Recognizing this circumstance, some courts have held that provisions that waive the right to sue as a class are unconscionably one-sided, regardless of how they are drafted. Other courts, however, have been willing to uphold class action waivers, despite their apparent one-sidedness.

In *Iberia Credit Bureau, Inc. v. Cingular Wireless LLC*,⁴⁶ cellular telephone customers filed a class action suit against their service providers.⁴⁷ Each of the plaintiffs’ contracts contained arbitration provisions and waiver of class action clauses.⁴⁸ The provision in question read: “Please read this section carefully. It affects rights that you may otherwise have. It provides for resolution of most disputes through arbitration instead of court trials and class actions. . . You agree that instead of suing in court, you will arbitrate any and all disputes. . . Even if

applicable law provides otherwise, you and we each waive our right to a trial by jury and to participate in class actions. . . . By this agreement, both you and we are waiving certain rights to litigate disputes in court.”⁴⁹

The Fifth Circuit stated that the language was “quite precise” and managed to bind only the consumer to waiving class action through meticulous use of the phrases “you and we” and simply “you.”⁵⁰ As such, the Fifth Circuit found that the waiver of class action clause to be unconscionably one-sided.

In *Ingle v. Circuit City Stores, Inc.*,⁵¹ the Ninth Circuit also found one-sidedness in a provision. *Ingle* involved a former employee who sued her former employer, Circuit City.⁵² The employee had signed an arbitration agreement as a condition of employment required by Circuit City.⁵³ The arbitration agreement contained a class action waiver clause.⁵⁴ The clause was drafted in a way that it applied equally to both Circuit City and the employee.⁵⁵

The employee sought to avoid arbitration by asserting that the class action waiver clause, among other clauses, was unconscionable.⁵⁶ The Ninth Circuit agreed, stating that the “manifest one-sidedness of the no class action provision at issue here is blindingly obvious.”⁵⁷ The court noted that it could not “conceive of any circumstances under which an employer would bring a class action proceeding against an employee.”⁵⁸ As such, the court held that despite the fact that the clause, as drafted, applied equally to all parties, the provision operated “solely to the advantage of Circuit City” and was therefore unconscionable.⁵⁹

In contrast, the Southern District of California recently held that provisions waiving the right to bring a class suit are not per se unconscionable.⁶⁰ In *Laster v. T-Mobile USA, Inc.*, the court held that class action waivers are unconscionable only if (1) the waiver is contained in a consumer contract of adhesion, in which small amounts of damages are at issue, and (2) it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.⁶¹

2. Limitation of remedies

Yet another advantage, and potential pitfall, to a well-crafted arbitration clause is the opportunity to limit potential remedies of the parties. Such a provision can work to limit exposure of the parties and can provide for a degree of predictability in dispute resolution. Typically, parties seek to limit, or avoid altogether, remedies made expressly available by statute and rights to appeal.

a. Limiting remedies available by statute

Texas law does not require that all statutory remedies be provided in arbitration proceedings.⁶² *In re Luna* involved an employment dispute whereby Luna, the employee, signed an arbitration agreement upon employment.⁶³ Luna asserted that the arbitration agreement's prohibition of reinstatement as a potential remedy was substantively unconscionable because the remedy was expressly allowable under the Texas Labor Code.⁶⁴ The court was unsympathetic to Luna's arguments and held that an arbitration provision that waives statutory-given remedies is enforceable.⁶⁵

However, in *Ingle v. Circuit City Stores, Inc.*,⁶⁶ discussed *supra*, the Ninth Circuit reached the opposite conclusion. Specifically, the court held that the arbitration provision in question was unconscionable, and therefore not enforceable, because it failed to provide various types of relief that would otherwise be available in court.”⁶⁷

b. Limiting the right to appeal

Generally, parties may limit their right to appeal an arbitrator's decision; however, such an agreement must be “clear and unequivocal.”⁶⁸ In *Bowen v. Amoco Pipeline Co.*, the parties, pursuant to a prior agreement, arbitrated a dispute over damages caused by an oil pipeline leak.⁶⁹ The arbitration panel found for the plaintiff and awarded damages.⁷⁰ Thereafter, the plaintiff sought, and received, a confirmation of the award from the district court.⁷¹ The defendant appealed, claiming that the arbitrators exceeded their powers and acted in manifest disregard of the law.⁷²

The plaintiff moved to dismiss the appeal for lack of jurisdiction, citing a provision in the arbitration agreement that stated that the district court's ruling on the award was to be “final.”⁷³ The court stated that such language did not clearly indicate the parties' intent to waive their rights to appeal. Rather, the court stated: “the very statute from which we derive our jurisdiction, 28 U.S.C. § 1291, grants appellate courts jurisdiction from “all *final* decisions of the district courts.”⁷⁴ Hence, by agreeing that the district court's ruling shall be final, the parties merely reinforced the appellate jurisdiction conferred by § 1291.”⁷⁵

Recently, however, the 10th Circuit clarified the *Bowen* holding by indicating that although “final” does not necessarily waive the parties' rights to appeal, the phrase “final and nonappealable” does.⁷⁶

According to the Tenth Circuit, parties may waive their rights to appeal as long as the waiver is clear and unequivocal. The term “final” does not satisfy the clear and unequivocal test while the phrase “final and nonappealable” does.

3. Locale

Texas courts, like others across the country, historically invalidated forum-selection clauses for violating public policy.⁷⁷ Today, however, forum selection clauses are prima facie valid and enforceable unless enforcement of the clause would be unreasonable.⁷⁸

In the seminal case of *M/S Bremen v. Zapata Off-Shore Co.*,⁷⁹ the U.S. Supreme Court held that the clause's opponent has a "heavy burden" to make a "strong showing" that the forum-selection clause should be set aside.⁸⁰ This burden includes a clear showing that enforcement would be "unreasonable and unjust"; that the clause was "invalid for such reasons as fraud or overreaching"; that "enforcement would contravene a strong public policy of the forum in which suit is brought, whether declared by statute or by judicial decision"; or that "the contractual forum will be so gravely difficult and inconvenient" that the opponent "will for all practical purposes be deprived of his day in court."⁸¹

In *Phoenix Network Technologies (Europe) Ltd., v. Neon Systems, Inc.*,⁸² the parties agreed to a forum selection clause that designated the United Kingdom as the venue for suit. When a dispute between the parties arose, the plaintiff filed suit in Fort Bend County, Texas. The defendant moved to dismiss under the forum-selection clause, despite the fact that the contract had been assigned to it and therefore, had never signed the clause. The clause read: "The parties hereby agree that this Agreement and the provisions hereof shall be construed in accordance with English law and the venue for resolution of any disputes arising out of this Agreement shall be the United Kingdom."

The plaintiff argued, among other things, that the clause did not choose the United Kingdom as the exclusive forum. After determining that the standard set forth in *M/S Bremen* controlled, the Texas appellate court rejected the plaintiff's arguments and required the parties to litigate the dispute in the United Kingdom.

However, not all forum selection clauses will be enforced. In *Swain v. Auto Services, Inc.*,⁸³ a Missouri court struck down as unconscionable a clause that required arbitration in Arkansas. The consumer, who had purchased a car in Missouri, signed an agreement purporting that both parties would litigate any dispute in Arkansas. The court rejected the clause, stating that "an average consumer purchasing a car in Missouri would not reasonably expect that any disputes arising under the service plan accompanying the car would have to be resolved in another state."

As such, there appears to be, as with most clauses, a different standard of enforceability depending on whether the parties are sophisticated

parties or whether one party is a consumer or employee.

4. Waiver of arbitration

A party can waive its right to arbitrate by taking action inconsistent with the right to arbitrate, such as suing in court or defending a claim in court.⁸⁴

In *Nevada Gold & Casinos, Inc. v. American Heritage, Inc.*, the plaintiff's first move, after the dispute arose, was to demand arbitration. The plaintiff also filed suit in Texas state court regarding claims that were not subject to the arbitration clause. The defendant subsequently filed its own suit in Nevada state court. The plaintiff moved to stay that suit pending arbitration. The Nevada court denied the motion to stay. The plaintiff subsequently amended his claim in Texas state court to include claims subject to the arbitration agreement. These claims were litigated for about 18 months. The plaintiff then moved to stay the Texas proceedings pending the arbitration that had been originally filed. The defendant opposed, citing waiver. The plaintiff argued that it had always demonstrated an intent to arbitrate.

The primary focus in determining whether arbitration has been waived is the resulting prejudice to the party opposing arbitration.⁸⁵ Under this test, waiver may be shown when the party seeking to arbitrate: (1) knew of his right to arbitrate, (2) acted inconsistently with that right, and (3) prejudiced the other party by his inconsistent acts. Prejudice may be shown (1) when the parties use discovery not available in arbitration, (2) when they litigate substantial issues on the merits, or (3) when compelling arbitration would require a duplication of efforts.⁸⁶

The court, noting that only after litigating substantial issues and on the eve of trial did the party seek an order from the Texas court to compel arbitration, held that the opposing party had been prejudiced and therefore denied the motion to compel arbitration.⁸⁷

E. Ways to avoid waiving arbitration

- (1) Make a demand for arbitration early as possible.
- (2) Move to compel arbitration early.
- (3) Move to stay court proceedings pending arbitration.
- (4) Make all pleadings or discovery documents subject to the arbitration.
- (5) Revisit 1-3 every time you, or any party, amend claims.

F. The poor man's defense and proposed clause

A growing complaint of parties who utilize arbitration clauses in their commercial agreements is that they are ultimately deprived of their right to arbitrate because the opposing party is unwilling, or unable, to pay its share of the required deposit for arbitrator compensation and other fees.⁸⁸

When a party is faced with the poor man's defense, there are generally three options available.

- (1) The AAA will tell you that their method for resolving the dispute is to have the paying party pay the non-paying party's share and seek reimbursement as part of the final award. Depending on the situation, the client may be willing to pay the entire arbitration fee to avoid the costs inherent with traditional litigation.
- (2) A second option is to file an action in court to obtain an order requiring the nonpaying party to pay its share. However, this option puts the parties in court, the exact place they sought to avoid by drafting an arbitration clause.
- (3) The final option is to discontinue the arbitration and file suit in state court, arguing that the nonpaying party has waived its right to arbitrate. Of course, this option is only of use if you are seeking to avoid arbitration.

Recent academic discussion has suggested that drafters include a waiver clause by which the parties agree that if either party is unable or unwilling to pay for its share of arbitration, then the arbitration shall proceed without that nonpaying party's participation.⁸⁹ Essentially, the paying party would put on its case without any response from the non-paying party and the arbitrator would decide the case upon hearing evidence from only the paying party. Drafters should be aware that such a clause is likely to only be successful in commercial transactions. Many courts have ruled arbitration clauses to be unconscionable if they force a consumer/employee, or any unsophisticated party, to pay upfront arbitration costs.

A form of provision is as follows:

"Each party shall bear its own costs and expenses, an equal share of the arbitrators' compensation and administrative charges of the arbitration and shall make deposits with the [provider] of its share of the amounts requested by the [provider]. Failure or refusal by a party to pay its share of the deposits for arbitrators' compensation and administrative charges shall constitute a waiver by that party of its rights to be heard,

present evidence, cross-examine witnesses, and assert counterclaims. Informing the arbitrator(s) of a party's failure to pay its share of the deposits for arbitrators' compensation and administrative charges for the purpose of implementing this waiver provision shall not be deemed to affect the arbitrator(s) impartiality or ability to proceed with the arbitration."⁹⁰

IV. MISCELLANEOUS TOPICS

A. Waiver of jury trials

Of course, all arbitration clauses essentially waive the right to a jury trial. This, however, should not be confused with a stand-alone provision that purports to waive a jury trial. Some courts have looked unfavorably on jury trial waiver provisions.⁹¹ For example, in *Grafton Partners LP v. Superior Court*, the California Supreme Court held that California constitutional and statutory provisions do not permit predispute jury waivers, and therefore, the court refused to enforce such a waiver.

However, in *Rivercenter Associates v. Rivera*,⁹² the Texas Supreme Court seem to acknowledge the enforceability of the waiver, but nevertheless refused to enforce it because the party seeking to enforcement waited more than four months to assert its right. In *Rivercenter*, the jury-wavier provision read: "The parties hereby waive trial by jury in any action, proceeding or counterclaim brought by either party against the other on any matter whatsoever arising out of, or in any way connected with, the Lease, the relationship of Lessor and Lessee created hereby, Lessee's use or occupancy of the Demised Premises, and/or any claim for injury or damage."

The plaintiff (Rivercenter) filed a contract action against defendants and defendants subsequently filed a jury demand. Four months after the jury demand, the plaintiff filed a motion to quash. The Texas Supreme Court upheld the denial of the motion because the moving party failed to show "diligent pursuit of its right to a non-jury trial."

B. Shortening the statute of limitations period

Generally speaking, the shortening of a statute of limitations period is not unconscionable and will be enforced by courts.⁹³ In *In re Luna*, the Houston Court of Appeals considered a clause stating: "The party seeking to arbitrate a dispute must submit written notice of claim within the earlier of one year or the time period prescribed by the statute or common law cause of action under which the claim is brought." The statutory limitations period for the claim asserted was two years. The court upheld the shortening of the two-year limitations period to one year because the clause applied equally to both parties.

In *EZ Pawn Corp. v. Mancias*, the Texas Supreme Court upheld an agreement limiting the time to bring a claim to 185 days.⁹⁴

However, courts in other jurisdictions have been willing to strike down provision that limit the statute of limitations period due to one-sidedness.⁹⁵ In *Ingle*, the Ninth Circuit examined a clause stating all claims: “shall be submitted not later than one year after the date on which the Associate knew, or through reasonable diligence should have known, of the facts giving rise to the Associate’s claim(s). The failure of an Associate to initiate arbitration within the one-year time limit shall constitute a waiver with respect to that dispute relative to that Associate.” The Ninth Circuit refused to enforce such a clause on the ground that it bound the employee without binding the employer.

Fortunately, the outcome in *Ingle* is easily avoided. Simply put, a clause shortening the limitations period must apply equally to all parties—just like all other contract provisions.

Also worth noting is the fact that the Uniform Commercial Code, provisions of which are adopted by nearly every state and governs the sale of goods, allows parties to limit the four year limitations period to a period not shorter than one year.⁹⁶

It should also be noted that although parties are usually allowed to shorten the time proscribed for filing a claim, parties are generally not allowed to extend the limitations period. In New York, for example, CPLR §201 requires that “no court shall extend the time limited by law for the commencement of an action.”

C. Enforcing an arbitration agreement against a party that never signed it

There are ways for a party who never signed, or even knew about, an arbitration agreement to be bound by it. In fact, Texas Courts have recognized six theories that may bind a non-signing party to arbitration agreements: (1) incorporation by reference, (2) assumption, (3) agency, (4) alter ego, (5) third-party beneficiary, and (6) equitable estoppel. The one most likely to land a party in arbitration, however, is equitable estoppel.

The theory of equitable estoppel has been applied in a rash of recent Texas Supreme Court cases to bind a party to arbitration despite the fact that the party never signed the arbitration agreement.⁹⁷

In *In re First Merit*, a father purchased a home for his adult daughter to live in. Although only the father signed the contract, the daughter was forced to arbitrate her personal injury claim against the homebuilder. The Court held that a non-signatory to a contract can be bound to arbitrate if it seeks to derive a direct benefit from the contract containing the arbitration provisions. Although the daughter sought to avoid arbitration on the ground that she never

signed the contract, the court rejected this argument, stating that “a litigant who sues based on a contract subjects himself or herself to the contract’s terms.” As such, the plaintiff was bound to arbitrate in accordance with the agreement that she had never signed.

In re Weekley Homes had similar fact pattern to *First Merit*, and therefore not surprisingly, concluded with a similar result. In *Weekley Homes*, the plaintiff’s father purchased a home for the plaintiff. Shortly after the plaintiff moved in, many structural problems developed. The plaintiff’s father filed breach of contract and warranty claims against the builder. The plaintiff sued only for personal injuries that allegedly developed from defendant’s negligent repairs. The Texas Supreme Court relied on *First Merit* for the proposition that “a litigant who sues based on a contract subjects him or herself to the contract’s terms.” However, the plaintiff in *Weekley Homes* was suing for personal injuries—a tort claim which was not based on the contract. The Court nevertheless held that a party sues on a contract “if it seeks. . .to derive a direct benefit from the contract containing the arbitration provisions.” The Court expounded on the phrase “direct benefit” by stating: “a nonparty may seek or obtain direct benefits from a contract by means other than a lawsuit. In some cases, a nonparty may be compelled to arbitrate if it deliberately seeks and obtains substantial benefits from the contract itself. The analysis here focuses on the nonparty’s conduct during the performance of the contract. We recognize that direct-benefits estoppel has yet to be endorsed by the United States Supreme Court, and that its application and boundaries are not entirely clear. For example, while federal courts often state the test as whether a nonsignatory has ‘embraced the contract,’ the metaphor gives little guidance in deciding what particular conduct embraces or merely shakes hands with it. Indeed, the equitable nature of the doctrine may render firm standards inappropriate, requiring trial courts to exercise some discretion based on the facts of each case.”

The Court found that the plaintiff had obtained a direct benefit under the contract because she directed how the features of the home should be constructed, repeatedly demanded extensive repairs, and received reimbursement for expenses she personally incurred. Further, she also conducted unsuccessful settlement negotiations with the defendant about moving the family into a new home. As such, the Court stated that because the plaintiff “obtained these substantial actions from Weekley by demanding compliance with provisions of the contract, [the plaintiff] cannot equitably object to the arbitration clause attached to them.

V. SAMPLE PROVISIONS

A. Standard arbitration provisions

The following are examples of common arbitration provisions.

1. Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by arbitration administered by the [name of entity] under its Commercial Arbitration Rules, and judgment on the award rendered by the arbitrator(s) may be entered and enforced by any court having jurisdiction.
2. The parties agree that any claim or dispute between them or against any agent, employee, successor, or assign of the other, whether related to this agreement or otherwise, and any claim or dispute related to this agreement or the relationship or duties contemplated under this contract, including the validity of this arbitration clause, shall be resolved by binding arbitration by the [name arbitrating entity], under the Code of Procedure then in effect. Any award of the arbitrator(s) may be entered as a judgment in any court having jurisdiction.
3. Any controversy or claim arising out of or relating to this Purchase Agreement or the breach thereof shall be settled by binding arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association. Any controversy or claim subject to this arbitration provision shall be decided by one arbitrator, and judgment on the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. Any arbitration proceeding shall be conducted in the city and state where the real property that is the subject of this Agreement is located.
4. If there is any dispute among the partners as to the interpretation of any provision of this agreement or the rights and obligations of any partner hereunder, such dispute shall be resolved through binding arbitration.

B. Governing law provisions

A common clause in arbitration provisions is a governing law clause. The governing law clause essentially allows the parties to agree to have their future disputes resolved under the law of a particular jurisdiction, without actually litigating, or arbitrating, in that jurisdiction. Considerations in drafting a governing law clause into an arbitration agreement include: (1) whether the substantive law is favorable to the client in anticipated breach situations, (2) the extent to which the jurisdiction's law has been developed and settled, and (3) the client's and

lawyer's familiarity with the jurisdiction's law.⁹⁸ Examples of governing law provisions are:

1. This Agreement shall be governed by and construed in accordance with the laws of the State of Texas, notwithstanding choice-of-law rules or principles to the contrary.
2. All documents executed pursuant to the transactions contemplated herein, including, without limitation, this Agreement shall be deemed to be Agreements made under, and for all purposes shall be construed in accordance with, the internal laws and judicial decisions of the State of Texas.

C. Cost provisions

1. The arbitrator will have the exclusive authority to determine and award costs of arbitration and the costs incurred by any party for their attorneys, advisors and consultants.
2. The compensation of the neutral arbitrator shall be borne by the parties equally, and shall be paid before the award is delivered to the parties. Statutory costs are recoverable by the prevailing party, if so ordered by the arbitrator. The prevailing party shall submit a request for statutory costs to the neutral arbitrator within 10 days after receiving the arbitration award. Objections to the costs bill by the non prevailing party shall be made within 10 days after receipt of the cost bill by the non-prevailing party. The award is not final until the neutral arbitrator makes a final ruling on the cost bill, which shall be made no longer than 30 days from the original award date, unless the parties agree otherwise. If the arbitrator fails to award costs pursuant to this provision, the prevailing party can seek recovery in the [trial court of jurisdiction] at the time the prevailing party seeks to confirm the award.

VI. CONCLUSION

In conclusion, arbitration agreements possess the potential to save time and money for clients. Further, when drafted properly, these provisions can be used to limit the potential exposure of companies and allow for a more predictable forecast with respect to potential disputes.

FOOTNOTES

*The author would like to acknowledge the assistance of Jason Marlin in the preparation of this article.

¹ Task Force on ADR Effectiveness, Am. Bar. Ass'n, Survey on Arbitration (2003); available at www.instituteforlegalreform.org/resources/ArbtrationStudyFinal.pdf.

² *Parfi Holding AB v. Mirror Image Internet, Inc.*, 817 A.2d 149 (Del. Supr. 2002).

³ *Id.*

⁴ *SBC Interactive, Inc. v. Corporate Media Partners*, 1997 WL 810008 (Del. Ch. 1997)

⁵ *Id.*

⁶ *Pennzoil Exploration & Prod. Co. v. Ramco Energy Ltd.*, 139 F.3d 1061, 1067-69 (5th Cir.1998); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 625-26 (1985).

⁷ *Pennzoil Exploration and Production Co. v. Ramco Energy Ltd.*, 139 F.3d 1061, 1067-68 (5th Cir. 1998).

⁸ *Id.*

⁹ *Fleet Tire Serv. Of N. Little Rock v. Oliver Rubber Co.*, 118 F.3d 619, 621 (8th Cir. 1997)

¹⁰ *Lebanon Chem. Corp. v. United Farmers Plant Food, Inc.*, 179 F.3d 1095, 1101 (8th Cir. 1999).

¹¹ 942 F.2d 138 (2nd Cir. 1991).

¹² *Cornell Univ. v. UAW Local 2300*, 942 F.2d 138, 140 (2nd Cir. 1991).

¹³ *Lebanon Chem. Corp. v. United Farmers Plant Food, Inc.*, 179 F.3d 1095, 1101 (8th Cir. 1999).

¹⁴ § 2 of the FAA

¹⁵ *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 944 (1995).

¹⁶ *Iberia* at 166.

¹⁷ *Carter v. Countrywide Credit Industries, Inc.*, 362 F.3d 294, 301 (5th Cir. 2004); *In re Halliburton Co.*, 80 S.W.3d 566, 571 (Tex.2002).

¹⁸ *Battels v. Sears National Bank*, 365 F.Supp.2d 1205 (M.D. Ala. 2005).

¹⁹ *Id.* at 1207.

²⁰ *Id.*

²¹ *Id.* at 1207-08.

²² *Id.*

²³ *Id.* at 1213-15.

²⁴ *Hoefs v. CACV of Colorado, LLC*, 365 F. Supp.2d 69 (D. Mass 2005).

²⁵ *Id.* at 71.

²⁶ *Id.*

²⁷ *Id.* at 72.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.* at 73.

³³ *Id.* at 75.

³⁴ *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

³⁵ *Id.*

³⁶ 89 F.3d 252 (5th Cir. 1996).

³⁷ *Id.* at 254.

³⁸ *Id.*

³⁹ *Id.* at 255.

⁴⁰ *Id.* at 259.

⁴¹ *Id.*

⁴² *Armendariz v. Foundation Health Psychcare Serv.*, 24 Cal. 4th 83, 113 (Cal. 2000).

⁴³ *Little v. Auto Stiegler, Inc.*, 63 P.3d 979 (2003).

⁴⁴ *Circuit City Stores v. Najd*, 294 F.3d 1104 (9th Cir. 2002); *Circuit City Stores v. Ahmed*, 283 F.3d 1198, 1200 (9th Cir. 2002).

⁴⁵ *Kinney v. United Healthcare Servs., Inc.*, 83 Cal.Rptr.2d 348 (1999).

⁴⁶ 379 F.3d 159 (5th Cir. 2004).

⁴⁷ *Id.* at 162.

⁴⁸ *Id.* at 168.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ 328 F.3d 1165, 1176 (9th Cir. 2003).

⁵² *Id.* at 1169.

⁵³ *Id.*

⁵⁴ *Id.* at 1175-76.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.* at 1176.

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Laster v. T-Mobile USA, Inc.*, 2005 WL 3610616 (S.D. Cal. 2005) (citing *Discover Bank v. Superior Court of Los Angeles*, 30 Cal.4th 148, 162-63 (Cal. 2005)).

⁶¹ *Id.*

⁶² *Pony Express Courier Corp. v. Morris*, 921 S.W.2d 817, 822 (Tex.App.-San Antonio 1996, no pet.); *In re Luna*, 175 S.W.3d 315, (Tex. App.—Houston [1st Dist.] 2004) (holding that an arbitration clause's exclusion of reinstatement to employee's position and preclusion of punitive damages is not unconscionable, despite the fact that these remedies are made available by statute).

⁶³ *In re Luna*, 175 S.W.3d at 318.

⁶⁴ *Id.* at 322.

⁶⁵ *Id.* at 323.

⁶⁶ 328 F.3d 1165, 1178 (9th Cir. 2003).

⁶⁷ *Id.*; (citing *Paladino v. Avnet Computer Techs, Inc.*, 134 F.3d 1054, 1059 (11th Cir. 1998)).

⁶⁸ *Bowen v. Amoco Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001).

⁶⁹ *Id.* at 927-28, 930.

⁷⁰ *Id.* at 930.

⁷¹ *Id.*

⁷² *Id.* at 930, 932.

⁷³ *Id.* at 930.

⁷⁴ *Id.* at 931. (emphasis added)

⁷⁵ *Id.*

⁷⁶ *MACTEC, Inc. v. Gorelick*, 427 F.3d 821, 830, (10th Cir. 2005).

⁷⁷ *In re AIU Ins. Co.*, 148 S.W.3d 109, 111 (Tex.2004); *see also M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 9 (1972).

⁷⁸ *Carter v. CountryWide Credit Industries, Inc.*, 362 F.3d 294, 299 (5th Cir. 2004).

⁷⁹ 407 U.S. 1, 9 (1972).

⁸⁰ *M/S Bremen*, 407 U.S. at 15.

⁸¹ *Id.*

⁸² 177 S.W.3d 605 (Tex. App.—Houston [1st Dist.] 2005).

⁸³ 128 S.W.3d 103 (Mo. Ct. App. 2004).

⁸⁴ *Uwaydah v. Van Wert County Hospital*, 246 F.Supp. 2d 808 (N.D. Ohio 2002); *Baker v. Stevens*, 114 P.3d 580 (Utah 2005); *Nevada Gold & Casinos, Inc. v. American Heritage, Inc.*, 110 P.3d 481 (Nevada 2005).

⁸⁵ *Nevada Gold & Casinos, Inc. v. American Heritage, Inc.*, 110 P.3d 481, 485 (Nevada 2005).

⁸⁶ *Id.*

⁸⁷ *Id.*

⁸⁸ DeWitt, Richard, No Pay No Play, 60-APR Disp. Resol. J. 27 (Feb.-April, 2005).

⁸⁹ *Id.*

⁹⁰ *Id.*

⁹¹ *Grafton Partners LP v. Superior Court*, 116 P.3d 479 (Cal. 2005).

⁹² 858 S.W.2d 366 (Tex. 1993).

⁹³ *In re Luna*, 175 S.W.3d 315, 324 (Tex.App.—Houston [1st Dist.] 2004).

⁹⁴ 934 S.W.2d 87 (Tex. 1996).

⁹⁵ *See Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1175 (9th Cir. 2003).

⁹⁶ U.C.C. §2-275(1).

⁹⁷ *In re Kellog Brown & Root, Inc.*, 166 S.W.3d 732, 739 (Tex. 2005); *In re FirstMerit Bank, N.A.*, 52 S.W.3d 749 (Tex. 2001); *In re Weekley Homes, L.P.*, No. 04-0119 (Tex. Sup. Ct.—October 28, 2005).

⁹⁸ Brad S. Karp, *The Litigation Angle in Drafting Commercial Agreements*, Practising Law Institute, 1459 PLI (Dec. 2004-Jan.2005).