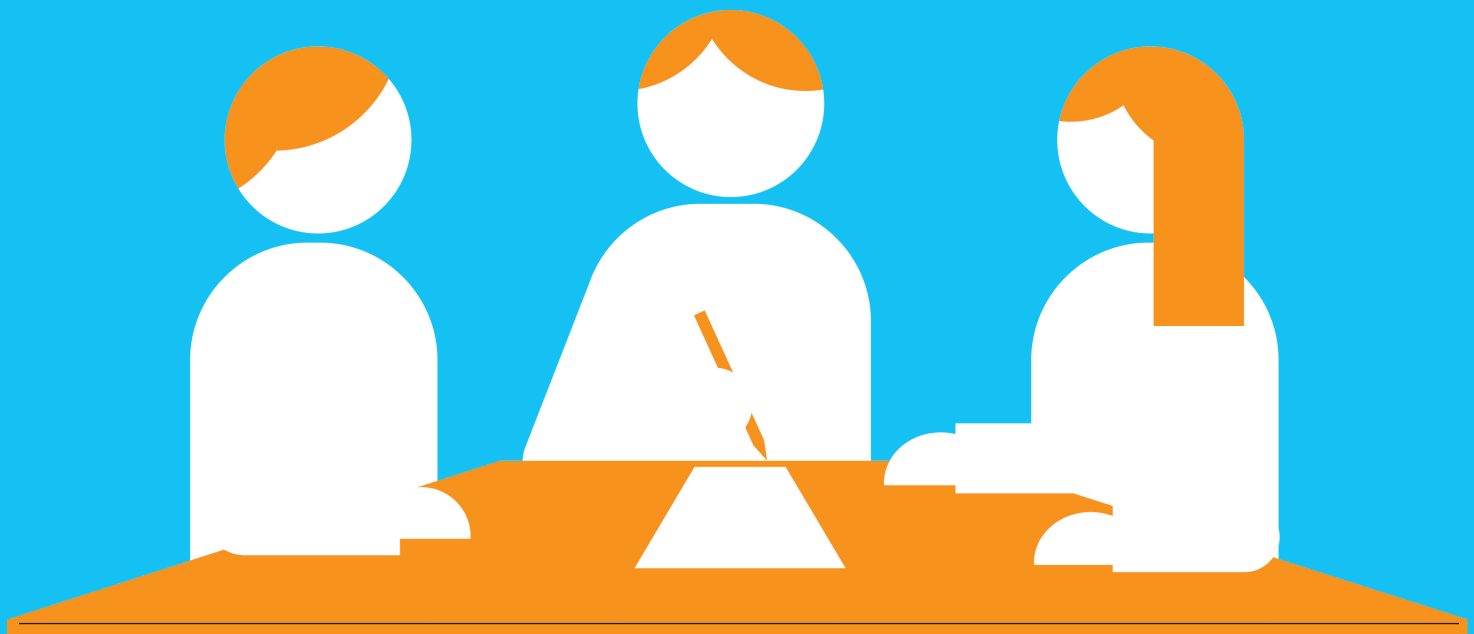
ARBITRATION CLAUSES: A CONTEMPORARY LOOK AT ADVANCED DRAFTING CONSIDERATIONS AND OPPORTUNITIES

by REBECCA J. CALLAHAN

This article assumes the reader understands the basics of arbitration clauses, and delves into more complex and advanced concepts with respect to arbitration clauses. As arbitration has grown as an accepted dispute resolution process, it is not surprising that reported cases concerning arbitration have increased. In the past twenty years there have usually been several noteworthy cases reported at both the state and federal levels each year. Some of those cases have led to some advanced drafting considerations and opportunities, a few of which are discussed below.



Scope of the Arbitrator's Power

In civil litigation, the power of the court over the parties and the subject matter of the dispute are both discussed under the general topic of "jurisdiction." In arbitration, "jurisdiction" is the term used to discuss the arbitrator's power over the parties. "Arbitrability" is the term used to describe the scope of the arbitrator's power to both decide particular claims and issues, and make awards of particular types of relief. There are three sources for an arbitrator's subject-matter decision-making authority: (1) the parties' arbitration agreement; (2) the applicable law and the cases construing the same; or (3) the applicable rules governing the arbitration.

Understanding and defining the scope of the arbitrator's decision-making authority is important because, at the back-end of the process, one of the statutory grounds for vacating an arbitrator's award is that the arbitrator exceeded or acted at variance to the scope of his or her authority. 9 U.S.C. § 10(a)(4); *Oxford Health Plans LLC v. Sutter*, __ U.S. __, 133 S.Ct. 2064, 2068 (2013); *E. Associated Coal Corp. v. United Mine Workers of Am., Dist. 17*, 531 U.S. 57, 62 (2000). In this regard, the Supreme Court has held that parties are "generally free to structure their arbitration agreements as they see fit." *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995); *AT&T Techs., Inc. v. Commc'ns Workers of Am.*, 475 U.S. 643, 648-49 (1986). When drafting an arbitration clause, thought should be given to defining the scope of the arbitrator's decision-making power. In particular, does the arbitrator have the power to decide arbitrability of the particular dispute? This question presents a drafting trap for the unwary.

The general rule is that, absent clear and unmistakable evidence of the parties' contrary intent, courts—not arbitrators—are to determine questions of arbitrability. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995). However, many courts have recognized the power of arbitrators to decide this gateway issue. Some courts have found that when a clause refers to a particular provider's rules and those rules give the arbitrator the power to determine any dispute concerning arbitrability, the reference to the rules is sufficient evidence of the parties "clear and unmistakable" agreement to let the arbitrator decide such matters. *See, e.g.*, *Brennan v. Opus Bank*, 796 F.3d 1125 (9th Cir. 2015); *Brinkley v. Monterey Fin. Servs., Inc.*, 242 Cal. App. 4th 314 (2015). Also, both AAA Commercial Rule R-7 and JAMS Rule 11(c) give the arbitrator the power to hear and decide arbitrability.

The following is an example of language empowering the arbitrator to decide arbitrability, if that is the parties' contracting desire:

> The Arbitrator, and not any federal, state or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, enforceability or formation of this Agreement including, but not limited to, disputes about the validity, enforceability, arbitrability or scope of this arbitration agreement.

On the flip-side, the following is an example of language making it clear that the arbitrator does *not* have the power to decide arbitrability:

> Notwithstanding the foregoing, any dispute relating to the validity, interpretation, enforceability or scope of this Agreement including, but not limited to, any claim that all or any part of this Agreement is void, voidable, or otherwise unenforceable, shall not be subject to arbitration.

Entry of Judgment on the Award

An arbitration award, standing alone, is unenforceable beyond asking the losing party to perform. In order to have access to judgment creditor enforcement rights under state law, the award first must be confirmed as a judgment. Both the Federal Arbitration Act (FAA) and the California Arbitration Act (CAA) provide that a party to an arbitration may apply to the court for confirmation and entry of judgment on an award. 9 U.S.C. § 9; Cal. Civil Proc. Code § 1285. That being said, there is a drafting trap for the unwary contained in Section 9 of the FAA. That provision states that judicial confirmation is available only "if the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court . . . ." It is thus recommended that the following sentence be included in any arbitration clause or agreement: Judgment on the award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof.

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Provisional Relief

In response to the perceived need for a mechanism to award interim relief within the arbitral system, in 2006 the International Centre for Dispute Resolution (ICDR) incorporated emergency arbitrator proceedings into its rules. In the following ten years, almost every major arbitration provider has followed suit—including the American Arbitration Association (AAA) in 2013 (Rule 38(e)) and JAMS in 2014 (Rule 2(c)(iv)). As a result, when the AAA or JAMS rules are referenced in a clause, they will include the emergency provisions for provisional relief. Importantly, the developing case law—including the high-profile 2013 decision of the S.D.N.Y., *Yahoo! Inc. v. Microsoft Corp.*, 983 F.Supp. 2d 310 (S.D.N.Y. 2013)—indicates that decisions by emergency

arbitrators are likely to be enforced by the courts. Still, the courts will be the preferred venue when relief is needed on an *ex parte* basis because, with only a few exceptions, the emergency arbitrator rules of most providers do *not* allow for *ex parte* relief.

If the arbitration agreement references the AAA or JAMS rules, it is not necessary to provide for the arbitrator to decide requests for provisional relief, but it will not hurt. The following is a sample provision:

> The parties hereto agree that any claim arising out of, relating to or in connection with this agreement . . . shall be finally settled by binding arbitration administered by the American Arbitration Association in accordance with its Commercial Rules, including any requests for interim, provisional or emergency relief that is necessary to protect the arbitral process or the rights or property of any party pending the arbitrator's appointment or the issuance of a final award in the arbitration.

On the flip side, if the parties want to preserve access to the courts for emergency or provisional relief, then there needs to be an express provision in the arbitration clause that overrides the provider's rules on the subject. The following is a sample sentence to be added at the end of the arbitration clause:

> Notwithstanding the foregoing and without waiving any other right or remedy, a party may seek from a court having jurisdiction any interim, provisional or emergency relief that is necessary to protect the arbitral process and/or the rights or property of any party pending the arbitrator's appointment or the issuance of a final award in the arbitration.

Award of Fees and Costs

The recovery of prevailing party attorney's fees and costs is an important subject that should be dealt with expressly in the arbitration clause, keeping in mind that fee-shifting incentives built into the contract may promote trial over settlement if a dispute later arises. This is a context-driven inquiry in which the parties have three options: (1) forbid an award; (2) require an award ; or (3) leave such an award to the discretion of the arbitrator(s). The following are examples of each:

> ***Forbid the award:*** Each party shall bear its own costs, fees, and expenses associated with any arbitration and related court proceedings.
>
> ***Require the award:*** If the arbitrator determines that a party has generally prevailed in the arbitration proceeding, then the arbitrator shall award to that party its (reasonable/actual) out-of-pocket expenses related to the arbitration and any court proceedings related thereto, including filing fees, arbitrator compensation, provider fees and charges, attorney's fees, court reporter fees, and other costs typically awarded to a prevailing party in court. *Note*: the key word is "shall."
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> ***Make the award of attorney's fees and costs a matter of discretion:*** If the arbitrator determines that a party has generally prevailed in the arbitration proceeding, then the arbitrator may award to that party its (reasonable/actual) out-of-pocket expenses related to the arbitration and any court proceedings related thereto, including filing fees, arbitrator compensation, provider fees and charges, attorney's fees, court reporter fees, and other costs typically awarded to a prevailing party in court. *Note:* The key word is "may."

The Availability of Statutes of Limitation as an Affirmative Defense

The traditional theory is that parties contract for arbitration to avoid the higher costs and longer delays of litigation. In order to achieve these goals, parties to arbitration greatly curtail, or even forego, many of the procedural "safeguards" of litigation, including motion practice, broad discovery, and appellate review. At the same time, parties do not generally expect that by agreeing to arbitration the resolution of the dispute will be conducted without any regard for substantive law. The question is whether statutes of limitation are procedural or substantive.

There has been much debate as to whether statutes of limitation defenses are among the procedural safeguards that are potentially lost when parties choose arbitration, or whether they are substantive rights that apply regardless of the dispute resolution forum. This debate is invited because the law of arbitration is clear that arbitrators "may base their decision upon broad principles of justice and equity, and in doing so may expressly or impliedly reject a claim that a party might successfully have asserted in a judicial action." *Moncharsh v. Heily & Blase*, 3 Cal. 4th 1, 10-12 (1992).

This applies equally to rulings on affirmative defenses. Where there is a valid arbitration agreement in place, it is for the arbitrator to decide. In this regard, the California Supreme Court has recently ruled that the fact that an arbitrator might decide a statute of limitations affirmative defense differently from a court does not provide a legitimate basis for denying a motion to compel arbitration of the dispute. *Wagner Constr. Co. v. Pac. Mech. Corp.*, 41 Cal. 4th 19, 28 (2016). The following are sample clauses to consider:

> ***Sample 1:*** The arbitrators must act in conformity with rules of law, including but not limited to recognizing the statute of limitations applicable to any legal, equitable, or statutory claim.
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> ***Sample 2:*** No claim may be brought after the passage of time which would preclude a claim regarding the same or similar subject matter being commenced in a court of competent jurisdiction.
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> ***Sample 3:*** The arbitrator must apply applicable statutes of limitations and claims of privilege recognized at law, and applicable substantive law consistent with the Federal Arbitration Act. The arbitrator is authorized to award all remedies permitted by the substantive law that would apply if the action were pending in court.

Successors and Assigns

The general rule is that one must be a party to an arbitration agreement to be bound by it. While there is a strong public policy in favor of arbitration, the law is equally clear that a party cannot be compelled to arbitrate a dispute that he has not agreed to resolve by arbitration. *Monschke v. Timber Ridge Assisted Liv-*

ing, LLC, 244 Cal. App. 4th 583 (2016); *Buckner v. Tamarin*, 98 Cal. App. 4th 140 (2002). Courts have recognized an exception to the general rule in the context of mergers and acquisitions and assignment/assumption situations where a non-signatory acquires the signatory's contractual rights, duties, assets, interests, etc. and is found to have stepped into the shoes of the earlier contracting party. *Marenco v. DirecTV LLC*, 233 Cal. App. 4th 1409 (2015).

Factual context is key. In *McArthur v. McArthur*, 224 Cal. App. 4th 651 (2014), the trust instrument contained an arbitration clause. While binding on the successor trustee to the decedent, the beneficiary was not a signatory *and* was challenging the validity of the trust instrument on the grounds of undue influence and lack of testamentary capacity. The motion to compel arbitration was denied, and affirmed on appeal. The First Circuit Court of Appeal left the door open as to whether enforcement of an arbitration clause contained in a trust instrument is required if the trust beneficiary is claiming rights or benefits under the trust instrument. In dictum, the court suggested that the answer would be yes.

While there are contexts in which a broad "successors and assigns" clause may not be enforceable, it does not hurt to include one. The following is a sample clause:

> This arbitration agreement is binding on and shall inure to the benefit of the parties' respective successors, assigns, agents, representatives, affiliates, and anyone connected with or claiming through any party, including but not limited to a trustee in bankruptcy or an assignee for the benefit of creditors.

Discovery

In litigation in the courts, there is currently a recognized, statutory "right" to discovery. No such "right" exists in arbitration, unless the parties' agreement provides for the same. Historically, discovery was not allowed in arbitration or litigation. At the time the FAA was enacted in 1925, its litigation counterpart did *not* include discovery procedures. In both litigation and arbitration, each party relied on documents in its possession and testimony given by witnesses at trial. And cross-examination was a true art form, *e.g.*, in the 1960s drama where Perry Mason defended dozens of falsely accused people and managed to clear every one of them, usually by drawing out the real criminal on the witness stand. That all changed in 1938 when the Federal Rules of Civil Procedure (FRCP) included discovery rules intended to prevent surprise at trial. Those rules have increased and been amended over the years so that the discovery phase of most litigation matters is the most costly and time-consuming aspect of the case. However, the arbitration alternative has *not* changed in terms of statutory authority for discovery in arbitration. The FAA did not and does not now include discovery rules or procedures, and that is true with most state arbitration statutes, including the CAA. That being said, some providers have amended their rules to provide for some level of discovery, especially in complex cases.

If provisions for discovery are included in the parties' arbitration agreement or in agreements reached by their counsel in connection with the arbitration, those agreements are presumptively binding on the arbitrator. Where the parties' arbitration agreement is silent on the subject of discovery, but provides that the arbitration will be conducted in accordance with a provider's rules, then the discovery provisions of the arbitral tribunal's rules will govern. And those rules generally provide for broad discretion on the part of the arbitrator.

Discretion is generally exercised to allow a certain amount of discovery. Good cause is not difficult to establish when a party other than the requesting party is in control of documents or information a party needs to prepare and present its case. But, most arbitrators require discovery to be proportional to the dollars and issues in dispute: no fishing expeditions or cumulative discovery. The following are some sample "discovery" provisions for consideration:

> ***Example 1—very broad:*** The parties shall be allowed such discovery as would be available in federal court and such discovery shall be governed by the Federal Rules of Civil Procedure.
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> ***Example 2—very minimal:*** The parties shall be allowed discovery on good cause shown to the arbitrator, who shall have complete discretion to decide the matter.
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> ***Example 3—standardized for re-curring fact pattern cases:*** The parties shall each be allowed to take two depositions and each shall be allowed to propound ten requests each for production, admission, and interrogatories. Any further discovery shall be allowed only on good cause shown to the arbitrator, including agreement of the parties for expanded discovery.

Conclusion

Much like mediation, the parties who opt for arbitration have a tremendous opportunity to define for themselves the process that will best adjudicate their disputes in an efficient, fair, and economic manner. When the decision has been made to include a pre-dispute arbitration clause in a contract, thought and care should be given to what will and will not be included in that clause. The above are some thoughts and suggestions based on recent case decisions.

Part 1 of this two-part series covered "the basics," and was published in the February 2017 issue of Orange County Lawyer.

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