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Overdrafting Contractual Arbitration Clauses

By Garrett L. Boehm, Jr.

Sometimes the simple and straightforward can go awry. Most will agree that the purpose of contracts is to clearly delineate the extent and scope of the contracting parties' agreement. Typically that agreement will involve a description of each party's duties, responsibilities, and acts to be performed. Of course, every now and then, circumstances are such that a party cannot adhere to terms of the agreement. So, it is also very common for contracts to explicitly state how disputes will be resolved. One increasingly popular form of dispute resolution is arbitration.

Of course, there are many forms of arbitration and even more arbitrators. Arbitration providers range from government provided and publicly funded dispute resolution organizations to national private professional organizations like the American Arbitration Association, ADR Services, Inc., AIDA Reinsurance & Insurance Arbitration Society, JAMS, Resolute Systems LLC, CyberSettle.com, to regional organizations, to state specific organizations, and the list goes on and on. And, each entity may have its own rules governing how the arbitration will be conducted. Because the options can be overwhelming and can create uncertainty, parties may agree to arbitration with a specific arbitration provider. But, being too specific can backfire.

That's what happened in *Carr v. Gateway, Inc*., 2011 Ill. LEXIS 424 (Ill. Feb. 3, 2011). William Carr bought a computer from Gateway, but he felt that the processing speed did not measure up to Gateway's promises. So, he filed suit in Madison County. Without much surprise, Gateway did not want anything to do with defending a class action lawsuit in Madison County. Consequently, Gateway sought to dismiss the suit and to compel arbitration with the National Arbitration Forum (NAF) according to the terms of the sales agreement with Carr. Unfortunately for Gateway, the circuit court denied the motion. Gateway filed an interlocutory appeal, but during that appeal the NAF stopped accepting commercial arbitrations. Consequently, the appellate court affirmed the circuit court's denial of Gateway's motion to dismiss and to compel arbitration on the basis that the arbitration agreement failed due to the unavailability of the arbitral forum.

Undeterred, Gateway sought appeal before the Illinois Supreme Court to assess whether section 5 of the Federal Arbitration Act (9 U.S.C. §5 (2006)) permitted the circuit court to appoint a substitute arbitrator due to the unavailability of the parties' designated arbitral forum. In short, the Illinois Supreme Court said "no."

Section 4 of the Arbitration Act (9 U.S.C. §4 (2006)) permits a party in a civil action to petition the court for an order directing that arbitration proceed in the manner provided in the parties' arbitration agreement. Section 5 then provides if an agreement establishes a method for naming an arbitrator, that method will be followed. If the agreement does not provide a method for naming an arbitrator, the court will designate an arbitrator. Moreover, if there is any reason for a lapse in naming an arbitrator, the court can designate an arbitrator. *See* 9 U.S.C. §5 (2006).

Gateway thought that Section 5 should allow the Court to designate an alternate arbitration provider now that the National Arbitration Forum would not accept commercial arbitrations. There exists a series of cases that have held that if the choice of the arbitral forum is not an integral part of the agreement to arbitrate, but instead is an "ancillary logistical concern", the Court can appoint an alternate arbitrator according to section 5 of the Federal Arbitration Act. But, the *Carr* Court noted that in *Grant v. Magnolia Manor-Greenwood, Inc*., 383 S.C. 125, 678 S.E.2d 435 (S.C. 2009), the South Carolina Supreme Court refused to appoint an alternate arbitrator where the parties had agreed to a specific arbitrator, even if that specific arbitrator had become unavailable. The Illinois Supreme Court also noted *Carideo v. Dell, Inc.*, 2009 U.S. Dist. LEXIS 104600, 2009 WL 3485933 (W.D. Wash. Oct. 26, 2009), where the parties had designated the NAF as the arbitral forum with much of the same language in the Gateway agreement. That court held that the designation of NAF was integral to the contract. But, *Adler v. Dell, Inc.*, 2009 U.S. Dist. LEXIS 112204, 2009 WL 4580739 (E.D. Mich. Dec. 3, 2009), reached a contrary conclusion in construing an identical arbitration clause.

After reviewing these authorities, the Illinois Supreme Court agreed with Gateway that "the mere fact parties name an arbitral service to handle arbitrations and specify rules to be applied does not, standing alone, make that designation integral to the agreement." But, the Gateway agreement also provided that the arbitration would be conducted according to NAF rules. The parties had not argued, and the Illinois Supreme Court would not speculate, whether a substitute arbitrator *could* use NAF rules. Ultimately, the Illinois Supreme Court determined that "[t]he fact that the NAF restricts the use of its rules to only those entities and individuals providing arbitral services by agreement with the NAF militates in favor of a finding that the designation of the NAF and its rules was integral to the parties'

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agreement to arbitrate." Interestingly, the Court went outside of the contract to determine whether the arbitration clause in the contract was integral to the contract.

But, the nail in the coffin was another provision in the agreement that awarded fees and costs to the party that brought a motion to dismiss an arbitration proceeding submitted to an arbitration provider other than NAF. It was this penalty provision that convinced the Illinois Supreme Court that the arbitration clause selecting NAF as the sole available arbitration provider was integral to the contract such that Section 5 of the Federal Arbitration Act could not be applied to provide Carr (and the putative class) and Gateway with a substitute arbitrator.

Ultimately, the *Carr* opinion does not detract from the appropriateness of parties trying to discretely define the scope of methods and procedure for resolving contractual disputes. However, if the parties are so inclined, that agreement should provide for application of section 5 of the Federal Arbitration Act in the event that a chosen arbitrator and arbitration rules are unavailable so that a court may designate an alternative artibitrator. ♦