

# INSIGHT: Arbitration Agreements—If You Use Them, Make the Language Ironclad

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*Akin Gump attorneys examine recent court rulings on arbitration agreements and warn that even the most sophisticated entities can fall victim to drafting flaws. They advise using clear and unequivocal language, as strict interpretation of agreements can distort the parties' intent.*

In a controversial 2018 decision, Judge Gerald A. McHugh, of the Eastern District of Pennsylvania, expressed some reservations about the use of arbitration as a substitute for federal and state court litigation, particularly in the employment context.

In his opinion, he acknowledged pervasive problems associated with for-profit arbitration and the inherent unfairness of arbitration, writing in *Styczynski v. Marketsource Inc.*: “In *Gilmer*, the [Supreme] Court determined that arbitration was a comparable alternative to litigation. But it is not clear that, at the time those opinions were issued, there was data to support those assumptions. In the years since, scholars have continued to test those assumptions and have seemingly unsettled the notion that arbitration is superior or even sufficiently comparable to litigation.”

McHugh’s solution to the inherent problems of arbitration? “Courts must scrutinize the fairness of mandatory arbitration.”

Without commenting on the wisdom of Judge McHugh’s position, his decision provides good reason to examine both the use of arbitration and the drafting of arbitration clauses.

## **Making Clauses Ironclad**

The need to re-examine the drafting of arbitration agreements is particularly compelling in light of the recent line of U.S. Supreme Court decisions that have encouraged courts to shield opinions by arbitrators from judicial oversight.

The importance of drafting ironclad arbitration clauses is highlighted by the Supreme Court’s January 2019 decision in *Henry Schein Inc. v. Archer & White Sales Inc.* In *Schein*, the parties entered into a contract that provided for arbitration “except for actions seeking injunctive relief.” Despite this provision, Schein sought arbitration in conjunction with his claim for injunctive relief.

The district court found in favor of Archer and White and ruled that where a defendant’s argument for arbitration is “wholly groundless,” the district court may resolve the threshold question of arbitrability. The “wholly groundless” exception provides that courts, rather than arbitrators, decide questions of arbitrability when the claim for arbitration is “wholly groundless” or otherwise frivolous. The Fifth Circuit affirmed.

The Supreme Court vacated the Fifth Circuit’s holding and unanimously ruled that the “wholly groundless” exception is inconsistent with the Federal Arbitration Act (FAA). The **Supreme Court found** that there was no basis for the “wholly groundless” doctrine in

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the FAA. It ruled that an arbitrator, rather than the court, should decide the arbitrability of the injunctive relief sought.

The Supreme Court, echoing itself, ruled, “a court may not ‘rule on the potential merits of the underlying’ claim that is assigned by contract to an arbitrator, ‘even if it appears to the court to be frivolous.’” See *Schein* (quoting *AT&T Technologies Inc. v. Communications Workers*).

Historically, courts have served as the gatekeepers to arbitration, only sending those claims to arbitration that include “clear and unmistakable evidence” that the parties intend to arbitrate. *Schein* undercuts this historical practice, and could result in courts sending cases to arbitration, even when the parties have seemingly expressly provided otherwise.

The Supreme Court’s decision in *Schein* further insulates arbitration from judicial interference by preventing courts from scrutinizing claims for arbitration, even when such claims are “wholly groundless.” Increased deference to arbitrators means that parties should be particularly careful when drafting arbitration agreements.

In *Schein*’s wake, it follows that courts are likely to defer to arbitrators in cases when the agreement is unclear or silent as to the arbitrability of a specific issue.

### **Don’t Fall Victim to Drafting Flaws**

Parties that elect to use arbitration agreements should be aware that even the most sophisticated entities could fall victim to drafting flaws. Absent clear and unequivocal language, strict interpretation of arbitration agreements can lead to the distortion of parties’ intent.

For example, a judge in the Southern District of New York recently rejected a major financial institution’s appeal to the court to vacate the arbitrator’s ruling that allowed an arbitration to proceed on a class basis. The court found that since the arbitration agreement did not expressly exclude class-based arbitration, arbitration was permitted.

These cases teach us that proper drafting is the only mechanism to ensure that parties receive the benefits of arbitration. However, at the outset, parties should consider whether arbitration is appropriate

### **When Is Arbitration Beneficial?**

The paramount benefit of arbitration is that it provides an arena for disputes to be resolved confidentially. Confidentiality is invaluable for parties seeking to avoid public scrutiny.

Arbitration is also beneficial when dealing with multiple, small claims, such as in the case of consumer complaints. Multiplicitous suits are easily overwhelming. Arbitration may serve as a better venue for those small claims. Of course, if drafters seek to avoid arbitrators hearing certain types of claims, such as class-based actions, the arbitration clause should specify as much.

Parties should also consider whether the subject of the agreement is so complex, that it might be better handled by the courts. Arbitration is a venue that obtained popularity due to arbitrators’ ability to decide matters based on a limited scope of review and their expertise in a given field, but there is an advantage of having a case being heard by a judge that has expertise in handling complex matters on different subjects.

Even the Supreme Court recently suggested in that arbitration is *not* sophisticated enough for class-based actions. See *Epic Systems Corp. v. Lewis*.

Likewise, with sophisticated, complex matters, there is more at stake and parties may benefit from the ability to appeal a court’s ruling.

Courts are severely limited in their ability to review arbitrators' decisions. Sections 10 and 11 of the FAA provide bases for courts to vacate, modify, or correct an arbitrator's ruling; legal error is not a basis for a court's review of an arbitrator's award. Section 10 provides for the award to be vacated only for "manifest disregard" for the law, a near impossible standard.

Parties should consider the downsides of achieving a "final" result in arbitration. Fewer avenues are available to challenge an arbitrator's decision than that of a court.

Parties entering arbitration agreements should carefully and precisely draft language that specifies the parties' needs. The proper drafting of an arbitration clause in a contract should anticipate whether injunctive relief is available or desirable. Arbitrators do not have the power to grant injunctive relief unless specifically provided for in the agreement. To opt for arbitration is to forego injunctive relief, unless specifically provided for within an agreement.

In the same way, parties should also carefully draft language that specifies which claims ought to be heard before a court and which ought to be heard by an arbitrator.

While arbitration is a valuable alternative to litigation, parties will only reap the benefits of arbitration if their arbitration agreements are carefully crafted. If parties elect to arbitration, those drafting the agreement must ensure clarity in those terms.

*This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.*

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