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LITIGATION

Considering Unavailability When Drafting Arbitration Agreements

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Special to the Legal

In his article in *The Legal* ("Having Your Cake and Eating It, Too: Illusory Arbitration Agreements," published May 22), Charles Forer explained that if a party to an arbitration agreement retains the right to make a retroactive change, the agreement to arbitrate may be considered illusory and no longer binding.

But, can the unanticipated unavailability of a selected arbitrator, unrelated to the action of any party, also render the entire arbitration agreement unenforceable? As the following discussion will reflect, attorneys should consider this possibility when drafting arbitration agreements.

Often, attorneys are confronted by clients who are skeptical about engaging in arbitration, particularly because of the virtually absolute authority of the arbitrator whose decisions are generally not subject to appeal. The attorney may convince the client that this risk is not great as they will have the opportunity to pre-select the individual whose qualities and temperament are known and will not be subject to the uncertainty of dealing with an unknown judge or the vagaries of a lay jury.

The agreement to arbitrate, therefore, often specifically identifies the arbitrator for any current or future disputes. Later, when the time for the arbitration arrives, the selected individual becomes unavailable for one of several reasons, including health problems, scheduling difficulties or conflict of interest. One side may insist on proceeding with a substitute arbitrator. The originally unenthusiastic client, however, may object, stating that the only reason

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he or she had agreed to arbitrate initially was because of the confidence reposed in the named arbitrator. Now, if arbitration is to proceed without the named arbitrator, the original concern of the party to the arbitration reasserts itself.

A very similar issue was recently confronted by the U.S. Court of Appeals for the Third Circuit in the case of *Khan v. Dell*, (669 F. 3rd 350, 2012).

The opinion in *Khan* recites that a proposed class of purchasers of Dell computers sought to bring a class action against the computer manufacturer on the ground that its computer suffered from a design defect, and, as a result, Dell had violated the New Jersey Consumer Fraud Act, had breached express and implied warranties and a covenant of good faith, had engaged in negligent misrepresentation and had been unjustly enriched.

The difficulty confronting the *Khan* class was that purchasers of the computer had, in completing their transactions online, consented to Dell's conditions, which included an agreement to arbitrate all disputes through an organization known as the National Arbitration Forum. The agreement stated specifically in capital letters that any dispute "SHALL BE RESOLVED EXCLUSIVELY AND FINALLY BY BINDING ARBITRATION ADMINISTERED BY THE NATIONAL ARBITRATION FORUM (NAF) under its Code of Procedure then in effect." The arbitration provision did not designate a replacement forum if the NAF was unavailable for any reason but did incorporate the terms of the Federal Arbitration Act.

Ultimately, however, the NAF was not available to arbitrate these disputes. According to the opinion, in 2009, a consent judgment resolved litigation brought by the attorney general of Minnesota by barring the NAF from accepting or participating in any new consumer arbitrations. This resulted from government investigations allegedly revealing that the NAF had engaged in various deceptive practices that disadvantaged consumers.

Notwithstanding the unavailability of the NAF, Dell sought to compel arbitration. The federal district court denied Dell's motions on the ground that the arbitration agreement reflected the parties' intent to arbitrate exclusively in front of the NAF and not to be compelled to arbitrate before other than the designated arbitration forum.

A three judge panel in the Third Circuit, in a split decision, did not agree with the lower court. Judge Jane Roth, writing for a 2-1 majority, noted that Section 5 of the Federal Arbitration Act specifically "provides a mechanism for substituting an arbitrator when the designated arbitrator is unavailable." It states:

"If in the agreement provision be made for a method of naming or appointing an arbitrator … , such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator … upon the application of either party to the controversy the court

shall designate and appoint an arbitrator."

Virtually identical provisions are to be found in Pennsylvania's Arbitration Act and in the Revised Uniform Arbitration Act applicable in New Jersey.

Roth noted that generally, in considering whether the replacement should be named for the arbitrator, "courts have focused on whether the designation of the arbitrator was 'integral' to arbitration provision or was merely an ancillary consideration." Courts will decline the authority to appoint an arbitrator under the FAA only if the parties' choice in this regard is so central to the arbitration agreement that the unavailability of the arbitrator brings the agreement to an end. She stated, "In this light, the parties must have unambiguously expressed their intent not to arbitrate their disputes in the event that the designated arbitral forum is unavailable."

In considering the agreement, the court found that the language was ambiguous. It concluded that reference to the dispute being resolved "exclusively" could be read to mean that resolution should be pursued "exclusively" by binding arbitration or "exclusively" through the NAF.

The court acknowledged that judicial opinions have differed as to whether there was an ambiguity such that the courts could appoint a substitute arbitrator or whether this provision was so integral to the contract that such an appointment would represent a complete revision of the agreement.

Ultimately, however, the majority held that the specific incorporation of the FAA in the agreement coupled with the FAA's liberal policy in favor of arbitration warranted the conclusion that a court should be empowered to appoint the substitute arbitrator or arbitral forum.

In dissent, Judge Dolores Sloviter stated that the majority was merely giving lip service to the fundamental principle that arbitration is a matter of contract, and that the holding in this case violated this principle.

She noted that the pro-arbitration policy of the FAA should not operate without regard to the wishes of the parties. And here, she contended, the majority was relying on the language alone to suggest ambiguity, while ignoring other "clues" within the agreement itself that conveyed the true intention of the parties.

In particular, she emphasized that the so-called ambiguous language that provided "exclusively" for both binding arbitration and administration by the NAF was written in all capital letters while being surrounded by clauses written in lowercase letters. She contended, "This aesthetic prominence indicates the parties' intent for the entire phrase to be read together and emphasized as an essential part of the agreement." Moreover, the NAF was specifically named, its rules were to apply, no provision was made for an alternate arbitrator and the language used was mandatory, not permissive.

Sloviter did acknowledge, however, that judicial appointment of the arbitrator might be appropriate in another ordinary case. This case, however, was unusual in light of the consent judgment that barred the NAF from participating in these arbitrations.

A review of the *Kahn* case makes clear that parties should give serious attention to the selection of the arbitrator. If the dispute has not yet arisen, do the parties wish to name the individual arbitrator or the organization that will oversee the arbitration?

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If such individual or organization is named, does that selection reflect that the parties are reposing special confidence in that designee and would not consent to arbitration if the designee is unavailable for any reason?

If, in fact, the nomination is critical to the agreement, that should be specifically stated so that the parties do not find themselves, as in the *Khan* case, subject to the appointment of an unknown arbitrator by an unidentified member of the judiciary.

Moreover, both the FAA and the state uniform arbitration acts make clear that resort to the judiciary to select an arbitrator only comes into play if there is no provision in the agreement setting forth the method for the selection of the arbitrator. Many dispute resolution providers, within their rules, provide for the appointment of the initial and replacement arbitrators. The parties may conclude that it is to their advantage to designate one of those providers or some variation of their rules, or to devise their own rules as the means by which arbitrators may be selected if the parties are unable to agree on a substitute arbitrator.

In short, in drafting provisions for the selection of an arbitrator, the attorney must approach the matter as if he or she were drafting a will, with due consideration for contingent beneficiaries or representatives of the estate. In the case of arbitration, setting forth who the arbitrators are to be and how they or their successors are to be selected essentially assures the avoidance of what might be characterized as a form of arbitration intestacy. •