Is This an Agreement to Arbitrate? Recent Cases Confront this Issue

Judge Abraham J. Gafni (Ret.)
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Generally, determining whether contracting parties have agreed to arbitrate future disputes provides little difficulty. Typically, the agreement will employ the word arbitration; moreover, it will often identify a specific dispute resolution provider, and state what procedures (whether those of the provider or otherwise) are to be employed.

But if the dispute resolution provision does not specifically mention arbitration or refer to a specific provider or arbitration procedures, how does a court decide whether the parties intended the conflict to be resolved through court litigation or arbitration?

This issue the was confronted most recently by the Special Superior Court for Complex Business Cases of North Carolina in two cases in which the disputing parties had agreed to the appointment of independent accountants to resolve certain issues.

In the first, *Post v. Avita Drugs (*Sept. 1, 2017, CVS 798*),* the parties' stock purchase agreement, (SPA) provided a formula, based upon a calculation of "Adjusted EBIDTA" for determining Avita's payment obligation to Post. Any dispute relating to the calculation of the Adjusted EBIDTA was to be resolved by submitting the matter to an independent accountant.

Post filed a court action against Avita alleging numerous violations of the SPA. Included among these claims was Avita's manner of calculating "Adjusted EBIDTA." Avita sought a stay of all proceedings relating to the other claims in this court action pending resolution of

the correctness of the EBIDTA calculations under the independent accountant process set forth in the SPA.

The court recognized that initially it must decide whether the SPA's independent accountant process was in fact an "arbitration" which might warrant the grant of such a temporary stay.

Moreover, it determined that whether the procedure amounts to "arbitration" is governed by the Federal Arbitration Act (FAA). Somewhat remarkably, arbitration is not defined in the FAA, and, accordingly, the court would have to decide what Congress meant when it employed that term.

In these circumstances, the court relied on *Fit Tech v. Bally Total Fitness Holding, 374 F 3d 1 (1st Cir, 2004),* which noted that courts routinely consider, "how closely the specified procedure resembles classic arbitration … The question is whether the agreement exhibits the 'common incidents of arbitration': a final determination by 'an independent adjudicator',' 'substantive standards,' 'and an opportunity for each side to present its case'." Another federal court in North Carolina had also focused on ''whether the parties agreed to be bound by the decision of the third party as to the particular issue in dispute."

Here, the court found that all of these factors had been met in the SPA.

First, and most important, the SPA provided that, "the parties agreed to submit the dispute to an independent expert for a 'binding and conclusive' determination, 'absent manifest behavior.'" The finality of the accountant's determination is always strong evidence of arbitration.

In addition, the court noted that the "SPA requires the Independent Accountant to apply substantive standards—the standards set forth in the SPA for calculating Adjusted EBIDTA." The SPA "further establishes procedural guidance, including, among other things, the process for selecting an independent adjudicator and providing each side 'the opportunity to present' any written materials 'such party deems to be relevant.'"

Accordingly, the court concluded that the SPA's Independent Accountant process was arbitration as contemplated by the FAA. In such circumstances, it agreed to a stay of the court proceedings and final determination of other claims pending completion of the arbitration by the independent accountant.

Another judge in the Special Superior Court for Complex Business cases in North Carolina, however, when faced with the identical issue, reached a contrary conclusion based upon the facts presented to it. It held that the procedure set forth in the agreement did not support a finding that the standards of arbitration had been established.

That case, *Martin & Jones v. Olson* (Sept 25, NCBC 85, 17 CVS 1255) involved a law firm that had a written Fourth Amendment and Restatement of Operating Agreement (operating agreement. When seeking his early retirement benefits under the operating agreement, Olson contended that the remaining lawyers were manipulating the books and records so that those benefits would be reduced or eliminated. The law firm filed an action against Olson contending that he had engaged in activities detrimental to the firm. Olson replied

with a counterclaim alleging misdeeds by the firm, including those which affected his retirement benefits.

The law firm sought a stay as to Olson's general counterclaim on the ground that his claim with respect to retirement benefits must first be resolved pursuant to arbitration as mandated in the operating agreement.

Initially, the court decided that as the case involved interstate commerce, analysis of the operating agreement under the FAA would principally determine whether arbitration was required.

Specifically, the operating agreement provided:

"In the event of a dispute among the Members with respect to the determination of the net cash flow, net profit, net losses or capital account balances of the Law Firm, an independent certified public accountant shall be engaged by the law firm at the law firm's expense whose computation of such items shall be binding upon all the members."

As in the *Post* case*,* cited above, the court was required to decide whether the dispute resolution process constituted arbitration under the FAA; in addition, it also relied upon *Fit Tech,* cited above, for the standards in making this determination.

Here, the court found that the operating agreement did not meet the *Fit Tech,* standards. It acknowledged that the operating agreement did call for the disputes to be resolved by an independent certified public accountant and that the CPA's computation, "shall be binding upon all the members." However, unlike the SPA in *Post,* the operating agreement did not set forth any "substantive standards" such as "procedural guidance for selecting the independent CPA" (who under the operating agreement would be unilaterally selected and engaged by the law firm), or "the method by which the independent CPA will make a determination". Furthermore, the operating agreement does not "provide any means by which the parties can present evidence in support of their respective positions. In fact, as written, it is not at all clear how the process works."

In the absence of the various standards noted, the court could not conclude that the operating agreement resembled classic arbitration sufficient to "merit a finding that the parties agreed to arbitrate" issues relating to the retirement benefits.

These cases reflect that if you wish to assure that future disputes will be submitted to arbitration, care must be taken in the drafting of the dispute resolution provisions. Several factors provide strong indications of an intent to arbitrate. These may include:

- Including the word "arbitration" in the agreement.
- Setting forth how the arbitrator will be selected.
- Declaring that the decision of the arbitrator is final and binding.
- Stating that that you will be proceeding under the Arbitration Rules of a particular provider, or simply incorporating them into your agreement, even if the services of that particular provider are not to be utilized.

- Assuring that the procedures provide the opportunity for the parties to present evidence to the arbitrator.
- Sufficiently setting forth the scope of the disputes that may be resolved by the arbitration. (See my article of Sept. 26, 2017 in the Legal Intelligencer discussing this issue).
- To the extent that it would not otherwise be apparent, providing guidelines based upon which the arbitrator may make appropriate decisions.

In short, always assure that your dispute resolution process clearly sets outs what is to be decided, by whom, under what substantive standards and how the process is to be conducted. •

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