What Must Parties Understand When Agreeing to Arbitrate?

Judge Abraham J. Gafni (Ret.)
Published on November 19, 2018 in The Legal Intelligencer

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Parties generally give careful attention to the substantive provisions of an agreement. Dispute resolution provisions, however, are often included at the end of the negotiation as an afterthought. A recent appellate court opinion of first impression in New Jersey, however, (*Flanzman v. Jenny Craig,* Sup. Ct. of New Jersey, Appellate Division, Docket No. A-2580-17T1, Oct. 17) reflects that parties should consider those provisions more carefully to assure their enforceability.

The plaintiff was an 82-year-old employee of the defendant whose position was terminated after 26 years of employment. She filed a complaint alleging, among other issues, age harassment in violation of New Jersey law.

The defendant filed a motion to compel arbitration based upon an agreement executed 20 years after the plaintiff had commenced her employment.

The arbitration agreement provided in pertinent part: “Any and all claims or controversies arising out of or relating to the plaintiff’s employment, the termination thereof, or otherwise arising between the plaintiff and the defendant shall, in lieu of a jury or other civil trial, be settled by final and binding arbitration. This agreement to arbitrate includes all claims, whether arising in tort or contract and whether arising under statute or common law

including, but not limited to, any claim of breach of contract, discrimination or harassment of any kind."

The trial court noted that although the plaintiff had given up her right to a jury trial, the agreement failed to identify in what forum the case would be arbitrated. It determined, therefore, that it would decide the appropriate forum for the arbitration.

On appeal, the plaintiff argued that the arbitration agreement was invalid as a matter of contract law because it contained absolutely no reference to the process for generally selecting an arbitration forum. She asserted "that without that information communicated somehow in the agreement—whether it be by designating AAA, JAMS, or some other mechanism intended to replace her right to a jury trial—there exists no mutual assent."

The appellate court agreed with the plaintiff's contention. It noted that arbitration agreements are placed upon the same footing as other contracts and regulated under general state contract principles. Thus, an arbitration clause might be invalidated "upon such grounds as exist at law or in equity for the revocation of any contract." Accordingly, to be enforceable, the parties were required to reach an agreement by mutual assent and a meeting of the minds.

The court continued that such mutual assent requires that the party from whom an arbitration agreement has been extracted, unambiguously agrees to waive her statutory rights and has a clear understanding of the ramifications of that assent. Examples of such a lack of understanding might include a failure to note the waiver of a jury trial, an ambiguity in the agreement, the unavailability of the agreement at the time of execution or the absence of alternative procedures if the designated arbitral forum is unavailable.

In short, New Jersey courts have required that the arbitration provision must allow the party to understand "from clear and unambiguous language—both the rights that have been waived and the rights that have taken their place."

The court then considered the consequences "of failing to identify the process for selecting an arbitration forum, such as designating in the contract an arbitral institution itself or otherwise identifying a general method for selecting an arbitration forum."

The court pointed out that "selecting an arbitral institution informs the parties at a minimum about that institution's arbitration rules and procedures. Without knowing this basic information, parties will be unfamiliar with the rights that replaced judicial adjudication."

An institution's rules, according to the court, would typically inform the parties of such topics as notification, how proceedings are initiated, management conferences, discovery, location of hearings, number of arbitrators, communications with arbitrators, attendance at the hearings, dispositive motions, evidence, modification of awards, application to the courts, fees, expenses and costs. In short, the court found that the rules of the arbitral

forum selected would set out for the parties the substantive and procedural setting for the entire arbitration process.

Notwithstanding these comments, the court does emphasize that it did not mean to imply that there were any “magic words” that must be included in the agreement. Thus, although naming an arbitral forum would provide the arbitration framework, the parties are not required to identify one. No special language need be used. It is sufficient if the agreement identifies a process for selecting the forum that will conduct the arbitration. The inclusion of such a provision, the court states, would satisfy the requirement that the agreement reflects a “clear mutual understanding of the ramifications of the parties’ mutual assent to waive adjudication by a court of law.”

As an example, it cited a Mississippi case, *Oasis Health & Rehabilitation of Yazoo v. Smith*, 42 F. Supp. 3rd 821 S.D. Miss 2014) where a nonexistent arbitral institution had been selected. The agreement did, however, provide a procedure for selecting another organization or three arbitrators to conduct the arbitration.

The opinion of the New Jersey court is confusing. On the one hand, it seems to be suggesting that the selection of an ADR institution will sufficiently alert the parties to the existence of specific procedures that will be employed at the arbitration hearing.

At the conclusion of its opinion, however, the court states that naming such an institution is unnecessary. Rather, it is sufficient to merely set out satisfactory procedures for the selection of the arbitrators who would then presumably have the authority to determine how the arbitration would be conducted; and, that this process would be adequate to inform a party that it was waiving its court rights, even if it did not know what alternative procedures might ultimately be adopted by the arbitrators.

Interestingly, the opinion of the court makes no reference to and does not apparently consider the provisions of the New Jersey Arbitration Act (NJAA) that specifically provides for the selection of an arbitrator if the parties themselves have not provided for such. (The recently adopted Revised Statutory Arbitration Act in Pennsylvania (RSAA) contains the same provision at sec. 7321.12(a)). More importantly, the NJAA and RSAA do include many of the procedural rules ordinarily contained in an institutional forum’s rules or in the agreement itself.

In short, it is not clear how the court’s opinion which seems to conclude that simply including an alternative manner of arbitrator selection or naming an arbitral institution actually achieves the objective of establishing a “‘clear mutual understanding of the ramifications’ of the parties’ mutual assent to waive adjudication by a court of law.” To achieve this goal, it would appear to be more effective to have the agreement specifically explain that the parties are waiving certain rights and agreeing to other procedures that are set out in the arbitration agreement, the rules of the selected arbitral institution, or the state statute.

It will be interesting to track how courts in New Jersey and Pennsylvania, as well as other jurisdictions, ultimately determine what language will be sufficient to put a party on such notice. Will it really be enough to just state that the parties are waiving their right to a jury trial and court litigation and limit further provisions to how arbitrators are to be selected? Or, will courts require that the attention of the parties be directed to the relevant rules of the ADR institution or the NJAA or RSAA?

In the interim, however, this opinion and others sure to follow reflect that in drafting arbitration provisions, counsel are well-advised to consider whether they have put parties on sufficient notice as to what they are waiving and to what alternative procedures they will be subject so that the arbitration agreement may be enforced. •

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