Court Rejects Arbitration Clause That Fails To Specify the Forum and Applicable Rules

Many businesses have adopted contractual arbitration clauses in order to avoid litigation. But if a clause is not carefully drafted, the company may find itself in litigation challenging the enforceability of the arbitration provision.

That's what happened in a recent New Jersey Court of Appeals case, Flanzman v Jenny Craig, Inc., Superior Court of New Jersey, Appellate Division, Docket # A-2580-17T1 (November 13, 2018.)[1]

After the plaintiff filed suit for age discrimination and wrongful termination, the defendant company filed a motion to compel arbitration, based on an agreement the employee had signed that included this arbitration clause:

Arbitration Agreement

Any and all claims or controversies arising out of or relating to [plaintiff's] employment, the termination thereof, or otherwise arising between [plaintiff] and [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. . . . [Plaintiff] will pay the then-current Superior Court of California filing fee towards the costs of the arbitration (i.e., filing fees, administration fees, and arbitrator fees) . . . .

Applying a "basic principle of contract law" that there must be a "meeting of the minds," the Court held that this clause was not enforceable because it failed to designate a forum or the rules that would govern the arbitration process. Therefore, the Court reasoned, mutual assent was lacking, and the provision was unenforceable. It denied the motion to compel arbitration.

The Court dismissed the argument that under Section 5 of the Federal Arbitration Act, 9 U.S.C. § 5, it should have itself designated an arbitrator. Section 5 provides that:

"If in the agreement provision be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, 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 or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein; and unless otherwise provided in the agreement the arbitration shall be by a single arbitrator."

[1] https://njcourts.gov/attorneys/assets/opinions/appellate/published/a2580-17.pdf?cacheID=aG0SKJO

The Court held this statute inapplicable because (1) there was no Section 5 application before the judge, and (2) it was not that the "designated" arbitral forum was "unavailable," "but rather that there was no designated arbitral forum or general process selected by the parties in the first place. The parties did not reach any agreement at all."

Veteran arbitrator Jim Madison questions the Flanzman decision. He asked whether it conflicted with Supreme Court authority as long ago as in *Doctors Associates v. Casarotto* in 1996, which it held that Montana could not require a particular forum to be specified in an arbitration agreement. If the FAA does not require a forum to be specified in order to make an arbitration agreement enforceable, he argued, what authority allows a court to require the specification of a forum?

Whether or not Flanzman was correctly decided, it illustrates the perils of not thinking through the process. For example, contracting parties may agree that their arbitrators shall have particular subject matter knowledge say, in physics or chemistry. But if they designate a provider organization to administer the case, and that organization does not have arbitrators with the requisite knowledge, the parties may end up litigating that issue or the entire case.

Litigation over the application and/or enforcement of an arbitration clause defeats the purpose of having such a clause. It may result in added expense, delay and uncertainty while a court resolves the issue. To avoid situations like Flanzman, careful contract negotiators and drafters should think very carefully about the arbitration language they adopt and its real world application.

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