

Be Careful What You Wish For -  
The Pitfalls of Including an Arbitration Clause in your Contract Documents

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Much has been written about the supposed benefits of arbitration over traditional in-court litigation. Despite mixed opinions among the bench, bar and public as to whether arbitration is always truly preferable to formal judicial processes, many commercial contracts now require the use of arbitration to settle disputes between the parties. Many of these arbitration clauses also require the parties to use specific companies offering arbitration services (e.g., The American Arbitration Association, JAMS, and others). In turn, many of these private companies employ individualized rules and processes to administer their arbitration proceedings.

Significant legal problems can arise when there is a dispute whether a claim is subject to arbitration and, more importantly, who resolves that issue – the Court or the arbitrator.

The issue occurs when your contract documents provide that only certain claims and issues are subject to arbitration, as opposed to the more common arbitration clause that provides that all claims under a contract or agreement are subject to arbitration. Federal courts have generally held that a simple contractual reference to an obligation to follow the rules of a private arbitration entity divests courts of their general authority to decide whether a claim is actually subject to arbitration. As an example, assume your contract states that certain claims shall be arbitrated by the American Arbitration Association in accordance with its rules. A dispute then arises which was not formally covered by the contract. Does it have to go to arbitration? Federal courts have ruled that the mere reference to the AAA rules in your contract is enough to divest a court of authority to determine whether the claim is arbitrable, since the AAA rules allow the arbitrator to determine his jurisdiction over a claim.

In contrast, some state courts have ruled that mere reference to the AAA rules in a document or contract, without more, does not divest courts of the authority to decide the threshold issue of whether a particular claim must be arbitrated. The Virginia Supreme Court has yet to rule on this issue, leaving parties at risk of differing judicial outcomes depending on where the issue is raised.

Should you include an arbitration clause in your contracts or agreements? Given the uncertainty of the law on this point, it is advisable to decide in advance who will determine whether a specific claim is subject to arbitration: a judge or the arbitrator, who may not be a lawyer and in any case is not obliged to abide by judicial rules regarding evidence and the like. Then specifically spell that agreement out in your document. The alternative is to risk litigating a novel issue of law, with no certainty to the outcome.

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