

CONFLICTS BETWEEN ARBITRATION AGREEMENTS AND ARBITRATION RULES

Steven C. Bennett*

Arbitration is a “creature of contract.”¹ As a result, under the Federal Arbitration Act (“FAA”) and equivalent state laws, both the obligation to arbitrate and the specific terms under which arbitration will occur are typically determined by the agreement of the parties.² In many instances, parties choose to adopt the rules of an arbitration-sponsoring organization such as the American Arbitration Association (“AAA”). But parties are also free to adopt their own *ad hoc* procedures (sometimes based on elements of the rules of an arbitration-sponsoring organization) or to use the rules of an arbitration-sponsoring organization as a base and modify those rules to suit their needs.

What happens when the terms of an arbitration clause and the provisions of the rules of an arbitration-sponsoring organization conflict? In *Brady v. The Williams Capital Group, L.P.*,³ the New York Court of Appeals held that where inconsistency exists between an arbitration agreement and the AAA rules by which parties have agreed to arbitrate, the arbitrator must enforce the arbitration agreement rather than the AAA rules. This Article discusses the *Brady* case, related cases in other jurisdictions, and the implications of this line of authorities for arbitration practitioners and their clients.

I. THE BRADY CASE

Lorraine Brady (“Brady”) was a registered bond seller employed by The Williams Capital Group, L.P. (“Williams”). Wil-

* The author is a partner in the New York City offices of Jones Day. The views expressed are solely those of the author and should not be attributed to the author’s firm or its clients.

¹ See *Rent-A-Center, W., Inc. v. Jackson*, 130 S. Ct. 2772, 2776 (2010) (noting “fundamental principle that arbitration is a matter of contract”).

² See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 945 (1995) (“A party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration.”); *AT&T Techs, Inc. v. CWA*, 475 U.S. 643, 648 (1986) (“Arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.”) (quotation omitted).

³ 14 N.Y.3d 459 (2010).

liams required all employees to sign an employee manual as a condition of continued employment. The manual included an arbitration agreement, requiring employees to arbitrate any disputes under AAA rules. The arbitration agreement stated that “except as provided in this Agreement, any arbitration shall be in accordance with the then current Model Employment Arbitration Procedures of the American Arbitration Association” and that the company and the employee agreed to “equally share the fees and costs of the Arbitrator,” a provision that comported with then-existing AAA rules.⁴

Brady’s employment was terminated and shortly thereafter she commenced an arbitration proceeding, alleging discrimination. The AAA informed the parties that it would apply its later-adopted Rule 48, requiring the employer to pay all of the arbitrator’s compensation unless the employee voluntarily elects to pay a portion. Rule 48 conflicted with the provision in the arbitration agreement directing the parties to share the fees and costs of the arbitrator equally. Under the AAA National Rules for the Resolution of Employment Disputes, if “material inconsistency” exists between an arbitration agreement and the AAA rules, the arbitrator is to apply the AAA rules.⁵ As a result, the AAA sent Williams the bill for the entire arbitration. When Williams refused to pay the entire amount, the AAA cancelled the arbitration. Brady then filed a complaint either to compel Williams to arbitrate or to compel the AAA to enter a default judgment against Williams for failure to arbitrate.

The trial court reasoned that specific provisions in the arbitration agreement would trump conflicting AAA rules.⁶ The court stated that it could not “rewrite this unambiguous agreement by compelling respondent to comply with an AAA rule that [Brady] agreed would not bind the parties.” The trial court thus held that Brady would be required to pay her portion of the AAA fee to permit the arbitration to proceed.⁷

Ultimately, the New York Court of Appeals affirmed that reasoning, although it reached a different result. The Court of Appeals addressed the argument that applicable AAA rules must

⁴ *Brady*, 14 N.Y.3d at 462.

⁵ See NATIONAL RULES FOR THE RESOLUTION OF EMPLOYMENT DISPUTES, Rule 1, available at www.adr.org.

⁶ *Brady v. The Williams Capital Group, L.P.*, 17 Misc. 3d, 325, 328 (N.Y. Sup. Ct. 2007), rev’d, 878 N.Y.S.2d 693 (2009), *aff’d* as modified, 16 N.Y.3d 454.

⁷ *Id.*

supersede the parties' arbitration agreement. The court rejected that argument, agreeing with the trial court that AAA rules cannot prevail over clear language of the arbitration agreement.

The court cited *Matter of Salvano v. Merrill Lynch*,⁸ which stated that "the court's role is limited to interpretation and enforcement of the terms agreed to by the parties; it does not include the rewriting of their contract and the imposition of additional terms." The court, referencing *Credit Suisse First Boston Corp v. Pitofsky*,⁹ further stated that "arbitration is a creature of contract, and it has long been the policy of this State to interfere as little as possible with the freedom of consenting parties in structuring their arbitration relationship." Like the trial court, the Court of Appeals found that, because the parties explicitly agreed to be bound by the provisions of the arbitration agreement, and the agreement unambiguously addressed the payment of fees and costs of the arbitrator, the arbitration agreement would control.¹⁰

II. ADDITIONAL RECENT EXAMPLES OF CONFLICTS

The *Brady* opinion, choosing to enforce a specific arbitration agreement rather than the general rules of an arbitration sponsoring organization, accords with common principles of contract interpretation.¹¹ But the issue can become even more complicated. In

⁸ 85 N.Y.2d 173, 182–183 (1995).

⁹ 4 N.Y.3d 149, 155 (2005).

¹⁰ The Court of Appeals also addressed whether, under the specific facts of *Brady*, the fee-splitting provision in the arbitration agreement was enforceable as a matter of public policy, a matter not discussed by the trial court. The court found the record inadequate to make that determination, and remanded the case to the trial court for a hearing. The court left the choice between severing the provision and enforcing the rest of the arbitration agreement, or allowing the employee to choose between arbitration under an equal-share arrangement, or litigation in court, to the trial court.

¹¹ See, e.g., *GSI Comm. Solutions, Inc. v. Babycenter, L.L.C.*, 618 F.3d 204, 214 (2d Cir. 2010) ("Specific language in a contract will prevail over general language when there is an inconsistency between two provisions.") (citation omitted); *DBT GmbH v. J.L. Mining Co.*, 544 F. Supp. 2d 364, 378 (S.D.N.Y. 2008) ("Even if there was an inconsistency between a specific provision and a general provision of the contract . . . the specific provision controls."); *Herr v. Herr*, 949 N.Y.S.2d 786, 789 (3d Dep't 2012) ("Where a contract employs contradictory language, specific provisions control over general provisions.") (citation omitted); *DeWitt v. DeWitt*, 879 N.Y.S.2d 516 (2d Dep't 2009) ("Where there is an inconsistency between a specific provision and a general provision of a contract, the specific provision controls.") (citation omitted); *Contacare, Inc. v. Ciba-Geigy Corp.*, 853 N.Y.S.2d 783, 785 (4th Dep't 2008) ("The specific provision controls when there is an inconsistency.").

Hotels Nevada v. L.A. Pacific Center, Inc.,¹² for example, the arbitration agreement provided that arbitration would be conducted in accordance with AAA Commercial Rules, but also stated that “[t]he arbitration procedures shall follow the substantive Law of the State of Nevada, including the provisions of statutory law dealing with arbitration law, as it may exist at the time of the demand for arbitration, insofar as said provisions are not in conflict with this Agreement[.]” The agreement further provided that neutral arbitrators would be provided through Judicial Arbitration and Mediation Services (“JAMS”) and that “except as provided herein, the Federal Arbitration Act shall govern the interpretation, enforcement and all proceedings” concerning arbitrator appointment.¹³ When one of the three arbitrators became ill, the panel resolved to conduct the hearing with two arbitrators, providing a video record of the hearing to the third arbitrator at his hospital. The losing party argued that the hearing did not comport with the agreement and that, because the third arbitrator’s position had become “vacant,” the FAA should have been applied to choose a new third arbitrator. The appeals court ultimately concluded that the hearing procedure was within the panel’s “wide discretion,” because, although potentially conflicting, the agreement, statute and rules were all “silent” on the issue.¹⁴

The “material inconsistency” language in the AAA Employment Dispute Rules (at issue in *Brady*) received a limited application in *Trivedi v. Curexo Tech. Corp.*,¹⁵ where a former employee claimed that the arbitration agreement was unconscionable because it provided for recovery of attorney’s fees and costs if the employee lost.¹⁶ The company argued that the clause was “saved” by the “material inconsistency” clause in the AAA Rules, but the court held that “relying on a document [the Rules] that the [employee] was never provided cannot relieve [the employer] of the

¹² 203 Cal. App. 4th 336 (Cal. Ct. App. 2012).

¹³ See *id.* at 351 (citation omitted).

¹⁴ A similar issue appeared in *Lefkowitz v. HWF Holdings, LLC*, No. 4381-VCP, 2009 WL 3806299 (Del. Ch. Nov. 13, 2009), where the court held that an agreement calling for arbitration to be “administrated” under AAA Rules, but “governed” by the Delaware arbitration act, established a “hierarchy” for governance of arbitration procedures, with the Delaware statute acting as a “gap-filler.” *Id.* at *7.

¹⁵ 189 Cal. App. 4th 387 (Cal. Ct. App. 2010).

¹⁶ See *id.* at 395 (fees and cost provision “lessens his incentive to pursue claims deemed important to the public interest, and weakens the legal protection provided to plaintiffs who bring nonfrivolous actions”).

effect of the unlawful provision in the arbitration clause which it drafted and insisted upon.”¹⁷

Finally, in *NAACP of Camden Cty. East v. Foulke Mgmt. Corp.*,¹⁸ the court held that where precedence clauses in various agreements conflicted, the agreement had become “murky and conflicting,” resulting in its invalidity.¹⁹ The court held that there was no enforceable agreement because “[v]iewed in their totality, the arbitration provisions scattered among [various agreements] are too plagued with confusing terms and inconsistencies to put a reasonable consumer on fair notice of their intended meaning[.]”²⁰

III. IMPLICATIONS

Arbitration agreements commonly incorporate by reference the rules of an arbitration sponsoring organization, and such incorporation by reference is typically enforced.²¹ The use of “precedence” clauses, moreover, is common in drafting arbitration

¹⁷ *Id.* at 396 (citing *Fitz v. NCR Corp.*, 114 Cal. App. 4th 702 (Cal. Ct. App. 2004)); *see also* *Ontiveros v. DHL Express (USA), Inc.*, 164 Cal. App. 4th 494, 511 (Cal. Ct. App. 2008) (because specific term of agreement “trumps” AAA rule, despite “material inconsistency” language, unconscionable provision of agreement rendered arbitration invalid); *Jovich v. Green Hills Software, Inc.*, No. H026539, 2004 WL 2113277 at *8 (Cal. Ct. App. 2004) (despite “material inconsistency” rule, agreement explicitly provided that its provisions would “prevail” over contrary provisions; thus “provisions in the current AAA Rules cannot be substituted for conflicting unlawful” provisions in agreement); *O’Hare v. Municipal Resource Consultants*, 107 Cal. App. 4th 267, 281 (Cal. Ct. App. 2003) (rejecting “end run” around terms of contract); *but see* *In re Champion Tech., Inc.*, 222 S.W.2d 127, 133 (Tex. App. 2006) (provision of agreement permitting company to amend agreement at any time did not render agreement invalid, where AAA “material inconsistency” rule would “nullify the offending amendments”).

¹⁸ 24 A.3d 777 (N.J. Super. Ct. App. Div. 2011).

¹⁹ *See id.* at 796 (separate agreements both stated that “each would take precedence over any other agreements in the event of a dispute”).

²⁰ *See id.* at 794; *see also* *Woodlands Christian Academy v. Weiburst*, No. 09-10-00010-CV, 2010 WL 3910366 at *5 (Tex. App. 2010) (arbitration rules provided that “these rules shall control except where the state or federal rules specifically indicate that they may not be superseded;” thus, rules did not improperly limit statutory remedies).

²¹ *Mathis v. Screen Actors Guild Producer Pension Health Plan*, No. B220046, 2011 WL 199002 (Cal. Ct. App. 2011) (“no authority” for proposition that mere failure to attach copy of arbitration rules to agreement renders arbitration agreement unconscionable) (distinguishing cases); *Henderson v. Superior Court*, No. B219024, 2010 WL 745161 at *7 (Cal. Ct. App. 2010) (mere reference in arbitration agreement to arbitration rules, unattached to agreement, not unconscionable); *Peterson & Simpson v. IHC Health Serv., Inc.*, 217 P.3d 716, 721 (Utah Sup. Ct. 2009) (“incorporation by reference” of arbitration rules acceptable; no ambiguity created); *Swarbrick v. Umpqua Bank*, No. 2:08-cv-00532-MCE-DAD, 2008 WL 3166016 (E.D. Cal. Aug. 5, 2008) (incorporation of arbitration rules by reference not unconscionable).

agreements.²² Ordinarily, use of such a clause helps clarify the agreement,²³ and should help speed the parties through the arbitration process.²⁴ But, as *Brady* and similar cases illustrate, controversy may arise when application of precedence, between rules and the agreement, becomes uncertain or conflicting.

One might imagine that a “severance” provision in an agreement could solve the problem, providing that, in the event that any provision in the arbitration agreement or rules might be found invalid, that provision could be severed.²⁵ But, where conflicts arise and some provisions of the agreement (or rules) may be held unconscionable or otherwise void, some courts have refused to sever the offending provisions.²⁶ And not all courts will permit the pro-

²² See, e.g., *Davis v. Producers Ag. Ins. Co.*, No. 5:12-CV-92(MTT), 2013 WL 103195 at *7 n.9 (M.D. Ga. Jan. 8, 2013) (“If there are conflicts between any rules of the AAA and the provisions of your policy, the provisions of your policy will control.”); *Enderlin v. XM Satellite Radio Holdings, Inc.*, 4:06-CV-0032 GTE, 2008 WL 830262 at *1 (E.D. Ark. Mar. 25, 2008) (“If there is a conflict between the AAA Rules and the rules set forth in this Agreement, the rules set forth in this Agreement will govern.”); *Buzenes v. Nuvel Fin. Serv.*, No. B221870, 2012 WL 208051 at *1 (Cal. Ct. App. 2012) (“If the chosen arbitration organization’s rules conflict with this clause, then the provisions of this clause shall control.”); *Roberts v. El Cajon Motors, Inc.*, 200 Cal. App. 4th 832, 843 (Cal. Ct. App. 2011).

²³ See *Freedman v. Comcast Corp.*, 988 A.2d 68, 87 (Md. Ct. Spec. App. 2010) (provision that arbitration agreement would control in case of conflict with terms of arbitration rules did not render agreement unconscionable).

²⁴ See *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983) (goal of FAA to “move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible”); *Salim Oleochemicals v. M/V Shropshire*, 278 F.3d 90, 93 (2d Cir. 2002) (“Unnecessary delay of the arbitral process through appellate review is disfavored.”).

²⁵ See *Thicklin v. Fantasy Mobile Homes, Inc.*, 824 So.2d 723, 734 (Ala. 2002) (severability of arbitration provision applicable where contract expressly so provides); see also *Koffler Elec. Mech. Apparatus Repair, Inc. v. Warsila North Am., Inc.*, No. C-11-0052 EMC, 2011 WL 1086035 at *8 (N.D. Cal. Mar. 24, 2011) (holding that, on finding “one-sided nature” of particular arbitration provision, “the Court may sever the invalid provision rather than void the entire arbitration agreement.”).

²⁶ See, e.g., *Sanchez v. Valencia Holding Co.*, 201 Cal. App. 4th 74, 104 (Cal. Ct. App. 2012) (“Having found that the arbitration provision is permeated by unconscionability, we typically would remand the case to the trial court, allowing it, as a discretionary matter, to decide whether the doctrine of severability should apply. . . . Yet an arbitration agreement permeated by unconscionability, or one that contains unconscionable aspects that cannot be cured by severance, restriction, or duly authorized reformation, should not be enforced.”) (citation omitted); *NAACP of Camden Cty. East v. Foulke Mgmt. Corp.*, 24 A.3d 777, 798 (N.J. Super. Ct. App. Div. 2011) (“Severability is only an option if striking the unenforceable portions of an agreement leaves behind a clear residue that is manifestly consistent with the ‘central purpose’ of the contracting parties, and that is capable of enforcement.”); *Doubt v. NCR Corp.*, No. C 09-05917 SBA, 2010 WL 3619854 (N.D. Cal. Sept. 13, 2010) (denying severance of arbitration provisions, in “interests of justice”); *Harper v. Ultimo*, 113 Cal. App. 4th 1402 (Cal. Ct. App. 2003) (severance within “reasonable discretion” of trial court; contract to be enforced, even though arbitration agreement not enforced).

ponent of the arbitration agreement, after the fact, to offer to modify the arrangement to avoid invalidity.²⁷

What, then, remains for the careful practitioner, to avoid or mitigate this potential problem? Perhaps foremost is awareness. Practitioners sometimes adopt arbitration agreements based on the “last deal” in which an arbitration agreement appeared; and they often assume that adoption of the rules of a well-known arbitration sponsoring organization will cause no harm.²⁸ Yet, agreements apt in one context may not work in another. And arbitration rules change. Brief review of the specific terms of the arbitration agreement, and the applicable rules, at the time of drafting, can help avoid obvious problems.

Further, many disputes concerning the enforceability of terms in an arbitration agreement, versus conflicting terms in rules, have arisen in the context of consumer and employment arbitration.²⁹ These cases often turn on allegations of “unconscionability” in one or more provisions of the agreement or rules.³⁰ One way to help avoid controversy stemming from conflicts in the meaning and application of arbitration agreements and rules is to ensure that the agreement and rules generally comport with the requirements of arbitration due process.

The practitioner might also consider risks that arbitration rules may change,³¹ or that an arbitral institution may become unavaila-

²⁷ Compare *Ragone v. Atlantic Video*, 595 F.3d 115, 124 (2d Cir. 2010) (“Courts have accepted offers by parties to waive the enforcement of certain provisions of arbitration agreements, and have evaluated those agreements as modified by the parties’ after-the-fact waivers.”) with *Tillman v. Commercial Credit Loans, Inc.*, 655 S.E.2d 362, 372 (N.C. 2008) (Courts must “consider the agreement as drafted,” and “should not consider after-the-fact offers” to vary arbitration to meet standards of conscionability.).

²⁸ See Fredrick E. Sherman & Steven C. Bennett, *Pathological Arbitration Clauses*, 8/06 PRACTICAL LAWYER 43 (2006).

²⁹ Some criticism of the *Brady* court’s ruling on unconscionability issues has focused on the need for arbitration organizations to “self-regulate” to avoid unconscionable arrangements. See Martin H. Malin, *The Arbitration Fairness Act: It Need Not And Should Not Be An All Or Nothing Proposition*, 87 IND. L. J. 289, 310 (2012) (decision “threatens to undermine such self-regulation”); see also Gerald M. Levin, *Challenging Arbitration Agreements For Unconscionability: An Uphill Battle For Employees And Others*, 65 DISP. RESOL. J. 24, 27 (2011) (discussing *Brady* decision).

³⁰ See Steven C. Bennett & Dean A. Calloway, *A Closer Look At The Raging Consumer Arbitration Debate*, 65 DISPUTE RESOL. J. 28 (2010); see also Steven C. Bennett, *The Proposed Arbitration Fairness Act: Problems And Alternatives*, 67 DISP. RESOL. J. 32 (2012).

³¹ See *Leonard v. Terminix Int’l Co.*, 854 So.2d 529, 544 (Ala. Ct. 2003) (Where AAA rules provide for application in case of conflict with arbitration agreement, court must determine when rule change occurred to permit process that would avoid unconscionability.).

ble to administer the arbitration.³² To help avoid the risk that such changes might invalidate the arbitration process, a practitioner might consider providing an ultimate “fail safe,” in the form of referral of the matter to arbitration before an arbitrator to be chosen with the assistance of a specified court.³³ Similar issues may arise in which it is unclear, from the terms of the arbitration agreement and rules, whether the parties intend to delegate arbitrability issues to the arbitration tribunal itself.³⁴ Again, careful drafting can confirm the intent of the parties regarding arbitrability decision-making.³⁵

Finally, the practitioner should take care to ensure that specific evidence of assent to the arbitration agreement and rules appears.³⁶ The creation of agreements via Internet communications may be particularly problematic.³⁷ Careful planning and technology can help ensure that adequate evidence of mutual agreement exists.³⁸ Indeed, as with most matters in law, assessment of risks

³² See *QuickClick Loans, LLC v. Russell*, 943 N.E.2d 166, 173 (Ill. Ct. App. 2011) (“exclusive administrators” chosen in arbitration agreement “not available,” thus, “external events to the parties’ agreement have foreclosed the arbitration of the parties’ claims”); *Bedford Hlth. Props., LLC v. Estate of Davis*, 50 So.2d 362, 366 (Miss. Ct. App. 2010) (where “chosen forum for arbitration is unavailable,” no “valid agreement to arbitrate” existed).

³³ See *Khan v. Dell Inc.*, 669 F.3d 350 (3d Cir. 2012) (where agreement did not require arbitration “exclusively” before named forum, court had authority to appoint a substitute arbitrator when specified arbitration forum not available); see also THOMAS H. OEHMKE, *COMMERCIAL ARBITRATION*, Sec. 89:2 (2012) (“Arbitration remains enforceable even though the referenced institutional rules no longer exist or are unavailable, unless the use of such rules was central to the arbitration contract.”).

³⁴ See *Burlington Res. Oil & Gas Co. v. San Juan Basin Royalty Trust*, 249 S.W.3d 34, 41 (Tex. Ct. App. 2007) (arbitration referring to AAA rules did not provide “clear and unmistakable” evidence of delegation of arbitrability issues to arbitrator, where clause provided that to the extent that rules conflicted with agreement, the agreement would control.).

³⁵ See Steven C. Bennett, *The Developing American Approach To Arbitrability*, 57 *DISP. RESOL.* J. 9 (2003) (discussing importance of evidence of intent).

³⁶ See *Specht v. Netscape Comm.*, 306 F.3d 17 (2d Cir. 2002) (no agreement to terms of free software license where consumer lacked notice of terms and “browse wrap” form did not provide unambiguous manifestation of assent to terms); *Schnabel v. Trilegiant Corp.*, No. 3:10-CV-957 JCH, 2011 WL 797505 (D. Conn. Feb. 24, 2011) (no contract where users not required to “manifest assent” to stated terms).

³⁷ See Steven C. Bennett, *Click-Wrap Arbitration Clauses*, 8 *J. OF LEGAL STUDIES IN BUS.* 121 (2001).

³⁸ See *Grosvenor v. Qwest Corp.*, No. 09-cv-02848-MSK-KMT, 012 U.S. Dist. LEXIS 23472 (D. Colo. Feb. 23, 2012) (“clickwrap” arbitration agreement enforceable, even though not all agreement terms are included in document to which user assents; later “welcome letter” provided details and referred to web terms); *Bar-Ayal v. Time Warner Cable Inc.*, No. 03 CV 9905 KMW, 2006 WL 2990032 (S.D.N.Y. Oct. 16, 2006) (enforcing arbitration agreement despite claim that consumer did not read contract; by clicking “accept” button, after agreement appeared on scrollable window, customer assent created); see also *Forrest v. Verizon Comm., Inc.*,

and potential outcomes, before drafting an agreement, might be the real key to success.³⁹

805 A.2d 1007, 1010 (D.C. App. 2002) (enforcing clickwrap agreement); *Capi v. Microsoft Network, LLC*, 732 A.2d 528, 532 (N.J. App. 1999).

³⁹ See Sherman Kahn & David Kiferbaum, *Browsewrap Arbitration? Enforcing Arbitration Provisions In Online Terms Of Service*, 5 N.Y.S.B.A. NEW YORK DISPUTE RESOLUTION LAWYER 33 (2012) (offering practical suggestions for drafting enforceable online arbitration agreements).

