The Scope of Arbitration – Court Rulings and Legal Opinions

June 9, 2015

STATE BAR of NEW MEXICO
CENTER FOR LEGAL EDUCATION

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Presenter Biographies

ADR Series: The Scope of Arbitration – Court Rulings and Legal Opinions

Presenter Biographies

JOHN B. HIATT of the Hiatt Firm, is a private practice attorney focusing on government entities. He has been an Administrative Hearing Officer to the City of Santa Fe in Vehicle Forfeiture and STOP hearings and has performed subcontract work on behalf of the New Mexico Taxation and Revenue Department as counsel to County Property Tax Protest Boards. He has also worked for the City of Santa Fe as a Hearing Officer and has experience with substantive matters including criminal law, construction contracts and disputes, and has been a Guardian ad Litem on behalf of minors.

Peter G. Merrill is the President and CEO of Construction Dispute Resolution Services, LLC, the largest exclusive provider of construction ADR in the USA with construction ADR Specialists located in all 50 states, Washington DC and in several foreign countries. He currently represents the State Of New Mexico on the Executive Board of the National Association of Home Builders and is a past President of the New Mexico Home Builders Association and the Santa Fe Area Home Builders Association. He serves as a guest speaker and has written several articles on construction ADR industry processes. He is a member of the NM State Bar ADR Steering Committee.

Contract burden comes along with benefit

Marshall Martin / For the Journal

The New Mexico Court of Appeals plowed new ground in a recent arbitration case.

In Damon v. StrucSure Home Warranty, L.L.C., et. al, the dispute involved a lawsuit by the Damons against StucSure, a home warranty service, the Damons' seller, the real estate developer and home builder, and others for alleged damages caused by structural failures in the purchased home.

When the Damons noticed the structural failure, they made a claim to StrucSure under the construction warranty. They then filed suit against StrucSure in district court after their claim was refused, joining everyone who had been involved in the home's history.

The original owner-purchaser signed the warranty, as did the builder. The Damons bought the home from a financial service company that had bought the home from the original purchasers.

The StrucSure warranty contained an arbitration clause in the broadest form covering everything from negligence to fraud. The Damons did not sign the warranty agreement. They claimed that they did not know about it until they filed suit.

StrucSure filed a motion to compel the Damons to arbitrate under the warranty agreement.

Most lawyers would probably answer "no" when asked if an arbitration clause can be used to force arbitration against a person who did not sign the arbitration agreement. The respected district court judge in the Damon case thought so as well. She rejected StrucSure's motion to force the Damons to arbitrate the warranty claims.

The Court of Appeals reversed the district judge and ordered the Damons to arbitrate. The Court of Appeals ruled that since the Damons claimed the benefits of the StrucSure construction warranty, they were "equitably estopped" to claim that the same warranty agreement's duty to arbitrate did not bind them. In plain English, you cannot claim that you can enforce only part of a contract you like and escape the other parts of the same contract that you do not like. You have to take the burden with the benefits.

Although the Court of Appeals decision is well reasoned, there is some question if it is the last word. Apparently, there was no petition for further review by the New Mexico Supreme Court. Thus, the case is precedent in future cases, but the holding is subject to another review in a future case by the Supreme Court.

Equally important, the arbitration clause expressly provided that the clause was subject to the Federal Arbitration Act. The Court of Appeals stated that the issues of arbitrability would be governed by federal law and federal cases, not New Mexico law or the New Mexico Arbitration Act, even though the case was in state court.

Nonetheless, the case is substantial support for businesses that are sued in cases by plaintiffs who want to avoid arbitration or other burdensome contract provisions while taking advantage of favorable terms. One can see this happening in many financial service contracts, employment type contracts and in the residential construction industry.

Attorney Marshall G. Martin has experience in complex litigation, including securities, antitrust and lender liability law. He also has represented banks and private and public companies. He can be reached at 505-228-8506 or mgm@marshallgmartin.com.

Court Rejects Argument That Home Inspection Form Contract Was Contrary to Public Policy and Unconscionable

Professional Lines Alert March 7, 2011

Professional Lines Alert

The Illinois Appellate Court for the Fifth District recently considered whether a form home inspection contract should have been invalidated as contrary to public policy and because it was unconscionable and unreasonable. *Jackie Zerjal v. Daech & Bauer Construction, Inc.*, 939 N.E.2d 1067 (5th Dist. 2010). Plaintiff home buyer entered into a contract to have an existing house inspected by defendant home inspector. The buyer signed a two-page, 13-paragraph form contract, which provided only for a visual inspection of the property and preparation of a report on the apparent condition of the readily accessible systems and components of the property existing at the time of inspection. Latent and concealed defects and deficiencies were excluded from the inspection. The inspector assumed no liability for the costs of repairs or replacement arising from unreported defects unless given notice within 72 hours.

The inspector also disclaimed any warranties and limited his liability to the $175 cost of the inspection. Additionally, the contract provided that any legal action was to be brought within two years of the date of the inspection. Only the warranty disclaimer was printed in all capital letters.

The home inspection took place in 2006 and the buyer purchased the house in the same year. More than three years later, the buyer sued, alleging that the inspector should have reasonably known that the foundation and footing were decayed and unstable. The trial court granted the inspector's motion to dismiss based on the running of the two-year limitations period. The buyer appealed, arguing that the whole form contract was contrary to public policy and unconscionable.

The appellate court affirmed, finding that the exculpatory clause did not violate public policy. The court noted that in the recently enacted Illinois Home Inspection License Act (225 ILCS 441/1-1 (West 2008) the legislature did not address the scope of an inspector's liability. Additionally, there was no special relationship of a semi-public nature between a home inspector and a prospective home buyer sufficient to invalidate an exculpatory clause.

The court also found the liquidated damages provision valid because it was clear and explicit and located on the first page of the contract, despite the fact it was not in all capital letters. The buyer was under no compulsion to sign the contract and the fact that it was on a preprinted form did not render the contract unconscionable. The court refused to follow *Lucier v. Williams*, 366 N.J. Super. 485, 841 A.2d 907 (2004), a New Jersey case based on a consumer protection-oriented Home Inspection Act where a court held otherwise.

As to the two-year limitations period, the appellate court found that the private limitations period was valid and enforceable. It is well-established law that parties to a contract can agree to replace a statute of limitations as long as it is reasonable. The buyer presented no facts to support an argument that the two-year limitation was unreasonable. The inspector had no duty to inform the other party of the contents of the two-page contract of only 13 paragraphs and there were no allegations that the buyer was rushed or forced into signing this contract.

This opinion demonstrates that Illinois courts will uphold form contracts containing exculpatory clauses, liquidated damages provisions and private limitation periods in a consumer setting as not violative of public policy where the contract is short in length and the provisions are readily ascertainable to the consumer.

Practice Note

Professional service providers who are paid a small fee to render a limited service, where the potential liability could be huge because of the possibility of latent defects, should adopt a form contract with similar provisions to those mentioned in this decision. Performing even limited services like this based on a mere handshake almost guarantees a claim or lawsuit down the road. The form contract should be short and sweet, and the key provisions made conspicuous to the reader.

MONTGOMERY & ANDREWS
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June 2, 2010
VIA EMAIL

Peter G. Merrill
President and CEO
Construction Dispute Resolution Services, LLC
3113 Pueblo Sapawe
Santa Fe, New Mexico 87507

Re: WIN Inspection Agreement

Dear Peter,

We have reviewed the WIN Inspection Agreement in regard to the Limitation of Liability Clause contained therein. The Clause specifically limits the Company's liability to the fee paid for the inspection service. The question presented is whether CDRS arbitrators are bound by the Clause to limit any award against the Company and whether the arbitrator runs any risk in doing so should a court determine the Clause to be unenforceable.

The answer to the first question is that an arbitrator is bound by the scope of the arbitration as defined by the agreement between the parties, *Christmas v. Cimarron Realty*, 98 N.M. 330, 648 P.2d 788 (1982). Therefore the limitation of liability language contractually limits what relief the CDRS arbitrator may grant.

Furthermore, even if this Clause were to be unclear, it is the arbitrator's right to decide its meaning, *Timothy J. Heinsz*, 56 Desp. Resol. J. 38 (2001). Further, while a court may set aside an arbitration award if the underlying agreement is deemed by the court to be unconscionable, or otherwise invalid[1], New Mexico recognizes the doctrine of arbitral immunity NMSA 1978 § 44-7A-15 (2001), meaning the arbitrator may not be liable to either party for an incorrect, corrupt, or otherwise wrongful decision § 44-7A-24(1) and (2).

[1] In New Mexico it is possible that a Court might find that the anti-indemnification statute NMSA 1978 § 56-7-1 (1971) may make the subject clause unenforceable or the clause may be held by a Court to be unconscionable. See, *Cordova v. World Finance Corp.*, 2009-NMSC-021, 146 N.M. 256, 208 P.3d 901.

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While the above analysis is limited to New Mexico law, every federal circuit court which has considered the question has recognized the doctrine of arbitral immunity. *Pfannenstiel v. Merrill Lynch*, 477 F.3d 1155, 1158 (10th Cir. 2007). Indeed, even the United States Supreme Court has held that arbitrators exercise a "full exemption from liability for acts committed within the scope of their duties." *(Butz v. Economou*, 438 U.S. 478 (1978).

We hope the above analysis provides you with the legal analysis you need. Please let us know if we can be of further service.

Sincerely,

Stephen S. Hamilton

SSH/dho

INSPECTION AGREEMENT

You, the undersigned Client(s), herein referred to as "You/Your", have requested that We, along with our employees and any persons conducting inspections, herein referred to as "We"/"Our"/"Us", conduct an inspection of the Property consistent with the terms and conditions of this Agreement. The inspection service is being provided at the request of you, our Client(s), and is intended for your exclusive use and benefit. Not all conditions are apparent at the time of inspection, so it is recommended, and you agree herein, to consult with the Seller of the property regarding any significant deficiencies/malfunctions known to exist to the Seller. Please read the final report carefully, as additional information and details concerning the nature of the inspection are found in the report.

SCOPE OF THE INSPECTION:

Visual Home Inspection - The Home Inspection you receive is a **non-invasive**, **visual** examination of the readily accessible items identified in the inspection report. The inspector is not an expert in every building craft or profession. Therefore, the home inspection that we conduct is **not** technically exhaustive. The inspection is designed to identify unsafe/non-functioning systems, structures and /or components that were **exposed to view and apparent as of the time/day of the inspection**. A written inspection report will describe and identify the inspected systems, structures, or components of the building inspected, and shall list any unsafe or non functioning systems, structures and components observed during the inspection. The inspection report is a written opinion of a trained home inspector based upon what was visible and evident at the time of the inspection. The report is not a listing of repairs to be made and is not intended for use as a guide in re-negotiating a real estate transaction. Items that are not listed in the inspection report **were not inspected and are not included** under the scope of the inspection service provided. It is agreed that the inspector is not, as part of the inspection, determining compliance with installation guidelines, construction documents, manufactures specifications, building codes, local ordinances, zoning regulations, covenants, or other restrictions, including local interpretations thereof.

Inspection Standards - The home inspection and/or systems inspected will be performed in accordance with the scope and standards of practice of the *National Association of Home Inspectors (NAHI)* and/or the *American Society of Home Inspectors (ASHI) and in accordance with any specific State or Provincial standards and/or licensing requirement*. A copy of the standards of practice is available through your inspector.

GENERAL EXCLUSIONS:

The inspector cannot examine what cannot be seen by a non-invasive, visual examination. No removal of materials or dismantling of systems shall be performed during this inspection. The inspector is not required to, nor will he/she move furniture, floor coverings, insulation, stored materials, personal belongings, open walls or perform any type of destructive or invasive testing in order to perform the inspection. This inspection company is not responsible for any condition that may be covered, concealed or inaccessible because of, but not limited to, soil or vegetation, walls, structural members, furniture, floor coverings, insulation, stored items, personal belongings, water, ice, snow, soot or conditions that would be considered a danger to the inspector. The home inspection is not a compliance inspection or certification of compliance with past or present governmental codes or regulations of any kind.

Whether or not they are concealed or inaccessible, the following items and systems are not within the scope of the inspection service provided under this Agreement: *Engineering Analysis of any kind including structural integrity, system design problems, acoustical characteristics, functional adequacy, operational capacity or costs, quality or suitability for a particular use *Geological stability or ground condition of site *Soils or Soil Contamination *Scientific or specialized technician tests, readings or evaluations * Issues directly or indirectly related to Drywall from the People's Republic of China *Fireplace draft *Cosmetic items, including without limitation, paint, scratches, scrapes, dents, cracks, stains or faded surfaces, flooring, insulation unless required by law, wall coverings, carpeting, paneling, lawn and landscaping *Condominium or co-op common areas or areas under the management of the condominium or co-op association *Home warranty, system warranty and/or component warranty *Telephone and TV cables *Cisterns *Fountains *Low voltage lighting and electrical systems *Electrostatic precipitators *Electronic air cleaners or filters *Active or passive solar system *Pressure tests on central air conditioning systems *Furnace heat exchangers *Radiant heating systems *Free standing appliances and other personal property *Water volume or flow *Water conditioning/softening systems *Security system *Central vacuum system *Landscaping *Irrigation systems *We do not address conditions relating to animals, rodents or other household pests or the damage caused thereby. **Unless you have paid an additional fee and the specific item is noted and initialed by you and the inspector on page 2 of this Agreement, the following items are also excluded under this agreement and not within the scope of the inspection service:** (a) Septic System (b) Wells or Well Pump (c) Water Quality (d) Swimming pools, Saunas, Hot tubs, Spas/Whirlpools or attached equipment (e) Mold/Mildew/Fungus or spores thereof or conditions related to Mold, Mildew or Fungus (f) Detached Buildings or Equipment (g) Environmental hazards including, but not limited to; Asbestos, Radon, Lead, Formaldehyde, Electro Magnetic Fields (EMF's), Microwaves (h) Wood Destroying Organisms including, but not limited to, Termites, Carpenter Ants, Wood Boring Beetles and Fungal Rot.

THE INSPECTION AGREEMENT, THE HOME INSPECTION AND THE INSPECTION REPORT DO NOT CONSTITUTE A HOME WARRANTY, AN INSURANCE POLICY, OR A GUARANTEE OF ANY KIND; NOR DO THEY SUBSTITUTE FOR ANY DISCLOSURE STATEMENT AS MAY BE REQUIRED BY LAW. We do not turn on, ignite or inspect any utility service, major system, item or component that is shut down or not connected to a functioning system at the time of the inspection. All utility services and major systems must be turned on to perform the inspection. Therefore, you agree not to hold us responsible for future failure and repair, or for the non-discovery of any patent or latent defects in material, workmanship, or other conditions of the property which may occur or become evident after the inspection date; nor for any alleged non-disclosure of conditions that are the express responsibility of the seller of the property. You agree to assume all the risk for conditions, which are

concealed from view or inaccessible to us at the time of the inspection.

DISPUTE RESOLUTION AND REMEDY LIMITATION:

Notice Requirement - In the event that You have any dispute relating to this agreement, the inspection service, the inspection report, or You claim that there was any error or omission in the performance of the inspection service or writing of the report, You agree, upon discovering facts related to the dispute or any error or omission, to promptly notify Us in writing of the dispute or claim in order to provide Us or our representative a reasonable opportunity to reinspect and document the condition in dispute. In addition, if We determine that You have a legitimate dispute or claim, You will provide Us the opportunity to resolve the issue. Please understand that an unreasonable delay in affording Us with a notice of a dispute, claim or issue may prevent Us from remedying any valid dispute You might have.

Binding Arbitration - The undersigned parties below agree that any dispute between the parties, except those for non-payment of fees, that in any way, directly or indirectly, arising out of, connected with, or relating to the interpretation of this Agreement, the inspection service provided, the report or any other matter involving our service, shall be submitted to binding arbitration conducted by and according to the Accelerated Arbitration Rules and Procedures of Construction Dispute Resolution Services, LLC. You may recommend an alternative arbitration provider for our consideration. The arbitration decision shall be final and binding on all parties, and judgment upon the award rendered may be entered into any court having jurisdiction. In any dispute arising under this Agreement, Our inspection or the Inspection Report, the costs of the arbitration shall be the sole responsibility of the client up to and including the arbitration hearing. As part of the arbitration award, the arbitrator shall award to the prevailing party any or all costs of the arbitration process as he or she deems to be appropriate. Expenses related to personal attorneys, experts, engineers, witnesses, engineering reports or other inspection reports or similar individuals or documents shall be the direct responsibility of the parties and shall not be considered as part of the arbitration award. The arbitration award shall be limited in scope to the issues and terms as specified in the Inspection Agreement. No legal action or proceeding of any kind, including those sounding in tort or contract, can be commenced against Inspector/Inspection Company, or its officers, agents or employees more than two years from the date the Client discovers, or through the exercise of reasonable diligence should have discovered, the cause of action. In no event shall the time of commencement of legal action or proceeding exceed three years from the date of the inspection.

LIMITATION OF LIABILITY - IF WE, OUR EMPLOYEES, INSPECTORS, OR ANY OTHER PERSON YOU CLAIM TO BE OUR AGENT, ARE CARELESS OR NEGLIGENT IN PERFORMING THE INSPECTION AND/OR PREPARING THE REPORT AND/OR PROVIDING ANY SERVICES UNDER THIS AGREEMENT, THE TOTAL MONETARY LIABILITY OF THE INSPECTOR AND ANY OF ITS AGENTS OR EMPLOYEES SHALL NOT EXCEED $1,500.00 AND YOU RELEASE US FROM ANY ADDITIONAL LIABILITY. WE HAVE NO RESPONSIBILITY FOR THE POSSIBILITY YOU LOST AN OPPORTUNITY TO RENEGOTIATE WITH THE SELLER. THERE WILL BE NO RECOVERY FOR SECONDARY OR CONSEQUENTIAL DAMAGES BY ANY PERSON. Please initial that you agree to this limit of liability. (____).

Confidential Report - The inspection and report is being prepared for You, for Your own information and may not be used or relied upon by any other person unless that person is specifically named by Us in this Agreement as a recipient of the report. This report should not be relied upon by anyone other than the client(s). In addition, the client(s) agrees not to rely on this report alone in making decisions about the subject property. You agree to maintain the confidentiality of the report and reasonably protect the report from distribution to any other person. If you directly or indirectly cause the report to be distributed to any other person, You agree to indemnify, defend, and hold Us harmless if any third party brings a claim against Us relating to our inspection or the report. By initialing here (_____), You authorize Us to distribute copies of the Inspection report to the real estate agent(s) and/or mortgage company directly involved in this transaction, but they are not designated recipients of the report or this agreement, intended or otherwise.

Third Party Reliance (Seller's Inspection Only) - If anyone other than You will be relying on this agreement or inspection report, they are required to sign this Inspection Agreement, provide notice to Us, and submit a fee of $_____ for a Buyer's Consultation Inspection. This is only applicable for 60 days from the date of the Original Inspection. In the absence of these steps, We will not be liable for the information contained in the inspection report.

GENERAL PROVISIONS

Re-Inspections and Additional Services - Our fees are based on a single visit to the property and the preparation of the written inspection report. If additional visits, or reports, or services are required of Us for any reason, an additional fee will be charged. We may refer third party service providers to You and We may earn a fee for this referral. The company may arrange for these providers to send literature or make post inspection contact with the company's clients.

Client Authority - Each party signing this Agreement warrants and represents that he/she has the full capacity and authority to execute this Agreement on behalf of the named party. If this Agreement is executed on behalf of the Client by a third party, the person executing this Agreement expressly represents to Us that he/she has the full and complete authority to execute this Agreement on the Client's behalf and to fully and completely bind the Client to all of the terms, conditions, limitations, exceptions and exclusions of this Agreement.

This Agreement constitutes the entire integrated Agreement between the parties hereto pertaining to the subject matter hereof, and may be modified only by a written agreement signed by all of the parties hereto. No oral agreements, understandings, or representations shall change, modify, or amend any part of this agreement. The written report to be prepared by Inspector shall be considered the final and exclusive findings of the Inspector. Client shall not rely on any oral statements made by the Inspector prior to issuance of the written report. This Agreement shall be binding upon and inure to the benefit of the parties hereto and their heirs, successors and assigns. Should any provision of this Agreement be held by a court of competent jurisdiction or arbitration panel to be either invalid or unenforceable, the remaining provisions of this Agreement shall remain in full force and effect, unimpaired by the court or arbitration panel's holding.

123 Any Street, Madison, AL 35758

Property Address

For the purpose of this Inspeciton Agreement, the term:
Primary Inspection Service is defined as

04/20/2015 9:33AM

Date and Time of Inspection

Please conduct the following services for the fees noted below:

Total: $0.00

Paid Date

EXCLUSIONS ARE SET FORTH IN THIS INSPECTION AGREEMENT - PLEASE READ BEFORE SIGNING

ALL INSPECTION FEES ARE DUE AT TIME OF INSPECTION

Client acknowledges that they have read and understood all the terms, conditions and limitations of this Agreement and voluntarily agrees to be bound thereby and agrees to pay the fees listed above.

Date

FOR: **WIN Home Inspection**
dba WIN Home Inspection %orderinfo-cost-center%
9238 Madison Blvd #750, Madison, Alabama 35758

Buyer's Consultation Inspection

BY:_____
Inspector: License:

Client Email Address

The above Company who is a party to this contract is Independently Owned and Operated
Form IA0214TPCA © 2011 WIN Home Inspection

Memo

To: Stephen Hamilton
From: Lucas Conley
Date: April 13, 2015
Re: Authority of arbitrators to determine unconscionability of awards/arbitration clauses

Steve,

You asked me whether CDRS arbitrators are empowered to find arbitration clauses limiting awards in company contracts unconscionable where there is case law supporting this conclusion. Based on my reading of the law, arbitrators are bound to adhere to the terms of the contract rather than their own conception of law, justice, or policy. While the United States Supreme Court has cautioned courts from interfering with arbitration —holding that, in the name of efficiency, a court should vacate an arbitrator's decision "only in very unusual circumstances," *Oxford Health Plans LLC v. Sutter*, 133 S. Ct. 2064, 2068, (2013)—the Court has repeatedly held that an arbitrator exceeds his authority and may be overturned where he issues "an award that simply reflects his own notions of economic justice rather than drawing its essence from the contract," *id.*, or "impose[s his] own conception of sound policy." *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 675 (2010). In short, "arbitrators can exceed their powers by going beyond the authority provided by the bargained-for agreement or by going beyond their contractual authority to craft a remedy *under the law*." *Cedar Fair, L.P. v. Falfas*, 2014-Ohio-3943, ¶ 7 (internal quotation marks and citations omitted) (emphasis added), citing *Oxford Health Plans LLC*, 133 S. Ct. 2064 (2013).

It should also be noted that the decisions of the two New Jersey courts that held limitation-of-liability clauses unconscionable are fact-specific, light on federal law, and do not cite the United States Supreme Court. *See Lucier v. Williams*, 841 A.2d 907 (App. Div. 2004); *Marbro, Inc. v. Borough of Tinton Falls*, 688 A.2d 159 (Ch. Div. 1996). *See also* Peter J. Smith, *Lucier and Mango: The Future of Contractual Limitations in New Jersey?*, Connell Foley law firm, available at http://www.connellfoley.com/content/page/lucier-and-mango-future-contractual-limitations-liability-new-jersey. For contracts formed in New Jersey, *Lucier* and *Mango* may empower an arbitrator to find clauses limiting awards unconscionable. Outside of New Jersey and any other state with similar case law, there is ample legal support to recommend a policy of arbitrators adhering to the terms of the contract.

Courts are split as to whether arbitrators may decide questions of unconscionability

Courts are unclear on where and how arbitrators may determine the conscionability of contract clauses. "In a number of cases, courts have ruled upon claims of unconscionability involving an arbitration clause itself while referring claims of unconscionability going to the contract as a whole to arbitration. Other courts are of the opinion that claims of unconscionability are to be decided by the court as a matter of law." 22 A.L.R.6th 49 (Originally published in 2007). "The U.S. allocation rule is evolving toward one of deference to the arbitrator, allowing the arbitrator to make an initial determination of whether there is an enforceable agreement to

arbitrate." Karen Halverson Cross, *Letting the Arbitrator Decide Unconscionability Challenges*, 26 Ohio St. J. on Disp. Resol. 1, 1 (2011).[1]

> "In a subset of U.S. arbitrability decisions, courts have applied dictum from *First Options of Chicago, Inc. v. Kaplan* [514 U.S. 938 (1995)] to find that *parties to a standard-form, mandatory arbitration agreement contracted for the arbitrator to determine whether the arbitration agreement is unconscionable*. The Supreme Court's recent decision in *Rent-A-Center West v. Jackson* [561 U.S. 63 (2010)] appears to uphold this line of case law. However, since *Rent-A-Center* is based on the separability rule of *Prima Paint v. Flood & Conklin Manufacturing Co.* [388 U.S. 395 (1967)], the decision leaves unresolved important questions regarding the scope and implications of the *First Options* dictum."

Cross, *supra*, 1-2 (emphasis added).

Based on recent decisions, courts will defer to arbitrators where the contracts include language that emphasizes that the arbitrator has the sole power to rule on the existence, scope, and validity of the arbitration and severability clauses. In one recent and interesting opinion, a California appeals court ruled that a delegation clause (contained within an arbitration provision) empowering the arbitrator to determine the enforceability of the arbitration provision was not unconscionable. *See Malone v. Superior Court*, 226 Cal. App. 4th 1551, 1570-71 (2014) ("The delegation clause is not inherently unfair—it is not unilateral; it does not provide for a biased decisionmaker. Moreover, the clause is clear and unmistakable; and it is not hidden in fine print in a prolix form.") Another recent (albeit unpublished) opinion from a California court of appeals pointed up the importance of severability clauses in drafting arbitration clauses. *See Eakins v. Corinthian Colleges, Inc.*, No. E058330, 2015 WL 758286, at *1 (Cal. Ct. App. Feb. 23, 2015) (ruling that the arbitration clause was not substantively unconscionable, and to the extent that it did have defects, it was saved by a severability clause).

However, courts are clear that arbitrators must adhere to the terms of the contract and may not impose their own concept of public policy

In *Oxford Health Plans LLC*, the United States Supreme Court held that arbitrators risk exceeding the scope of their authority if they step outside of the bargained-for terms of the contract. *See Oxford Health Plans LLC*, 133 S. Ct. 2064 (2013). There, the Court stated, "Only if the arbitrator acts outside the scope of his contractually delegated authority—*issuing an award that simply reflects his own notions of economic justice rather than drawing its essence from the contract*—may a court overturn his determination." *Id.* at 2068 (internal quotation marks and citations omitted). This holding was in line with the Court's decision in *Stolt-Nielsen S.A.*, three years earlier.

> It is only when an arbitrator strays from interpretation and application of the agreement and effectively dispenses his own brand of industrial justice that his decision may be unenforceable. . . . In that situation, an arbitration decision may be vacated under § 10(a)(4) of the FAA [Federal Arbitration Act] on the ground

[1] Available at http://repository.jmls.edu/cgi/viewcontent.cgi?article=1350&context=facpubs.

> that the arbitrator exceeded his powers, for the task of an arbitrator is to interpret and enforce a contract, not to make public policy.

Id. at 672 (internal quotation marks and citations omitted).

The Ohio State Supreme Court, citing to *Oxford Health Plans LLC,* summed up this principle well in an opinion from last year:

> [A]rbitrators can exceed their powers by going beyond the authority provided by the bargained-for agreement or by going beyond their contractual authority to craft a remedy *under the law*. . . . So long as there is a good-faith argument that an arbitrator's award is authorized by the contract that provides the arbitrator's authority, the award is within the arbitrator's power, but an award departs from the essence of a contract when: (1) the award conflicts with the express terms of the agreement, and/or (2) the award is without rational support or cannot be rationally derived from the terms of the agreement.

Cedar Fair, L.P. v. Falfas, 2014-Ohio-3943, ¶ 7 (internal quotation marks and citations omitted) (emphasis added), citing *Oxford Health Plans LLC*, 133 S. Ct. 2064 (2013). The language above—"going beyond the authority provided by the bargained-for agreement . . . to craft a remedy under the law"—is particularly notable in the context of the question presented in this memo. The implication is that even where the law allows for a different resolution, the arbitrator is bound to the terms the parties agreed to in the contract.

In sum:

> Arbitrators are bound by the contracts and other rules that give them power to act[.] Accordingly, an arbitrator must act within the scope of the authority conferred upon him or her by the parties. *Arbitrators may not exceed their authority, nor decide matters not submitted by the parties nor issues not within the scope of the agreement to arbitrate.* The doctrine that any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration is subject to constraints, in that an arbitrator's decision must stand so long as the arbitrator, acting within the scope of his or her delegated authority, is arguably construing the contract, and *the Federal Arbitration Act expressly provides that an award may be vacated where the arbitrators exceeded their powers.* Arbitrators may not assume to exercise powers which they do not possess, such as rewriting agreements between the parties, or determining the rights and obligations of persons not parties to the agreement or the proceedings. In other words, *arbitrators cannot deviate from their instructions, or determine questions which the agreement or submission declares they shall have no power to decide.*

6 C.J.S. Arbitration § 102 (internal citations omitted) (emphasis added).

An older summation of US case law is very similar:

> In deciding the issues submitted for arbitration, arbitrators are confined to the interpretation and application of the parties' underlying agreement; thus, the arbitrators' powers are not unlimited. E.g., Roy Stone Transfer Corp v Teamsters, Chauffeurs, Local Union, No 22, 752 F2d 949 (4th Cir Va 1985); Detroit Coil Co v International Association of Machinists & Aerospace Workers, 594 F2d 575 (6th Cir Mich 1979) cert den 444 US 840 (1979); Coast Trading Co v Pacific Molasses Co, 681 F2d 1195 (9th Cir Or 1982); South Conejos School District v Martinez, 709 P2d 594 (Colo App 1985); Ostroff v Keystone Insurance Co, 357 Pa Super 109, 515 A2d 584 (1986) app den 515 Pa 582, 527 A2d 542 (1987) app den Petition of Ostroff, 515 Pa 582, 527 A2d 542 (1987); Nicolet High School District v Nicolet Education Association, 118 Wis2d 707, 348 NW2d 175 (1984). The award must conform to the agreement. Aamot v Eneboe, 352 NW2d 647 (SD 1984). In making the award, the arbitrators cannot go beyond the agreement unless it is ambiguous. Grand Rapids Die Casting Corp v United Automobile, Aerospace & Agricultural Implement Workers of America, UAW, Local Union, No 159, 684 F2d 413 (6th Cir Mich 1982) [arbitrator cannot modify plain and unambiguous provisions of agreement]; Zeigler Coal Co v United Mine Workers, 484 FSupp 445 (CD Ill 1980) [where agreement is express, arbitrator cannot go outside agreement]. *Although an arbitrator may look to outside sources for guidance in reaching a decision, the decision must still draw its essence from the parties' agreement to arbitrate.* Detroit Coil Co v International Association of Machinists & Aerospace Workers, 594 F2d 575 (6th Cir Mich 1979) cert den 444 US 840 (1979).

27 Causes of Action 113 (Originally published in 1992) (database updated March 2015) (emphasis added).

Conclusion

Though the law is unclear as to an arbitrators' authority to rule on the unconscionability of particular clauses—with courts across the country ruling differently based on the unique facts and language of each case—the majority of courts have found that arbitrators who step outside the bargained-for terms of the contract will exceed their authority. Ultimately, though a court might uphold an arbitrator's decision to look to outside law concerning the conscionability of an award limitation, there is ample legal support to recommend a policy of arbitrators adhering to the contract rather than imposing their own conceptions of law, economic justice, or sound public policy.