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Arbitration

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ARBITRATION

INTRODUCTION

During the survey period between September 1994 and September 1995, the Tenth Circuit decided four arbitration cases. Two of these cases have fairly narrow consequences because they concern arbitration only in the securities industry. In *Metz v. Merrill Lynch*,[1] the court held that Title VII claims must be arbitrated pursuant to an arbitration clause contained in an agreement between a broker and the National Securities Dealers Association.[2] In *Kelley v. Michaels*,[3] the court extended the authority of arbitrators by allowing them to award punitive damages under a contract containing conflicting choice of law and arbitration clauses on punitive awards.[4]

The two cases involving arbitration outside the securities industry have broader implications. In *Coors Brewing Co. v. Molson Breweries*,[5] the court refined the scope of arbitration agreements by holding that "arising in connection with" language mandates arbitration of disputes sufficiently connected to a contract containing an arbitration agreement.[6] In *ARW Exploration Corp. v. Aguirre*,[7] the court held that an arbitrator may not use the alter ego principle[8] to compel nonparties to arbitrate because only the court, not the arbitrator, may compel a party to arbitrate.[9]

This Survey first presents background information on each of these recent cases. It then discusses the decisions and analyzes their ramifications. The Survey examines the holdings of these cases in light of similar decisions by other circuits and offers some explanation of the rationale behind the decisions.

I. ARBITRATION IN THE SECURITIES INDUSTRY

Arbitration, used in the securities industry for over a century,[10] has become an important part of the trade, with approximately 6,600 cases submitted to arbitration per year.[11] Arbitration resolves disputes between securities

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1. 39 F.3d 1482 (10th Cir. 1994).
2. *Metz*, 39 F.3d at 1487-88.
3. 59 F.3d 1050 (10th Cir. 1995).
4. *Kelley*, 59 F. 3d at 1055.
5. 51 F.3d 1511 (10th Cir. 1995).
6. *Molson*, 51 F.3d at 1515.
7. 45 F.3d 1455 (10th Cir. 1995).
8. *See infra* notes 160-67 and accompanying text.
9. *ARW Exploration Corp.*, 45 F.3d at 1460-61.
10. Amy Hutner, *U.S. General Accounting Office Report Re Employment Discrimination: How Registered Representatives Fare in Discrimination Disputes*, *in* SECURITIES ARBITRATION 1994, at 453 (PLI Corp. L. & Prac. Course Handbook Series No. 852, 1994).
11. Martin L. Budd, *Securities Industry Arbitration—Recent Issues*, C977 ALI-ABA 205, 207 (1995).

firms, between firms and customers, and between firms and their employees.[12] While the American Arbitration Association handles eight to ten percent of the cases, the National Association of Securities Dealers (NASD) manages the majority of cases.[13]

A. *Employee Statutory Rights in the Securities Industry*

1. Background

In some instances, the increasingly broad scope of arbitration[14] intersects with a large assortment of federal statutory rights for employees.[15] For example, under Title VII, which prohibits employment discrimination and encourages equal employment opportunities,[16] an employee may pursue remedies in several forums.[17] These include state and local agencies and the federal courts.[18] Title VII and arbitration intersect because the right to a jury trial granted by Title VII does not render a claim inappropriate for arbitration.[19] The statutory right to a judicial forum clashes with contractual rights stemming from contractual language that mandates an arbitral forum.

The securities industry routinely utilizes arbitration clauses. For example, when a brokerage house employs a securities broker as a registered representative,[20] industry regulatory organizations require the broker to sign a "Uniform Application for Securities and Commodities Industry Representative and/or Agent Form."[21] The form, a private agreement between the employee and the regulatory organization, contains a clause requiring arbitration of disputes between the employee broker and the employer brokerage firm.[22] An

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12. Hutner, *supra* note 10, at 451.

13. Budd, *supra* note 11, at 207.

14. In the mid-to-late 1980s, a series of Supreme Court cases significantly expanded the scope of arbitrable disputes, including claims based on statutory rights. Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989) (holding that a statutory claim must be arbitrated under a predispute arbitration agreement unless the agreement was the result of fraud or the arbitration would undermine the statutory right); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (stating that an agreement to arbitrate future statutory claims must be enforced under the Federal Arbitration Act, absent a clear congressional intent to the contrary, which may be inferred if the statute's underlying purpose conflicts with arbitration); Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) (explaining that an international agreement containing a broad arbitration clause subjects antitrust claims to arbitration).

15. IAN R. MACNEIL ET AL., FEDERAL ARBITRATION LAW § 16.5.1.1 (1994). Other statutorily-created employee rights include those granted by the Age Discrimination in Employment Act of 1967, 29 U.S.C. §§ 621-634 (1988); the Employee Retirement Income Security Program Act of 1974, 29 U.S.C. §§ 1001-1461 (1988); and the Fair Labor Standards Act of 1938, 29 U.S.C. §§ 201-219 (1988).

16. 42 U.S.C. § 2000(e) (1988).

17. *Id.* § 2000e-5(f)(3).

18. *Id.*

19. Nghiem v. NEC Elec., Inc., 25 F.3d 1437, 1441 (9th Cir. 1994), *cert. denied*, 115 S. Ct. 638 (1994).

20. Registered representatives are firm employees who deal with customers' buy-sell orders. Hutner, *supra* note 10, at 451.

21. MACNEIL ET AL., *supra* note 15, § 13.3.3.

22. *Id.* Though brokerage firms require that brokers with the firm register with one of the regulatory organizations such as NASD, the registration applications do not fall under the Federal Arbitration Act § 1 employment exception because the applications are not employment contracts. *Id.* at § 16.5.3.1; *see also* Willis v. Dean Witter Reynolds, Inc., 948 F.2d 305, 312 (6th Cir. 1991)

employee may nevertheless seek to avoid arbitration of statutory claims based on a public policy argument,[23] citing the inadequacy of arbitration to address statutory rights.[24]

A landmark arbitration case, *Gilmer v. Interstate/Johnson Lane Corp.*,[25] opened the door to mandated arbitration of statutory claims and severely curtailed the public policy argument.[26] In *Gilmer*, pursuant to an arbitration clause contained in a broker's representative application, the U.S. Supreme Court decided that a claim under the Age Discrimination in Employment Act[27] (ADEA) was subject to mandatory arbitration.[28] The Fifth Circuit extended the reach of *Gilmer* by holding that a broker's Title VII claim must be arbitrated.[29] A broad reading of *Gilmer* permits arbitration of any statutory claim when an employment contract contains an arbitration agreement.[30]

When determining whether to mandate arbitration of statutory claims, courts tend to apply *Gilmer* mechanically and compel arbitration.[31] Although

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(explaining that an arbitration agreement contained in a securities registration agreement does not fall under the FAA § 1 contract of employment exception).

23. MACNEIL ET AL., *supra* note 15, § 13.3.4.

24. *See* Alexander v. Gardner-Denver Co., 415 U.S. 36, 56-57 (1974) (holding that Title VII claims are not suitable for arbitration). As an informal procedure, arbitration is inappropriate to deal with statutory rights due to inadequate fact finding, procedural inadequacies, and the likelihood of a decision based on the parties' agreement rather than the statute or application of industry standards rather than law. *Id. But see* Patrick O. Gudridge, *Title VII Arbitration*, 16 BERKELEY J. EMPLOYMENT & LAB. L. 209, 210 n.4 (1995) ("At minimum, it might be thought, the *Gardner-Denver* line is no longer relevant outside the collective bargaining context."). *See generally* MACNEIL ET AL., *supra* note 15, § 11.6 (stating that the public policy defense is most often available in a collective bargaining context).

25. 500 U.S. 20 (1991).

26. *Gilmer*, 500 U.S. at 23.

27. 29 U.S.C. §§ 621-634 (1988).

28. *Gilmer*, 500 U.S. at 27. The Court rejected the employee's broad policy argument that compulsory arbitration does not comport with the underlying purpose of the ADEA. *Id.* at 26-27. The decision also rested in part on the Federal Arbitration Act's policy favoring arbitration. *Id.* at 25 (citing Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983) (explaining that the FAA "establishes that, as a matter of federal law, any doubts concerning the scope of arbitral issues should be resolved in favor of arbitration")). Another important aspect of *Gilmer* lies in the Court's discussion of Alexander v. Gardner-Denver Co., 415 U.S. 36 (1974). The Court stated that *Alexander* involved arbitration in a collective bargaining context and was not decided under the FAA. *Gilmer*, 500 U.S. at 22. By distinguishing *Alexander* in this manner, the Court created two lines of cases regarding the appropriateness of arbitrating statutory claims. For a discussion of Tenth Circuit decisions on collective bargaining arbitration, see Kerri M. Pertcheck, *Arbitration Survey*, 72 DENV. U. L. REV. 571 (1995). *See generally* Stephen W. Skrainka, *The Utility of Arbitration Agreements in Employment Manuals and Collective Bargaining Agreements for Resolving Civil Rights, Age and ADA Claims*, 37 ST. LOUIS U. L.J. 985 (1993) (discussing the role of arbitration in the collective bargaining context).

29. Alford v. Dean Witter Reynolds, Inc., 939 F.2d 229, 230 (5th Cir. 1991) (concluding that "[b]ecause both the ADEA and Title VII are similar civil rights statutes, and both are enforced by the EEOC . . . we have little trouble concluding that Title VII claims can be subjected to compulsory arbitration"). This case is especially relevant because of its importance to the court's decision in *Metz*, discussed *infra* notes 34-48 and accompanying text.

30. Martin H. Malin & Robert F. Ladenson, *Privatizing Justice: A Jurisprudential Perspective on Labor and Employment Arbitration from the Steelworkers Trilogy to* Gilmer, 44 HASTINGS L.J. 1187, 1189 (1993). Scholars, however, express wariness regarding arbitration of all statutory claims because arbitration may resolve controversies based on nonlegal social values rather than the law. Additionally, judicial forums are more suited to choose between conflicting public values inherent in statutory claims. *Id.*

31. *Id.* at 1202; *see* Mago v. Shearson Lehman Hutton, Inc., 956 F.2d 932, 935 (9th Cir.

some circuits have foreclosed the arbitration of Title VII claims based on arbitration agreements in a securities registration,[32] the majority of circuits require it.[33]

2. *Metz v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*[34]

a. *Facts*

Kelli Lyn Metz, an employee of Merrill Lynch, registered as a broker with NASD.[35] An arbitration clause in the registration application required Metz to arbitrate all disputes or claims with Merrill Lynch.[36] Upon termination, Metz filed a district court complaint alleging Title VII violations.[37] Merrill Lynch responded with a motion to compel arbitration and stay court proceedings.[38] The district court held that the Title VII claims were not subject to compulsory arbitration.[39] Merrill Lynch's motion to reconsider was denied, and the company requested dismissal of a subsequent interlocutory

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1992); Willis v. Dean Witter Reynolds, Inc., 948 F.2d 305, 307 (6th Cir. 1991); Alford v. Dean Witter Reynolds, Inc., 939 F.2d 229, 230 (5th Cir. 1991).

32. Farrand v. Lutheran Bhd., 993 F.2d 1253, 1255 (7th Cir. 1993) (concluding that the language of the arbitration agreement does not require the arbitration of disputes between NASD members and a registered representative of the member); Utley v. Goldman Sachs & Co., 883 F.2d 184, 187 (1st Cir. 1989) (stating that based on the text of Title VII and congressional intent, an employee cannot be required to arbitrate prior to a judicial hearing); Swenson v. Management Recruiters Int'l, 858 F.2d 1304, 1307 (8th Cir. 1988) (explaining that Title VII promotes public interest and arbitration may hamper this effort).

33. Bender v. A.G. Edwards & Sons, Inc., 971 F.2d 698, 700 (11th Cir. 1992) (stating the plaintiff did not waive the right to a judicial forum since the dispute may be pursued in arbitration and if those proceedings are legally deficient, the plaintiff may move for judicial review); Mago v. Shearson Lehman Hutton, Inc., 956 F.2d 932, 935 (9th Cir. 1992) (finding that in a private agreement containing an arbitration clause, plaintiff did not meet the burden of showing congressional intent to preclude Title VII arbitration because the purpose of Title VII is similar to that of the ADEA); Willis v. Dean Witter Reynolds, Inc., 948 F.2d 305, 312 (6th Cir. 1991) (explaining that an arbitration agreement contained in a securities registration agreement does not fall under the FAA § 1 contract of employment exception and must therefore stand); Alford v. Dean Witter Reynolds, Inc., 939 F.2d 229, 230 (5th Cir. 1991) (holding that Title VII claims, like ADEA claims, are subject to arbitration under the FAA).

34. 39 F.3d 1482 (10th Cir. 1994).

35. *Metz*, 39 F.3d at 1485-86. Brokerage firms normally require brokers to register with a regulatory organization. *See supra* notes 20-24 and accompanying text.

36. *Metz*, 39 F.3d at 1486. By registering with NASD, Metz agreed to abide by all NASD rules. Metz v. Merrill Lynch, No. CIV-89-1548-P, 1990 WL 68532, at *1 (W.D. Okla. 1990). The NASD Manual, ¶ 3744, states:

> It may be deemed conduct inconsistent with just and equitable principles of trade and a violation of Article III, Section 1 of the Rules of Fair Practice for a member or a person associated with a member to fail to submit a dispute for arbitration under the Code of Arbitration Procedure as required by that Code . . . .

Metz, 39 F.3d at 1488 n.6.

37. *Metz*, 39 F.3d at 1485-86. Already on probation for poor performance, Metz informed management of her pregnancy. *Id.* Her immediate supervisor told Metz that women returning from maternity leave often did not adequately perform their duties or failed to return at all. *Id.* Typically, the brokers decided how to distribute their accounts during a leave. *Id.* In this case, however, Metz's supervisor told her that he would make that decision. *Id.* Within two weeks, Metz and her supervisor argued about one of Metz's accounts. *Id.* Metz was fired shortly thereafter. *Id.* The Title VII claim alleged unlawful discrimination and discharge due to her pregnancy. *Id.*

38. *Id.*

39. *Id.*

appeal, citing multiple circuit court decisions holding that Title VII claims do not have to be arbitrated.[40]

After the bench trial resulted in a $53,747 judgment for Metz on the Title VII claim, Merrill Lynch filed a motion to vacate the judgment and sought to compel arbitration of the Title VII claim.[41] The company based the motion to vacate on a change in the law that occurred after the dismissal of the interlocutory appeal.[42] The district court denied the motion to vacate, denied a subsequent motion for reconsideration, and Merrill Lynch filed an appeal in the Tenth Circuit.[43]

b. *Decision*

Relying on the Supreme Court's enforcement of the arbitration clause in *Gilmer*, the Tenth Circuit concluded that Metz must arbitrate her Title VII claim.[44] As an alternative to her main contention that Title VII claims do not have to be arbitrated, Metz argued that FAA section 1 precluded arbitration even if the Title VII claims were subject to mandatory arbitration.[45] FAA section 1, however, does not apply to arbitration clauses contained in a registration application[46] and Metz's duty to arbitrate arose from her broker registration with NASD, not the employment contract with Merrill Lynch.[47] As a result, the Tenth Circuit concluded that Metz must arbitrate her Title VII claim.[48]

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40. *Id.*

41. *Id.*

42. *Id.* In *Alford v. Dean Witter Reynolds, Inc.*, decided after Merrill Lynch sought dismissal of the appeal, the Fifth Circuit held that Title VII claims may be subject to compulsory arbitration. Alford v. Dean Witter Reynolds, Inc., 939 F.2d 229, 230 (5th Cir. 1991).

43. *Metz*, 39 F.3d at 1486.

44. *Id.* at 1487. The court based much of its reasoning on the similar purposes of the ADEA and Title VII. "Congress closely modeled the ADEA upon Title VII and [the two] statutes are similar both in their aims and in their substantive prohibitions." *Id.* (quoting Cooper v. Asplundh Tree Expert Co., 836 F.2d 1544, 1553-54 (10th Cir. 1988)).

45. *Id.* at 1488. FAA § 1 provides in part that "nothing herein contained shall apply to contracts of employment of . . . workers engaged in foreign or interstate commerce." 9 U.S.C. § 1 (1994).

46. *Metz*, 39 F.3d at 1488. The *Metz* court relied on *Gilmer*:

> [I]t would be inappropriate to address the scope of . . . [FAA] § 1 exclusion because the arbitration clause being enforced here is not contained in a contract of employment . . . . The record before us does not show, and the parties do not contend, that Gilmer's employment agreement with Interstate contained a written arbitration clause. Rather, the arbitration clause at issue is in Gilmer's security registration application, which is a contract with the securities exchange, not with Interstate. The lower courts addressing the issue uniformly have concluded that the exclusionary clause of § 1 of FAA is inapplicable to arbitration clauses contained in such registration application.

Gilmer, 500 U.S. at 25 n.2.

47. *Id.*

48. *Metz*, 39 F.3d at 1488. Although generally holding that Merrill Lynch has the right to compel Metz to arbitrate her Title VII claims, the court further found that in this specific instance, Merrill Lynch waived that right by failing to renew its final demand for arbitration in a timely manner. *Id.* at 1490.

3. Analysis

Regardless of the advantages of arbitration,[49] employees fear that mandatory arbitration of statutory claims forces them to relinquish their statutory rights.[50] By allowing mandatory arbitration of statutory rights, courts permit employers to condition employment on the relinquishment of these rights. Thus, through mandatory arbitration policies, business entities may escape the requirements of regulatory legislation.[51]

Attorney awareness of the potential consequences of entering into such agreements reduces the risk that an employee will inadvertently waive statutory rights. Unequal bargaining power, however, makes it difficult to address this risk regardless of the attorney's awareness. Employees have little chance of influencing boilerplate language, such as the language contained in the NASD arbitration clause. Unfortunately, the realities of the job market indicate that employees will continue to sacrifice their right to a judicial forum in order to obtain or retain employment.

4. Other Circuits[52]

The Fifth and Ninth Circuits recently addressed mandatory arbitration of Title VII claims based on arbitration agreements contained in securities registration applications.[53] Both of these cases were decided by circuit courts that previously upheld mandatory arbitration of Title VII claims.[54] The cases further develop and refine the law surrounding mandatory arbitration of employment issues.

The Fifth Circuit's decision in *Williams v. Cigna Financial Advisors*[55] differs from *Metz* in that the employee joined the brokerage firm before the NASD arbitration rules included employment disputes.[56] But because the

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49. "Speed, lower costs, informality, the ability to gain a more suitable neutral decisionmaker, and privacy are the advantages usually cited in support of arbitration. Many of arbitration's alleged advantages result from the autonomy parties gain when they decide to arbitrate rather than go to court." LEONARD L. RISKIN & JAMES E. WESTBROOK, DISPUTE RESOLUTION AND LAWYERS 297 (1987).

50. Patrick D. Smith, Comment, *Arbitration—The Court Opens the Door to Arbitration of Employment Disputes:* Gilmer v. Interstate/Johnson Lane Corp., 17 J. CORP. L. 865, 865 (1992); *see, e.g.*, Alexander v. Gardner-Denver Co., 415 U.S. 36, 56 (1974).

51. MACNEIL ET AL., *supra* note 15, § 16.5.4.1. For a general discussion of considerations in employer-drafted mandatory arbitration policies, see Garry G. Mathiason & Pavneet S. Uppal, *Evaluating and Using Employer-Initiated Arbitration Policies and Agreements: Preparing the Workplace for the Twenty-First Century*, C902 ALI-ABA 875 (1994).

52. The "Other Circuits" sections of this Survey discusses only federal circuit court cases decided within the survey period of September 1994 to September 1995.

53. Williams v. Cigna Fin. Advisors, Inc., 56 F.3d 656 (5th Cir. 1995); Prudential Ins. Co. of Am. v. Lai, 42 F.3d 1299 (9th Cir. 1994).

54. The court in Alford v. Dean Witter Reynolds, Inc., 939 F.2d 229 (5th Cir. 1991), found that Title VII claims, based on their similarity to ADEA claims, are subject to arbitration under the FAA. *Id.* at 230. The court in Mago v. Shearson Lehman Hutton Inc., 956 F.2d 932 (9th Cir. 1992), found that the plaintiff did not meet her burden of showing that Congress intended to preclude Title VII arbitration because the purpose of Title VII corresponds to that of the ADEA. *Id.* at 935.

55. 56 F.3d 656 (5th Cir. 1995).

56. *Williams*, 56 F.3d at 659. The opinion also addressed a second contention that the employee did not knowingly and voluntarily surrender his right to a judicial forum, based on the

employee signed a second registration after the amendment of the NASD securities registration, the court held that he had agreed to arbitrate employment claims.[57] By requiring the employee to arbitrate his Title VII claim, the Fifth Circuit Court extended the reach of mandatory arbitration for Title VII claims to the securities industry.

The Ninth Circuit, in contrast, restricted compulsory arbitration of Title VII claims in the securities industry in *Prudential Insurance Company of America v. Lai*.[58] The *Lai* court held that brokerage firm employees cannot be subject to mandatory arbitration of Title VII claims without a "knowing" waiver of statutory remedies.[59] The decision relied on two factors.[60] First, the court held that Congress intended that the waiver of statutory rights result only from a knowing agreement to arbitrate employment disputes.[61] In *Lai*, the registration application did not specifically describe the controversies covered under the arbitration clause.[62] As a result, the employees did not knowingly surrender statutory remedies and could not be forced to arbitrate Title VII claims.[63]

Second, the court recognized that the public policies underlying Title VII deserve at least as much recognition as the FAA's arbitration policy.[64] The court noted that arbitral forums, especially in sexual harassment cases, may not be appropriate.[65]

Older Workers Benefit Protection Act, 29 U.S.C. § 626(f)(1) (1994). The Older Workers Benefit Protection Act (OWBPA) requires a written waiver of statutory rights. The court determined that the OWBPA did not apply here because it primarily involves waiver of claims and rights under the statute rather than waiver of judicial forums. *Williams*, 56 F.3d at 660.

57. *Williams*, 56 F.3d at 658.

58. 42 F.3d 1299 (9th Cir. 1994).

59. *Prudential Ins. Co.*, 42 F.3d at 1304-05.

60. *Id.* In making this decision, the court relied heavily on *Alexander*, although it is normally applied in a collective bargaining context. *See supra* note 28.

61. *Prudential Ins. Co.*, 42 F.3d at 1304. According to a House of Representatives' report, Congress intended to "encourage[] the use of alternative means of dispute resolution . . . where appropriate" and that alternative dispute resolution should "supplement, not supplant" the remedies provided by Title VII. *Id.* (quoting H.R. REP. NO. 40, 102d Cong., 1st Sess. (1991), *reprinted in* 1991 U.S.C.C.A.N. 549, 635). In fact, Senator Dole specifically stated that arbitration should be endorsed only "where the parties knowingly and voluntarily elect to use these methods." *Id.* at 1305 (quoting 137 CONG. REC. S15,472, S15,478 (daily ed. Oct. 30, 1991) (statement of Sen. Dole)).

62. *Id.* at 1302. The registration agreement stated, "I agree to arbitrate any dispute, claim or controversy that may arise between me or my firm . . . that is required to be arbitrated under the rules, constitutions, or bylaws of the organizations with which I register." *Id.* The NASD Manual, in turn, requires that "[a]ny dispute, claim or controversy eligible for submission under Part I of this Code between or among members and/or associated persons . . . arising in connection with the business of such member(s) or in connection with the activities of such associated person(s), shall be arbitrated under this Code . . . ." *Id.* (quoting NASD Manual, Code of Arbitration Procedure, ¶ 3708).

63. *Id.* at 1305. In addition, the employees did not receive a copy of the NASD Manual. *Id.* at 1303. However, even if they had, the court found the language would not give them notice that they must arbitrate Title VII claims. *Id.* at 1305.

64. *Id.*

65. *Id.* "[I]n an area as personal and emotionally charged as sexual harassment and discrimination, the procedural right to a hearing before a jury of one's peers, rather than a [NASD arbitration] panel . . . may be especially important." *Id.* at 1305 n.4.

B. *Punitive Damages in Securities Arbitration*

1. Background

As arbitrators' authority to decide substantive disputes continues to expand, their power to award punitive damages becomes increasingly important, especially in the securities industry.[66] At one time the securities industry actually encouraged the use of arbitration, in part to avoid large jury awards.[67] Brokers now complain, however, about arbitrators' power to make punitive awards and the narrow grounds available to appeal such awards.[68]

Agreements routinely used in the securities industry often designate, through choice of law clauses, the use of New York state law. Unlike most states, New York does not allow arbitrators to grant punitive awards.[69] In the same agreement, parties may agree to use certain arbitration rules, such as those of the American Arbitration Association or NASD, which impliedly *do* permit such awards.[70] As a result, the arbitration clause may be inherently contradictory.[71] To further complicate an already complex situation, the FAA does not directly address the propriety of arbitral punitive damage awards.[72]

Until recently, to determine if a particular arbitrator had the power to award punitive damages, a court had to resolve the conflict between federal law and divergent state laws by determining whether the FAA preempts state law prohibiting punitive awards by arbitrators.[73] Lacking guidance from the Supreme Court, the Second and Seventh Circuits applied state law[74] while other circuits applied federal law.[75] The Supreme Court resolved the circuit courts' inconsistency by redefining the analysis of arbitrator-awarded punitive damages in *Mastrobuono v. Shearson Lehman Hutton, Inc.*[76]

The *Mastrobuono* Court precluded use of the New York rule by finding that if parties agree to arbitrate punitive damages, the FAA dictates

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66. BERTHOLD H. HOENIGER, COMMERCIAL ARBITRATION HANDBOOK app. 7 at 7-2 (1990).

67. J. Stratton Shartel, *The Time Is Right for Limits on Punitive Damages in Securities Arbitration Cases*, INSIDE LITIG., Nov. 1994, at 2, 2.

68. *Id.*

69. Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793, 794 (N.Y. 1976) (stating that the arbitrator has no power to award punitive damages because it would violate public policy). The Second and Seventh Circuits applied the "New York Rule" and vacated the arbitral awards of punitive damages. Barbier v. Shearson Lehman Hutton Inc., 948 F.2d 117 (2d Cir. 1991); Fahnestock & Co. v. Waltman, 935 F.2d 512 (2d Cir. 1991); Pierson v. Dean, Witter, Reynolds, Inc., 742 F.2d 334 (7th Cir. 1984). Not coincidentally, the jurisdiction of these two circuits includes New York City and Chicago, major hubs for the securities industry.

70. Kenneth R. Davis, *A Proposed Framework for Reviewing Punitive Damages Awards of Commercial Arbitrators*, 58 ALB. L. REV. 55, 55 (1994).

71. *Id.*

72. *Id.* at 57.

73. Anthony M. Sabino, *Awarding Punitive Damages in Securities Industry Arbitration: Working for a Just Result*, 27 U. RICH. L. REV. 33, 33-34 (1992).

74. *See* Davis, *supra* note 70.

75. Baravati v. Josephthal, Lyon & Ross, Inc., 28 F.3d 704 (7th Cir. 1994); Lee v. Chica, 983 F.2d 883 (8th Cir. 1993); Todd Shipyards Corp. v. Cunard Line, Ltd., 943 F.2d 1056 (9th Cir. 1991); Raytheon Co. v. Automated Business Sys., 882 F.2d 6 (1st Cir. 1989); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378 (11th Cir. 1988); Willoughby Roofing & Supply Co. v. Kajima Int'l, 598 F. Supp. 353 (N.D. Ala. 1984), *aff'd*, 776 F.2d 269 (11th Cir. 1985).

76. 115 S. Ct. 1212 (1995).

enforcement of the contract *even if state law does not allow punitive damages*.[77] The customer/broker agreement in *Mastrobuono* stated that the inherently conflicting New York law and NASD rules would apply to the agreement.[78] To determine if the arbitration agreement reflected an implicit intent by the parties to include or exclude punitive damages, the choice of law and arbitration provisions first must be considered separately, and then construed as a whole.[79] Taken separately, neither clause precluded punitive damages.[80] Taken together, the provisions conflicted.[81] The Court concluded that New York law would apply to the contract in general, but not to the provisions of the arbitration clause.[82]

2. *Kelley v. Michaels*[83]

a. *Facts*

William Michaels, a broker with PaineWebber, handled two accounts for the Kelleys. The Kelleys entered into a Resource Management Account Agreement covering each account.[84] One year later, in October 1989, Michaels left

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77. *Mastrobuono*, 115 S. Ct. at 1217 (emphasis added). The FAA ensures that "private agreements are enforced according to their terms." *Id.* (citing Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989)).

78. *Id.* at 1214-15. Before *Mastrobuono*, New York law did not allow arbitrators to make punitive awards. *Garrity*, 353 N.E.2d at 794. NASD, however, does allow such awards. *See infra* note 107 and accompanying text.

79. *Mastrobuono*, 115 S. Ct. at 1217. The court in *Mastrobuono* interpreted the choice of law provision as a substitute for a conflict of laws analysis that otherwise would determine what law should be applied. *Id.* As such, the clause did not unequivocally preclude a punitive damages claim. *Id.* The arbitration clause, on the other hand, strongly suggested the appropriateness of punitive damages because it explicitly authorized arbitration under the NASD rules. *Id.* at 1218. The NASD Code of Arbitration Procedure, in turn, states that arbitrators may award "damages and other relief." NASD Code of Arbitration Procedure ¶ 3741(e) (1993). The court interpreted this broad provision to encompass punitive damages. *Id.* Moreover, the NASD Arbitrator's Manual states that an arbitrator may make punitive awards. *Id.*

80. *Mastrobuono*, 115 S. Ct. at 1218.

81. *Id.*

82. *Id.* The Court stated:

> [T]he best way to harmonize the choice of law provision with the arbitration provision is to read "the laws of the State of New York" to encompass substantive principles that New York courts would apply, but not to include special rules limiting the authority of arbitrators. Thus, the choice of law provision covers the rights and duties of the parties, while the arbitration clause covers arbitration; neither sentence intrudes upon the other.

Id. at 1219.

The Court employed fundamental contract principles when applying the second prong of the test—analyzing the meaning of the provisions taken together. The choice of law clause created ambiguity in an agreement that otherwise permits punitive damages: such ambiguities in the scope of an arbitration agreement are resolved in favor of arbitration. *Id.* at 1218 (citing *Volt Info. Sciences, Inc.*, 489 U.S. at 476); *see also* Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983). Additionally, common law contract principles dictate that any ambiguity be construed against the drafter. *Mastrobuono*, 115 S. Ct. at 1219. Finally, if the choice of law and arbitration clauses contradict, as asserted by Shearson-Lehman, the agreement violated another cardinal rule of contract construction requiring an interpretation that gives effect to all provisions and renders them consistent with one another. *Id.* Justice Thomas dissented, stating that the intent to preclude punitive damages was made clear through the choice of law clause because New York law explicitly prohibits arbitrators from awarding punitive damages while NASD rules merely implicitly allow such awards. *Id.* at 1223 (Thomas, J., dissenting).

83. 59 F.3d 1050 (10th Cir. 1995).

84. *Kelley*, 59 F.3d at 1051-52. Paragraph 12 of the PaineWebber agreement provided: "This

PaineWebber and joined Merrill Lynch, taking the Kelleys' accounts with him.[85] The Kelleys again signed Customer Agreements covering each account.[86] In 1991, their attorney sent Michaels a demand letter alleging churning,[87] unauthorized trading, unsuitable investments leading to portfolio losses, and needless liquidating commissions.[88] They settled with Merrill Lynch for $290,000 but the agreement specifically left open the possibility of pursuing claims against Michaels individually.[89]

The Kelleys filed a state action against Michaels alleging stockbroker fraud and federal securities violations.[90] The Kelleys dismissed the suit without prejudice after Michaels removed it to federal court.[91] The Kelleys filed a second state action which did not include the federal securities allegations.[92] When Michaels sought to compel arbitration, the Kelleys dismissed the second action without prejudice and instead filed a claim with NASD.[93] The NASD claim alleged breach of fiduciary duty, churning, unsuitable investments, and negligence. The Kelleys sought both actual and punitive damages from Michaels.[94] The arbitrators awarded the Kelleys $292,750 in actual damages and $505,217.50 in punitive damages.[95] After the Kelleys confirmed the award in federal district court, Michaels appealed.[96]

b. *Decision*

The Tenth Circuit affirmed the arbitral award of punitive damages.[97]

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agreement and its enforcement shall be construed and governed by the laws of the State of New York." *Id.* at 1052. Paragraph 15 of the agreement provided in part:

> I agree . . . that all controversies which may arise between you and me . . . concerning any transactions . . . shall be determined by arbitration. Any arbitration shall be in accordance with the rules in effect of either the New York Stock Exchange, Inc., American Stock Exchange, Inc., [or] National Association of Securities Dealers, Inc. . . .

Id.

85. *Id.*

86. *Id.* Paragraph 12 of the Merrill Lynch agreement stated in part: "This Agreement . . . will be governed by and interpreted under the laws of the State of New York." *Id.* Paragraph 11 of the agreement stated in part:

> I agree that all controversies which may arise between us . . . shall be determined by arbitration. Any arbitration under this agreement shall be conducted only before the New York Stock Exchange, Inc., the American Stock Exchange, Inc., . . . the National Association of Securities Dealers, Inc., . . . and in accordance with its arbitration rules then in force.

Id.

87. "Churning" occurs when a broker engages in transactions to generate unjustifiable commissions from the customer's loss or transaction costs. THOMAS L. HAZEN, THE LAW OF SECURITIES REGULATION § 10.10 (2d ed. 1990).

88. *Kelley*, 59 F.3d at 1052. Michaels charged for the commissions when transferring the Kelleys' accounts from PaineWebber to Merrill Lynch. *Id.*

89. *Id.*

90. *Id.*

91. *Id.* at 1052-53.

92. *Id.* at 1053.

93. *Id.*

94. *Id.*

95. *Id.* at 1051.

96. *Id.* at 1053.

97. *Id.* at 1050. The court rejected Michaels's arguments that: (1) the arbitrators exceeded

First, the court determined that in awarding punitive damages, the arbitration panel did not reach outside the specific claims made by the Kelleys.[98] The Kelleys' second state action clearly requested punitive damages for Michaels's conduct while at Merrill Lynch.[99]

Second, the court addressed whether the PaineWebber agreement or the Merrill Lynch agreement precluded an award of punitive damages.[100] Both agreements provided for arbitration in accordance with NASD rules, which do not preclude the possibility of punitive damages.[101] Both agreements, however, also provided for enforcement under New York state law, which does not allow arbitrators to award punitive damages. In light of the Supreme Court's holding in *Mastrobuono*, the Tenth Circuit concluded that the punitive damages award was proper.[102]

3. Analysis

Many brokerage agreements contain New York choice of law clauses.[103] As a result, *Mastrobuono* and its progeny, including *Kelley*, have far-reaching implications in the securities industry.[104] It is unlikely, however, that the decision will extend beyond the securities context because of the unique nature of securities arbitration.[105] To preclude arbitral punitive damages awards in the future, brokerage houses may attempt to draft documents more carefully, specifically precluding punitive damages awards.[106] The NASD, however, has attempted to divert this result by enacting a rule prohibiting its members from drafting agreements that preclude arbitral awards of punitive damages.[107]

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their authority because the Kelleys did not request punitive damages for Michaels's conduct while at Merrill Lynch; (2) the punitive damages award went against the choice of law clause; and (3) the award was excessive. *Id.* at 1051.

98. *Id.* at 1054. Michaels argued on appeal that because the language of the Demand for Relief did not specifically mention punitive damages for conduct while at Merrill Lynch, the arbitrators went beyond their authority. The court, in rejecting this reasoning, stated that the relief requested fairly sought punitive damages from Michaels, regardless of his place of employment. The Demand for Relief in the NASD claim, which formed the basis of the arbitrator's award, stated: "Based upon the foregoing, Claimants are entitled to the following relief: From PaineWebber and Michaels: a. Actual damages of $30,000; b. Interest as allowed by law; [and] c. Punitive damages in an amount that will deter others from doing what Respondent did to Claimants." *Id.* at 1054 n.3. The arbitration panel, paraphrasing the Demand for Relief, stated, "Claimants requested actual damages in the amount of $30,000.00, interest as allowed by law, punitive damages, legal fees, and costs against PaineWebber and Michaels." *Id.* at 1054.

99. *Id.* These allegations were incorporated into the NASD claim because the Kelleys dismissed that action in deference to the arbitration. *Id.*

100. *Id.* Michaels based his argument on the choice of law clause in the brokerage agreements: New York law does not allow arbitrators to award punitive damages. *Id.* (citing Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793 (N.Y. 1976)). *Mastrobuono*, directly on point, disposed of this argument. *Mastrobuono*, 115 S. Ct. 1212, 1218; *see supra* text accompanying notes 73-82.

101. *Kelley*, 59 F.3d at 1054; *see* CODE OF ARBITRATION PROCEDURE pt. 1, para. 3741 (National Association of Securities Dealers 1995).

102. *Kelley*, 59 F.3d at 1055.

103. *See infra* notes 79-82 and accompanying text.

104. Carroll E. Neeseman & Maren E. Nelson, *The Law of Securities Arbitration, in* SECURITIES ARBITRATION: 1995, at 263 (PLI Corp. L. & Prac. Course Handbook Series No. 899, 1995).

105. *Id.*

106. Isham R. Jones, III, *Exemplary Awards in Securities Arbitration: Short-Circuited Rights to Punitive Damages*, 1995 J. DISP. RESOL. 129, 152.

107. RULES OF FAIR PRACTICE Rule 21(f)(4) (National Association of Securities Dealers, Inc.

4. Other Circuits

Two other circuits, following the *Mastrobuono/Kelley* reasoning, recently addressed the power of arbitrators to award punitive damages in securities disputes. The Seventh Circuit, in *Smith Barney Inc. v. Schell,*[108] held that an arbitration agreement identical to that in *Mastrobuono* dictated reversing a district court's injunction preventing an arbitration panel from considering punitive damage claims.[109] Similarly, in *Davis v. Prudential Securities, Inc.,*[110] the Eleventh Circuit ruled that the arbitrator's authority included awarding punitive damages.[111] The arbitration clause in *Davis* was also virtually identical to that in *Mastrobuono.*[112] These cases, like *Kelley*, did little to augment the basic holding in *Mastrobuono* given the similarities of the language used in each of the four contracts.

II. SCOPE OF THE ARBITRATION AGREEMENT

A. *Background*

When construing arbitration clauses, courts often cast them as "broad" or "narrow."[113] Interpretation of the scope of an arbitration clause determines what issues will be arbitrated.[114] A broad clause[115] subjects all disputes that

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1991). The new rule applies only to agreements enacted after 1989. *Id.* at Rule (f)(5).

108. 53 F.3d 807 (7th Cir. 1995).

109. *Smith Barney Inc.*, 53 F.3d at 809.

110. 59 F.3d 1186 (11th Cir. 1995).

111. *Davis*, 59 F.3d at 1196.

112. *Id.* at 1189. In addition, the *Davis* court considered whether punitive damages awards by arbitrators violates the Due Process Clause of the Fifth and Fourteenth Amendments because arbitration lacks procedural protections and meaningful judicial review. *Id.* at 1190. The Eleventh Circuit concluded that a private arbitration contract lacks the required state action element of a due process claim. *Id.* at 1191.

113. *E.g.*, McDonnell Douglas Fin. Corp. v. Pennsylvania Power & Light Co., 858 F.2d 825, 832 (2d Cir. 1988).

114. The Second Circuit has remarked:

> Simply stated, a court should compel arbitration, and permit the arbitrator to decide whether the dispute falls within the clause, if the clause is 'broad.' In contrast, if the clause is 'narrow,' arbitration should not be compelled unless the court determines that the dispute falls within the clause. Specific words or phrases alone may not be determinative although words of limitation would indicate a narrower clause.

Prudential Lines v. Exxon Corp., 704 F.2d 59, 64 (2d Cir. 1983).

115. When a clause employs broad, encompassing language such as "arising out of," "relating to," or "connected with," a court should order arbitration of claims involving the formation, performance, modification, and termination of the contract. MACNEIL ET AL., *supra* note 15, at § 20.2.2.1. Courts have interpreted the following language as broad: "any and all differences, disputes or controversies arising out of," Folkways Music Publishers v. Weiss, 989 F.2d 108, 111 (2nd Cir. 1993); "any dispute," Hornbeck Offshore Corp. v. Coastal Carriers Corp., 981 F.2d 752, 754-55 (5th Cir. 1993); "any controversy arising out of the handling of any of the transactions referred to in this agreement," R.M. Perez & Assocs., Inc. v. Welch, 960 F.2d 534, 539 (5th Cir. 1992). Standard phrases seem to employ either "arising out of" or "related to/connected with" language. "An arbitration clause covering claims 'relating to' a contract is broader than a clause covering claims 'arising out of' a contract." International Talent Group, Inc. v. Copyright Mgmt., Inc., 629 F. Supp. 587, 592 (S.D.N.Y. 1986). Language such as "arising under" necessarily limits the arbitrable disputes to those directly related to the interpretation and performance of the contract. Mediterranean Enter. v. Ssangyong Corp., 708 F.2d 1458, 1463-64 (9th Cir. 1983). "Relating to" language extends the scope of the arbitration clause to include all disputes relating to the

arise out of a contract to arbitration, while a narrow clause limits the arbitrable disputes to those specifically enumerated.[116]

When parties draft a narrow clause, they open the door to the possibility of litigation to determine if a specific dispute falls within the scope of the arbitration clause.[117] The American Arbitration Association, for this reason, does not encourage utilizing overly restrictive language.[118]

In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*,[119] the Supreme Court interpreted the scope of a broad arbitration clause to determine the arbitrability of antitrust disputes.[120] Its holding affirmed the First Circuit's determination that antitrust claims fell within the scope of the international contract at issue.[121] A later case in the Ninth Circuit extended the *Mitsubishi* holding to domestic antitrust disputes.[122]

B. Coors Brewing Co. v. Molson Breweries[123]

1. Facts

In 1985, Coors Brewing Co. (Coors) and Molson Breweries of Canada, Ltd. (Molson) entered into an agreement allowing Molson to brew and distribute Coors's products in Canada.[124] This contract gave Molson access to information such as Coors's trademarks, brewing processes, and marketing data that Molson agreed to keep confidential.[125] In 1993, Molson entered into

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parties' agreement. Genesco, Inc. v. T. Kakiuchi & Co., 815 F.2d 840, 845 (2d Cir. 1987); Rhone-Poulenc Specialties Chimiques v. SCM Corp., 769 F.2d 1569, 1571 (Fed. Cir. 1985). The distinction between the disputes covered by the two different types of broad phrases, "arising under" and "relating to/connected with," rests on whether arbitral disputes involve the parties' contract itself or the relationship that arises from their contract.

116. McDonnell Douglas Fin. Corp. v. Pennsylvania Power & Light Co., 858 F.2d 825, 832 (2d Cir. 1988) The court construed as narrow the following clause:

> If the Company should disagree with any Owner's computation of the amount of the required indemnity payment or refund . . . or if any Owner should disagree with such good faith determination of the Company that there is substantial risk, then the Company and the Owner shall appoint an independent tax counsel to resolve the dispute and, if the parties cannot agree to the appointment of such counsel, said independent tax counsel shall be appointed by the American Arbitration Association.

Id.; *see also* MACNEIL ET AL., *supra* note 15, § 20.2.3.1.

117. COMMERCIAL ARBITRATION FOR THE 1990S, at 142 (Richard J. Medalie ed., 1991) [hereinafter COMMERCIAL ARBITRATION].

118. *Id.* at 143.

119. 473 U.S. 614 (1985).

120. *Mitsubishi*, 473 U.S. at 617. The clause stated, "All disputes, controversies or differences which may arise between [Mitsubishi] and [Soler] out of or in relation to Articles I-B through V of this Agreement or for the breach thereof, shall be finally settled by arbitration . . . ." *Id.*

121. *Id.* at 628-40. The First Circuit had concluded that the antitrust claims closely related to the contract since they stemmed from specific provisions in the contract. *Mitsubishi*, 723 F.2d at 159-61. The antitrust claims resulted from Mitsubishi's concerns about trademark, reputation, and goodwill. Because the contract addressed each of these factors, the arbitration clause applied to the antitrust claims. *Id.*

122. Nghiem v. NEC Elecs., 25 F.3d 1437 (9th Cir. 1994).

123. 51 F.3d 1511 (10th Cir. 1995).

124. *Coors Brewing Co.*, 51 F.3d at 1512. The agreement contained a broad arbitration clause stating, "Any dispute arising in connection with the implementation, interpretation or enforcement of this Agreement" shall be arbitrated. *Id.* at 1513.

125. *Id.*

a partnership with Miller Brewing Company (Miller), a competitor of Coors, and gave Miller a seat on the Molson board of directors.[126]

Coors filed two separate actions against Molson:[127] one to arbitrate various contract claims stemming from breach of confidentiality, and the second to litigate various antitrust claims.[128] Molson moved to stay the antitrust proceedings pending arbitration of the contract claims.[129] The district court denied the motion, and Molson sought expedited appeal on the grounds that "Coors ha[d] dressed up its contract claims in antitrust clothes" to avoid the arbitration clause in their agreement.[130] Coors responded that the antitrust and contract claims were distinct, and that Coors should be able to pursue an antitrust suit unrelated to the contract.[131]

Molson contended that the Supreme Court's decision in *Mitsubishi* indicated that even if the arbitration clause did not specifically address antitrust claims, antitrust disputes within the scope of the contract may be arbitrated.[132] Coors argued that *Mitsubishi* did not apply because: (1) the scope of the arbitration clause in *Mitsubishi* was broad while the scope of the Molson/Coors clause was narrow; and (2) even if antitrust claims generally fall under the scope of the Molson/Coors agreement, Coors's specific antitrust claims fell outside the scope of the contract and thus, were not subject to the arbitration clause.[133]

2. Decision

The Tenth Circuit held that antitrust claims unrelated to the contract may be litigated.[134] Specifically, it found that the antitrust claims regarding market concentration did not relate to the licensing agreement and may be litigated.[135] Antitrust claims regarding confidentiality and proprietary information, however, did relate to the contract and, therefore, must be arbitrated.[136] In reaching this decision, the court rejected Coors's unsupported contention that the arbitration clause was "narrow" and instead determined that the arbitration clause extended to the antitrust disputes within the scope of the agreement.[137]

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126. *Id.*

127. *Id.* In particular, Coors alleged that the Miller-Molson relationship restrained trade and lessened competition in the United States and North American beer markets. Second, Coors alleged that, as a result of Miller's seat on the Molson board, Miller would have access to confidential Coors's information. Finally, Coors alleged, also as a result of Miller's seat on the Molson board, that Miller could influence the distribution and marketing of Coors's products in Canada. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.* Coors claimed it had two distinct interests: protecting its rights under the contract and protecting its interest in competition in the North American beer market. It argued that the first category of interests fell under the arbitration clause while the second did not. *Id.*

132. *Id.* at 1514.

133. *Id.* at 1515.

134. *Id.* at 1516.

135. *Id.* at 1517.

136. *Id.* at 1517-18.

137. *Id.* at 1515. In reaching this conclusion, the court relied in part on the all-inclusive nature of the contract terms "implementation" and "enforcement." *Id.* By using the talasmanic word

Next, basing its analysis on *Mitsubishi*, the court examined the individual antitrust claims to determine which, if any, fell within the scope of the arbitration agreement.[138] The court ruled that Coors could litigate only those antitrust claims that lacked a reasonable factual connection to the contract and must arbitrate those antitrust claims that were sufficiently connected to the contract.[139]

C. *Analysis*

When litigating the scope of an arbitration clause, lawyers should recognize that arbitration cannot be avoided by "labelling."[140] As the Second Circuit put it, "In determining whether a particular claim falls within the scope of the parties' arbitration agreement, we focus on the factual allegations in the complaint rather than the legal causes of action asserted."[141] To avoid litigation, the attorney and client should pay close attention to the specific language of the contract.

As with any contract, the exact wording of an arbitration clause should be the result of close consultation between attorney and client. Lawyers should also draw on their own experiences, as well as that of others, to anticipate the disputes that are likely to occur in the course of a legal relationship.[142] In addition to these resources, lawyers may base arbitration clauses on existing contracts, gaining the experience of previous drafters. However, attorneys should take care to address the unique aspects of each situation.[143]

"narrow," Coors attempted to limit the scope of disputes subject to arbitration under the agreement but did not provide any support for this claim. *Id. But see* JEFFREY BARIST, COMMERCIAL ARBITRATION LAW AND CLAUSES: A DRAFTER'S GUIDE § 3.02[B] (1994) (stating that a narrow clause might read "[a]ny dispute, controversy, or claim arising under this contract shall be finally settled by arbitration").

138. *Coors Brewing Co.*, 51 F.3d at 1515. *Mitsubishi* held that only antitrust claims touching specified provisions of the agreement fell within the scope of the contract and therefore within the agreement's arbitration clause. Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 723 F.2d 155, 159-61 (1st Cir. 1983), *aff'd in part, rev'd in part*, 473 U.S. 614 (1985). The arbitration clause in the *Coors Brewing Co.* agreement provided that "all disputes, controversies or differences which may arise . . . out of or in relation to [specific parts of the contract]" shall be decided by arbitration. *Coors Brewing Co.*, 51 F.3d at 1515.

139. *Coors Brewing Co.*, 51 F.3d at 1516. In other words, the claims that did not relate to the continuing contractual relationship between Coors and Molson could be litigated. *Id.* at 1517. In particular, Coors's claims about market concentration could be litigated while its claims regarding confidential and proprietary information could not be arbitrated. *Id.*

140. For example, Molson claimed that Coors attempted to avoid arbitration by labelling contractual claims as antitrust claims. *Id.* at 1513.

141. Genesco, Inc. v. T. Kakiuchi & Co., 815 F.2d 840, 846 (2d Cir. 1987).

142. For example, discussing the quality and quantity of possible disputes with litigators in the field often provides contract drafters with special "hindsight." COMMERCIAL ARBITRATION, *supra* note 117, at 143-44.

143. Some of the factors which should bear on this analysis include the characteristics of the case, attributes of the parties, features of the environment, and the presence of settlement barriers. EDWARD A. DAUER, MANUAL OF DISPUTE RESOLUTION: ADR LAW AND PRACTICE § 7.03 (1994).

D. *Other Circuits*

A recent Second Circuit case, *Collins & Aikman Products Co. v. Building Systems*[144] addressed the scope of an arbitration agreement using both "arising out of" and "relating to" language.[145] The court, applying the "piecemeal principle,"[146] analyzed which claims raised arbitrable issues under the broad arbitration clause.[147] It found a claim for tortious interference with an employment contract not arbitrable because it did not "arise under" or "relate to" the agreement that contained the arbitration clause.[148] The court held that a tort claim for trade libel fell within the scope of a broad arbitration clause, however, because it was sufficiently related to the agreement.[149]

A Ninth Circuit case, *Tracer Research Corp. v. National Environmental Services Co.*,[150] involved an arbitration agreement containing "arising out of" language.[151] The court held that a misappropriation of trade secrets claim was not arbitrable, reasoning that the misappropriation constituted a wrong, independent from the licensing and nondisclosure agreement, even though the claim would not have arisen without the agreement.[152]

III. ARBITRATOR'S JURISDICTION OVER THE PERSON

A. *Background*

1. Determining If the Party Agreed to Arbitrate

Just as the terms of the contract control the scope of arbitration,[153] they also control who must arbitrate. Courts normally use state law contract principles to decide whether the parties agreed to arbitrate a specific dispute.[154]

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144. 58 F.3d 16 (2d Cir. 1995).

145. *Collins & Aikman Prods. Co.*, 58 F.3d at 18. The arbitration clause specifically stated, "Any claim arising out of or relating to this agreement shall be settled by arbitration." *Id.*

146. "The preeminent concern of Congress in passing the [Arbitration] Act was to enforce private agreements . . . and that concern requires that we rigorously enforce agreements to arbitrate, even if the result is 'piecemeal' litigation." *Id.* at 20 (quoting Dean Witter Reynolds Inc. v. Byrd, 470 U.S. 213, 221 (1985)).

147. *Id.*

148. *Id.* at 22. "[T]he employment contracts were third party contracts with no logical connection to the . . . agreements containing the arbitration clauses." *Id.*

149. *Id.* at 23. In summary, the court concluded:

> [I]f the arbitration clause is broad, there arises a presumption of arbitrability; if, however, the dispute is in respect of a matter that, on its face, is clearly collateral to the contract, then a court should test the presumption by reviewing the allegations underlying the dispute and by asking whether the claim alleged implicates issues of contract construction or the parties' rights and obligations under it. If the answer is yes, then the collateral dispute falls within the scope of the arbitration agreement; claims that present no question involving the construction of the contract, and no questions in respect of the parties' rights and obligations under it, are beyond the scope of the arbitration agreement.

Id.

150. 42 F.3d 1292 (9th Cir. 1994).

151. *Tracer Research Corp.*, 42 F.3d at 1295.

152. *Id.*

153. *See supra* part II.

154. First Options v. Kaplan, 115 S. Ct. 1920, 1924 (1995) (stating, however, that an important qualification is that courts cannot assume an agreement to arbitrate absent clear and unmistak-

In determining whether arbitration is required, the court ascertains whether the party has a duty to arbitrate the dispute.[155] Generally, absent an arbitration agreement, a party cannot be forced to submit a dispute to arbitration.[156] The court has the exclusive right to interpret the arbitration agreement to determine who is subject to arbitration, unless the parties agree otherwise.[157] If a court does not make its own determination that a party must arbitrate, but accepts the arbitrator's decision binding the party to arbitrate, the court will remand the case on appeal so that it can make its own finding.[158] In contrast, once the court has made a threshold determination about arbitrability, it cannot evaluate the arbitrator's decisions regarding the substantive merits of the case itself.[159]

2. The Alter Ego Doctrine

Under certain circumstances, even a nonsignatory to an agreement may be bound by that agreement.[160] For example, a court may pierce a corporate veil by applying the alter ego doctrine in order to reach a nonsignatory and force them to arbitrate a dispute.[161]

A litigant may demonstrate the alter ego doctrine by showing that a shareholder, overlooking their separate entities, used the corporation as an instrumentality to conduct his own personal affairs.[162] The alter ego doctrine stems not from an individual's actions but from misuse of the corporate form by its owners.[163] The advantages of limited personal liability for corporate shareholders encourages individuals to invest, because the "corporate veil" protects

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able evidence that an agreement was made).

155. AT&T Technologies, Inc. v. Communications Workers of Am., 475 U.S. 643, 649 (1986) (citing United Steelworkers of Am. v. Warrior and Gulf Navigation Co., 363 U.S. 574, 582-83 (1960)).

156. Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 478 (1989); *AT&T Technologies, Inc.*, 475 U.S. at 648 (citing United Steelworkers v. Warrior & Gulf Navigation Co., 363 U.S. 574, 582 (1960)).

157. *AT&T Technologies, Inc.*, 475 U.S. at 649 (citing *United Steelworkers*, 363 U.S. at 582-83). *Contra* Ralph Andrews Prod., Inc. v. Writers Guild of Am., 938 F.2d 128, 130 (9th Cir. 1991) (stating that parties may agree to submit to the arbitrator the question of arbitrability and consent to grant the arbitrator that authority may be implied from the parties' conduct).

158. *See* American Bell, Inc. v. Federation of Tel. Workers, 736 F.2d 879, 886-87 (3d Cir. 1984) (remanding to the district court the question whether a party should be subject to arbitration under veil-piercing principle).

159. Foster v. Turley, 808 F.2d 38, 42-43 (10th Cir. 1986) ("[T]he court is not authorized to decide the merits of an issue committed by the parties to arbitration.").

160. *See* BARIST, *supra* note 137, § 4.03.

161. *Id.* For example, nonsignatory agents, including partners and employees may be bound to arbitrate. *See also* MACNEIL ET AL., *supra* note 15, § 18.3.1.

162. *See* DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681, 685-87 (4th Cir. 1976) (stating that factors to consider in applying alter ego theory are: gross undercapitalization, failure to observe corporate formalities, non-payment of dividends, the insolvency of the debtor corporation at the time, siphoning of funds of the corporation by the dominant stockholder, non-functioning of other officers or directors, absence of corporate records, and the fact the corporation is merely a facade for the operations of the dominant stockholder). *See generally* MARTIN M. WEINSTEIN & JAMES J. DOHENY, MERTENS LAW OF FEDERAL INCOME TAXATION § 54A.13.50 (Supp. 1995).

163. Donsco, Inc. v. Casper Corp., 587 F.2d 602, 606 (3d Cir. 1978), *aff'd*, 633 F.2d 209 (3d Cir. 1980).

an investor so that risk is borne by the corporate entity, not the individual shareholder.[164] As a result, individuals may be tempted to form sham corporations to avoid obligations such as arbitration.

Determining whether the corporate veil should be pierced depends largely on the specific facts of a case.[165] The federal common-law alter ego doctrine is based on a two-part test.[166] Not every disregard of separateness justifies piercing the corporate veil. The corporation also must be a sham.[167]

B. ARW Exploration Corp. v. Aguirre[168]

1. Facts

Spyridon Armenis was the president and sole shareholder of ARW Exploration Corp. (ARW).[169] Twenty individual investors (plaintiffs) purchased interests in oil and gas ventures promoted by ARW.[170] Each of the plaintiffs entered into at least one of six joint venture agreements.[171] Five of the agreements contained an arbitration clause and were signed by Armenis in his capacity as ARW president.[172] The sixth agreement, however, did not contain an arbitration agreement, and was signed by Armenis as an individual rather than as a representative of ARW.[173]

The plaintiffs moved to compel ARW to arbitrate disputes connected with the six agreements, and also sought, through a third-party complaint, to require Armenis to arbitrate in an individual capacity.[174] The Oklahoma district court initially dismissed the third-party complaint.[175] However, the court later

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164. EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES § 20:01 (1986). In this way, personal assets of an individual shareholder cannot be reached if the corporation is liable. *Id.*

165. *Id.* § 20:02.

166. NLRB v. Greater Kansas City Roofing, 2 F.3d 1047, 1052 (10th Cir. 1993) (stating that the test consists of (1) determining whether the separate personalities and assets of the corporation and individual are blurred from unity of interest and lack of respect given to the separate entities, and (2) deciding whether the sanction of the corporate fiction would promote fraud, injustice, or evasion of legal obligations). Specific factors in the first prong of the test are:

> (1) whether a corporation is operated as a separate entity; (2) comingling of funds and other assets; (3) failure to maintain adequate corporate records or minutes; (4) the nature of the corporation's ownership and control; (5) absence of corporate assets and undercapitalization; (6) use of the corporation as a mere shell, instrumentality or conduit of an individual or another corporation; (7) disregard of legal formalities and the failure to maintain an arms-length relationship among related entities; and (8) diversion of the corporation's funds or assets to noncorporate uses.

Id. at 1052 n.6 (quoting United States v. Van Diviner, 822 F.2d 960, 965 (10th Cir. 1987)).

The second prong of the test requires inequitable behavior such as fraud, injustice, or unfairness. *Greater Kansas Roofing*, 2 F.3d at 1052; *see also* Doyn Aircraft v. Wylie, 443 F.2d 579 (10th Cir. 1971) (stating that when identities of the corporation and the individual merge and separation would lead to inequitable result, veil should be pierced).

167. Kaplan v. First Options, 19 F.3d 1503, 1520-21 (3d Cir. 1994).

168. 45 F.3d 1455 (10th Cir. 1995).

169. *ARW Exploration Corp.*, 45 F.3d at 1457.

170. *Id.*

171. *Id.*

172. *Id.* at 1458.

173. *Id.*

174. *Id.* at 1457.

175. *Id.*

consolidated the case with ARW's claim for injunctive relief, and transferred it to an Oklahoma federal district court.[176] After oral argument, the Oklahoma court ordered arbitration of all claims against ARW, as well as against Armenis individually.[177] During the subsequent arbitration, the arbitrator found that Armenis used ARW as an alter ego, and therefore decided in favor of the plaintiffs.[178] On appeal, Armenis contended that the district court, not the arbitrator, first must pierce the ARW corporate veil and determine that Armenis is an alter ego of ARW before he can be compelled to arbitrate as an individual.[179]

2. Decision

Although addressing the alter ego issue in its confirmation order, the district court essentially accepted the arbitrator's factual findings that Armenis used ARW as his alter ego.[180] The Tenth Circuit held that the responsibility for determining whether a party may be compelled to arbitrate belongs to the court, not the arbitrator.[181] The Tenth Circuit held that the district court must apply principles of corporate law, including the corporate veil doctrine, to determine whether Armenis should be forced to arbitrate individually.[182]

C. *Analysis*

ARW represented the first time the Tenth Circuit has applied the alter ego doctrine in the arbitration context. The court followed existing circuit precedent with regard to both corporate[183] and arbitration law.[184]

An attorney may assist a client to avoid arbitration imposed by the alter ego doctrine because many of the factors in the first prong of the test, maintenance of separate entities, can be controlled through careful planning and implementation of corporate structure and procedures. The second prong, inequitable behavior, is more difficult to control. The client perpetrating a fraud, for example, will likely manipulate otherwise adequate procedures. The best avenue for the attorney in this situation may consist of counseling the client on possible risks incurred from unscrupulous behavior.

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176. *Id.*
177. *Id.*
178. *Id.* at 1461.
179. *Id.* at 1458.
180. *Id.* at 1461.
181. *Id.* The district court erroneously concluded that it lacked the authority to overturn the arbitrator's finding that Armenis used ARW fraudulently and therefore must arbitrate individually. *Id.* This error resulted from mischaracterizing the rule that a district court cannot evaluate the substantive decisions of the arbitrator. *Id.*
182. *Id.* at 1460.
183. *Id.* at 1460-61 (citing Frank v. U.S. West, 3 F.3d 1357 (10th Cir. 1993); Quarles v. Fuqua Indus., 504 F.2d 1358 (10th Cir. 1974)).
184. *Id.* at 1461 (citing Foster v. Turley, 808 F.2d 38 (10th Cir. 1986)). However, the particular combination of issues in *ARW*—applying the alter ego principle in the arbitration context—had not been addressed previously by the Tenth Circuit.

D. *Other Circuits*

Other circuits did not address the alter ego concept in the arbitration context during the survey period. Though beyond the time period of this survey, the Second Circuit, with little discussion of the arbitrator's authority, remanded a case in which the district court held that the arbitrator, not the court, should determine if two companies were alter egos.[185]

CONCLUSION

The decisions discussed in this Survey illustrate the increasing use of arbitration in different contexts. *In Metz*, the court did not establish new precedent but rather refined previous trends. For better or worse, it further extended the reach of arbitration into the statutory arena. In *Kelley*, the court also cultivated existing precedent by further defining the scope of arbitrators' power. By giving more power to the arbitrator, *Kelly*, like *Metz*, extended arbitration. *Coors*, while not fostering the application of arbitration into new areas, refined the interpretation of arbitration clauses, emphasizing the importance of precise drafting. In contrast to these three cases that advance the application of arbitration, *ARW* reinforces the limitation on the power of an arbitrator to compel a party to arbitrate. As the use of alternative dispute resolution continues to evolve, the courts and the legislature must work to define its role as a substitute for adjudication.

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185. Doctor's Assocs., Inc. v. Distajo, Nos. 94-9207, 9293, 9209, 7183, 1995 WL 540584, at *3 (2d Cir. 1995).