Contracts: Enforceability of Arbitration Agreements

Richard S. Gottlieb, Resident Superior Court Judge,
Judicial District 21A
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I. APPLICABLE STATUTES

a. Federal Arbitration Act ("FAA"), 9 U.S.C. § et seq.

i. Applies to arbitration agreements in maritime transactions and in transactions involving commerce. (see *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 590 (2008)).

ii. Does not create independent basis for federal jurisdiction. In North Carolina court, parties may seek to compel arbitration under either the FAA or the NCRUAA.

b. The North Carolina Revised Uniform Arbitration Act ("NCRUAA"), N.C.G.S. §§ 1-569.1 to 1-569.31.

i. The NCRUAA is North Carolina's version of the Revised Uniform Arbitration Act (RUAA) and requires courts to construe it uniformly with other states that enacted the RUAA. N.C.G.S. § 1-567.88.

c. Interaction between the FAA and NCRUAA

i. Both the FAA and NCRUAA reflect a legislative desire to encourage dispute resolution through private arbitration.

1. The principal legislative purpose behind enactment of the RUAA is to provide and encourage an expedited, efficient, relatively uncomplicated, alternative means of dispute resolution, with limited judicial intervention or participation and without the primary expense of litigation—attorney's fees. Indeed, the purpose of arbitration is to reach a final settlement of the disputed matters without litigation. *Gemini Drilling & Found., LLC v. Nat'l Fire Ins. Co.*, 192 N.C. App. 376, 665 S.E.2d 505 (2008).

ii. The FAA governs any contract evidencing a transaction involving commerce. The FAA's term involving commerce is considered the functional equivalent of affecting commerce. It is broader than the term in commerce and signals intent to exercise Congress' commerce power to the full. *Advantage Assets, Inc. II v. Howell*, 190 N.C. App. 443, 663 S.E.2d 8 (2008); *WMS, Inc. v. Weaver*, 166 N.C. App. 352, 602 S.E.2d 706 (2004).

iii. The FAA preempts state law in the event of a conflict.

1. The United States Supreme Court has held that the FAA contains no express preemptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. *Scottish Re Life Corp. v. Transamerica Occidental Life Ins. Co.*, 184 N.C. App. 292, 647 S.E.2d 102 (2007). Because state law is preempted only to the extent that it actually conflicts with federal law, courts must therefore determine whether application of the RUAA would undermine the goals and policies of the FAA. *Id.*
2. The question of whether the FAA or the NCRUAA applies is a question of fact which should be determined by the trial court. *United States Tr. Co., N.A. v. Stanford Grp. Co.*, 199 N.C. App. 287, 681 S.E.2d 512 (2009).
3. The FAA does not prevent North Carolina state courts from applying state contract law to determine whether the parties have entered into an arbitration agreement. *See T.M.C.S., Inc. v. Marco Contractors, Inc.*, 780 S.E.2d 588, 597 (N.C. Ct. App. 2015).
4. Determining whether the FAA applies "is critical because the FAA preempts conflicting state law[.]" *Sillins v. Ness*, 164 N.C. App. 755, 757-58, 596 S.E.2d 874, 876 (2004).
5. *The trial court should state which law, the FAA or the NCRUAA, it has found to apply since the determination may determine the outcome of a motion to compel arbitration. See, e.g. Eddings v. S. Orthopedic & Musculoskeletal Assocs.*, 356 N.C. 285, 569 S.E.2d 645 (2002) (per curiam) (remanding for the trial court to determine whether or not the FAA or NCRUAA was applicable).

II. TWO PRELIMINARY (*MAYBE THREE*) ISSUES FOR THE COURT

a. When presented with a motion to compel arbitration, the court "shall proceed to summarily decide" whether there is an enforceable agreement to arbitrate. N.C.G.S. § 1-569.7(a). Whether a particular dispute is subject to

arbitration is a conclusion of law, reviewable *de novo* by the appellate court. *Carter v. TD Ameritrade Holding Corp.*, 218 N.C. App. 222, 226, 721 S.E.2d 256, 260 (2012).

b. The court must decide 1) if a valid arbitration agreement exists; 2) if the dispute falls within the valid arbitration agreement; and (*if raised*) 3) if the party seeking to compel arbitration has waived it. N.C.G.S. § 1-569.6(b); *see Emmanuel African Methodist Episcopal Church v. Reynolds Constr. Co.,* 217 N.C. App. 176, 718 S.E.2d 201 (2011)*; D.P. Sols., Inc. v. Xplore-Tech Servs. Private, Ltd.,* 211 N.C. App. 632, 710 S.E.2d 297 (2011)*; Pressler v. Duke Univ.,* 199 N.C. App. 586, 685 S.E.2d 6 (2009)*; Edwards v. Taylor,* 182 N.C. App. 722, 643 S.E.2d 51 (2007)*; Steffes v. DeLapp,* 177 N.C. App. 802, 629 S.E.2d 892 (2006).

    i. Once the court has ruled on these issues, any additional issues, including procedural arbitrability questions, are for the arbitrator to decide. *See Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 85 (2002); *Ragan*, 531 S.E.2d at 876 (arbitrability issues for the arbitrator to decide).

    ii. The issue will generally come to the court in the form of a motion to compel or stay arbitration. N.C.G.S. § 1-569.7.

    iii. Public policy favors settling disputes by means of arbitration. *Prime S. Homes, Inc. v. Byrd*, 102 N.C. App. 255, 401 S.E.2d 822 (1991).

c. Does a valid arbitration agreement exist?

    i. The court determines the validity of an arbitration agreement itself, while the arbitrator determines the validity and enforceability of the agreement containing an arbitration provision. N.C.G.S. § 1-569.6(b-c).

    ii. In considering whether the parties' arbitration agreement is valid, the court applies general principles of North Carolina contract law. *See T.M.C.S.*, 780 S.E.2d at 597; *Brown v. Centex Homes*, 171 N.C. App. 741, 615 S.E.2d 86, 89 (2005).

        1. Unless it can be said with confident authority that the arbitration clause cannot be read to include the asserted

dispute, the court should grant the parties' motion to arbitrate the particular grievance. *Hobbs Staffing Servs., Inc. v. Lumbermens Mut. Cas. Co.*, 168 N.C. App. 223, 606 S.E.2d 708 (2005).

2. Public policy requires courts to resolve any doubts in favor of arbitration. *Ruffin Woody & Assocs. v. Person Cnty.*, 92 N.C. App. 129, 374 S.E.2d 165 (1988).
3. Before a valid contract can exist, there must be mutual agreement between the parties as to the terms of the contract. *Normile v. Miller*, 313 N.C. 98, 326 S.E.2d 11 (1985).

iii. What about fraud?

1. Under § 4 of the FAA, a claim for fraud in the inducement is arbitrable, particularly where the arbitration clause is broad, because the arbitration provision of a contract is severable. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04, 87 S. Ct. 1801 (1967).
2. Under North Carolina law, the determination of whether a dispute is subject to arbitration involves a two pronged analysis; the court must ascertain both (1) whether the parties had a valid agreement to arbitrate, and also (2) whether the specific dispute falls within the substantive scope of that agreement. *Raspet v. Buck,* 147 N.C. App. 133, 135-36, 554 S.E.2d 676, 678 (2001).
    a. Courts may consider, for example, where the parties had the opportunity to read and understand the arbitration provision. *McMillan v. Unique Places, LLC*, 2015 NCBC LEXIS 3 (2018).

iv. What about unconscionability?

1. "Although [a]rbitration is favored in North Carolina . . . 'equity may require invalidation of an arbitration agreement that is unconscionable.'" *Tillman v. Commer. Credit Loans, Inc.*, 362 N.C. 93, 101, 655 S.E.2d 362, 369 (2008); *King v. Bryant*, 369 N.C. 451, 795 S.E.2d 340 (2017) (upholding the trial

court's finding of unconscionability based on constructive fraud where a fiduciary duty exists between a physician and patient and the arbitration provision was not explained to the patient), *cert. denied*, *Bryant v. King*, 138 S. Ct. 314 (2017).

d. What is the scope of the arbitration agreement?
    i. Assuming a valid arbitration agreement exists, the court must next consider whether the specific dispute falls within the substantive scope of that agreement. *Fontana v. Se. Anesthesiology Consultants, P.A.*, 221 N.C. App. 582, 589, 729 S.E.2d 80, 86 (2012); *Epic Games, Inc. v. Murphy-Johnson*, 785 S.E.2d 137, 143 (2015)
        1. "To determine if a particular dispute is subject to arbitration, this Court must examine the language of the agreement, including the arbitration clause in particular, and determine if the dispute falls within its scope." *Fontana*, 221 N.C. App. at 589, 729 S.E.2d at 86.
        2. Arbitration agreements are usually considered "broad" or "narrow." The broader the agreement, the more types of disputes under the agreement will be arbitrable.
        3. Examples of broad arbitration provisions:
            a. "any complaint, controversy, or question which may arise with respect to this contract."
            b. "any controversy or claim arising out of or relating to this contract, or to the breach thereof."
            c. "every controversy or claim arising under or out of the provisions of this agreement and disputes with respect to the making or validity of this agreement."
        4. Narrow arbitration provisions may limit arbitration to certain provisions of the agreement or may be written to exclude certain types of disputes from arbitration.

e. Waiver
    i. As with any contract based right, arbitration may be waived.

ii. Because of North Carolina's strong public policy in favor of arbitration, courts closely scrutinize any allegation that a party waived its right to arbitrate (see *Cyclone Roofing Co. v. David M. La Fave Co.,* 312 N.C. 224, 321 S.E.2d 872 (1984).

iii. A party has impliedly waived its contractual right to arbitration if by its delay or by actions it takes which are inconsistent with arbitration, another party to the contract is prejudiced by the order compelling arbitration. *See, e.g.*, *Carolina Throwing Co. v. S & E Novelty Corp.*, 442 F.2d 329, 331 (4th Cir. 1971) ("'waiver . . . may not rest mechanically on some act such as the filing of a complaint or answer but must find a basis in prejudice to the objecting party'") (quoting *Batson Yam & Fabrics Mach. Grp., Inc. v. Saurer-Allma GmbH-Allgauer Maschinenbau*, 311 F. Supp. 68, 73 (D.S.C. 1970)).

iv. Examples in which a party may be prejudiced:

1. If the party is forced to bear the expense of an expensive trial. *E.g. E. C. Ernst, Inc. v. Manhattan Constr. Co.*, 551 F.2d 1026 (5th Cir. 1977), *cert. denied*, *Providence Hosp. v. Manhattan Constr. Co.*, 434 U.S. 1067, 98 S. Ct. 1246 (1978);
2. If evidence has been lost or destroyed due to delay demanding arbitration. M*oses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 103 S. Ct. 927 (1983);
3. A party opponent has engaged in judicial discovery not otherwise available in arbitration. *Prime S. Homes*, 102 N.C. App. 255, 401 S.E.2d 822; *Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 n.7 (2d Cir. 1968);
4. By reason of delay, a party has taken steps in litigation to its detriment or expended significant amounts of money thereupon. *Town of Belville v. Urban Smart Growth, LLC*, 796 S.E.2d 817 (N.C. Ct. App. 2017); *Michelin Tire Corp. v. Todd*, 568 F. Supp. 622, 625-26 (D. Md. 1983).

v. BUT, simply filing a lawsuit or engaging in some discovery does not necessarily waive arbitration. *Cyclone Roofing*, 312 N.C. 224, 321 S.E.2d 872.

III. MOTIONS TO COMPEL ARBITRATION

a. If a lawsuit is pending, a party should move pursuant to N.C.G.S. § 1-569.5(b) to compel arbitration. *Adams v. Nelson*, 313 N.C. 442, 329 S.E.2d 322 (1985) (the proper procedure for staying litigation and compelling arbitration is by a proper motion).

b. If a lawsuit is not pending, the party seeking to compel arbitration files a motion pursuant to N.C.G.S. § 1-569.5(b) and serves it in the manner provided for the service of a summons.

c. The court stays all proceedings on claims in the lawsuit that are alleged to be subject to arbitration pending a determination on the motion to compel arbitration. N.C.G.S. § 1-569.7(f).

d. If the court orders arbitration, the court stays all judicial proceedings involving claims that are subject to arbitration. N.C.G.S. § 1-569.5(g).

e. **An order *DENYING* a motion to compel arbitration must include findings of fact as to (i) whether the parties had a valid agreement to arbitrate; and (ii) whether the dispute falls within the substantive scope of that agreement. Cornelius v. Lipscomb**, 224 N.C. App. 14, 16–17, 734 S.E.2d 870 (2012); *Griessel v. Temas Eye Ctr., P.C.*, 199 N.C. App. 314, 317, 681 S.E.2d 446 (2009).

f. Although they are interlocutory, orders denying motions to compel arbitration or granting motions to stay arbitration are immediately appealable in North Carolina because they affect a substantial right. N.C.G.S. § 1-569.28(a); *see Prime S. Homes*, 102 N.C. App. at 258, 401 S.E.2d at 825.

IV. THIRD PARTIES AND NON-SIGNATORIES TO ARBITRATION AGREEMENT

a. A non-signatory can enforce, or be bound by, an arbitration provision within a contract executed by other parties. *Smith Jamison Constr. v. Apac-Atlantic, Inc.* 811 S.E.2d 635 (N.C. Ct. App. 2018) (citing *Wash. Square Sec., Inc. v. Aune*,

385 F.3d 432, 435 (4th Cir. 2004)) (quoting *Int'l. Paper Co. v. Schwabedissen Maschinen & Anlagen GMBH*, 206 F.3d 411, 416-17 (4th Cir. 2000)).

d. The doctrine of equitable estoppel is the most frequently argued basis for requiring a non-signatory to a contract to arbitrate a dispute. *See Ellen v. A.C. Schultes of Md., Inc.*, 172 N.C. App. 317, 321, 615 S.E.2d 729, 732 (2005) ("In the arbitration context, the doctrine recognizes that a party may be estopped from asserting that the lack of his signature on a written contract precludes enforcement of the contract's arbitration clause when he has consistently maintained that other provisions of the same contract should be enforced to benefit him."), *cert. denied*, 360 N.C. 575, 635 S.E.2d 430 (2006).

V. PROVISIONAL REMEDIES

a. The court may issues orders for provisional remedies to protect the effectiveness of the arbitration proceeding to the same extent and under the same conditions as if the dispute were the subject of a civil action. N.C.G.S. § 1-569.8(a).

b. Once the arbitrator is appointed, however, the parties must petition the arbitrator for provisional remedies. N.C.G.S. § 1-569.8(b)(1). Unless, the matter is urgent and arbitrator is not available or the arbitrator cannot provide an adequate remedy. N.C.G.S. § 1-569.8(b)(2).

c. A party does NOT waive the right to arbitration by first seeking to have the court issue provisional relief. N.C.G.S. § 1-569.8(c).

VI. APPOINTMENT OF THE ARBITRATOR

a. If the parties to an agreement to arbitrate have agreed on a method for selecting an arbitrator, that method is to be followed. N.C.G.S. § 1-569.11(a).

b. If the agreed upon method fails or if no method for selecting an arbitrator was agreed upon, the court may appoint the arbitrator. *Id.*