

Client Alert

July 2008

Drafting Arbitration Provisions to Mitigate Bad Arbitrator Decisions

Parties drafting arbitration provisions have long sought ways to circumvent the principle of arbitral finality, which provides that courts may not correct an arbitration award merely because the arbitrator's decision is clearly erroneous in law or fact. One such method is to limit the arbitrator's power to change the terms of the contract, particularly the important terms.

Last month, the California Supreme Court, in *Gueyffier v. Ann Summers, Ltd.*, 43 Cal. 4th 1179 (2008), gave guidance on how to do that. In *Gueyffier*, the Court upheld an arbitration decision that excused the performance of a material provision of a contract, despite another provision that barred the arbitrator from "modifying or changing" any material terms of the contract.

According to the Court, what the parties drafting the provision needed to say is that the arbitrator has no power to "modify, change, or *excuse the performance of*" a material term.

Celine Gueyffier opened an Ann Summers lingerie store in the Beverly Center mall under a franchise agreement with Ann Summers, Ltd. The opening was a "disaster," complete with tomatoes being thrown at the store and insults being yelled at Ms. Gueyffier. In 2001, Ms. Gueyffier petitioned for arbitration under the arbitration provision in the franchise agreement, and sought consequential damages for the franchisor's failure to provide adequate training, guidance, and assistance.

The franchise agreement also provided that Ann Summers would not be held in breach of the agreement, unless Ms. Gueyffier first gave notice of the breach, and 60 days' opportunity to cure. That provision was expressly denominated as being "material." Moreover, the arbitration provision explicitly provided that in no event may the arbitrator "modify or change" any material provision of the agreement.

In 2005, four years after the petition, the arbitrator ruled that Ms. Gueyffier was excused from giving the notice of breach and opportunity to cure, and awarded \$478,030 in consequential damages to Ms. Gueyffier. Ann Summers filed a motion to vacate the award in the superior court, arguing that: (a) Ms. Gueyffier failed to give notice of any breach, let alone an opportunity to cure; (b) the arbitrator's finding that excused giving such notice and affording an opportunity to cure, as an "idle act," amounted to a "modification or change" of a material term; and (c) the finding therefore exceeded the arbitrator's power (a basis for vacating an award).

The trial court disagreed and upheld the award, the Court of Appeal reversed the trial court and vacated the award, and, seven years after Ms. Gueyffier petitioned for arbitration, the Supreme Court reversed the Court of Appeal. In ordering the Court of Appeal to reinstate the award, the Supreme Court held that the provision did not unambiguously prohibit the arbitrator from *excusing performance*

of a contractual condition where the arbitrator had concluded, because the breaches were uncurable, that performance would have been an idle act.

In sum, parties drafting an arbitration provision can maximize their chances of having an arbitrator enforce the terms of their contract by labeling the important terms "material," and including in the arbitration provision a clause that the arbitrator has no power to "modify, change, or excuse the performance of" any material term of the contract.

