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Injunction Carve-Outs in Arbitration: Emergency Only, or All Equity Claims?

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Arbitration may end sooner and more efficiently than litigation, but it is slower to begin. A courthouse is just sitting there waiting for a complaint to be filed. An arbitrator, by contrast, has to be appointed, and it can take time for the process to get going. And when a case does not present issues that must be resolved immediately, that may not be a problem.

But where a case has emergency features—the dissemination of trade secrets, the raiding of a party's customers, the destruction of its facilities—arbitration can be particularly ill-suited. Parties who need relief *now* cannot tolerate being imprisoned in the cage of a drawn-out arbitrator-selection process.

For precisely this reason, the common law has long recognized an exception to the general rule in favor of enforcing the exclusive nature of arbitration clauses. Even when parties state that "any and all issues under this contract shall be resolved by arbitration," courts have found that a party can seek injunctive relief to prevent irreparable injury, so long as the court is not deciding the core issue committed by the parties to arbitration. *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Bradley*, 756 F.2d 1048, 1053 (4th Cir. 1985)("where a dispute is subject to mandatory arbitration under the Federal Arbitration Act, a district court has the discretion to grant a preliminary injunction to preserve the status quo pending the arbitration of the parties' dispute if the enjoined conduct would render that process a 'hollow formality.'"); *Alliance Consulting Inc. v. Warrior Energy Res. LLC*, No. 5:2017-cv-03541, 2017 BL 283376 (S.D. W. Va. Aug. 14, 2017)(addressing a preliminary injunction when the dispute resolution clause did not specifically provide a court with jurisdiction to hear such a dispute).

For that same reason, parties electing arbitration frequently insert into their clauses a provision allowing for temporary and emergent equitable relief, which makes clear to the court that arbitration is not the exclusive remedy in these situations. Such a provision may read "provided that, nothing in this clause shall bar a party from seeking injunctive relief in emergent circumstances, including but not limited to the dissemination of its intellectual property."

But what happens when parties intending to preserve their right to seek emergency relief in court instead safeguard their right to seek all equitable relief? All emergency relief is, to be sure, equitable—but not all equitable relief is emergent. Consider the following clause:

Any controversy or claim arising out of or relating to this Agreement or the breach, termination, or validity thereof, except for temporary, preliminary, or permanent injunctive relief **or any other form of equitable relief**, shall be settled by binding arbitration … (Emphasis added.)

A strict textual reading of this arbitration clause reveals an inherent tension: on the one hand, the clause gives the arbitrator the power to hear "any controversy or claim arising out of or relating to this Agreement."

Yet, at the same time, the clause pulls away from the arbitrator the power to hear claims for "temporary, preliminary, or permanent injunctive relief or any other form of equitable relief." What did the parties intend? Should *all* non-emergent merits issues be arbitrated? Or just non-equitable issues?

This tension is exacerbated by the leading doctrinal underpinnings of arbitration law—namely, that (1) arbitration agreements are a creature of contract and should be enforced as written, (2) enforcing arbitration agreements promotes efficiency, and (3) contracts should generally be interpreted so as to promote arbitration.

This puts courts in a bind. Presented with a non-emergent equitable claim stemming from an agreement with an equitable carve-out like the provision above, a court may adopt a strictly textual approach and bar the arbitrator from considering the equitable claims.

This may especially be the case where a party either has second thoughts about arbitrating, or simply wants to slow down the case. The arbitration's defendant—that is, the respondent—can file a motion before the arbitrator attempting to strip the tribunal from jurisdiction over the equitable claims.

If that party is a plaintiff ("claimant"), it can simply tack on a specific performance claim, which sounds in equity, to its core breach of contract claims. And presto! At least some of the claims are now in court. The "mandatory" arbitration clause is no longer exclusive, and instead has been defeated by a court interpreting literally the above equitable carve-out, notwithstanding the principles of efficiency and promoting arbitration.

This cannot be right. The exception should not swallow the rule. Parties should not be saddled with piecemeal procedures. Parties should be permitted to make emergent exceptions to their mandatory arbitration clauses, but that is *all* they should be permitted to do once they commit to arbitration.

Literal enforcement here is bad policy. Courts should be encouraged to favor the Federal Arbitration Act's pro-arbitration policy, not to mention the mandate of Rule 1 of the Federal Rules of Civil Procedure that courts should seek "to secure the just, speedy, and inexpensive determination of every action and proceeding."

It is a daunting thing to tell a commercial court not to follow clear contract language crafted by sophisticated parties. That flies in the face of basic contract law.

This article nevertheless takes the position that in this situation, that is precisely what courts should do. Courts should only enforce the equitable carve-outs to confer jurisdiction when there is an actual emergency requiring a quick decision or when a decision is otherwise necessary to preserve or in aid of the ultimate arbitration.

Any other result violates public policy, the Federal Arbitration Act, and can result in ridiculous and unintended

outcomes in practice. The tension must be resolved in favor of efficiency and promoting arbitration.

Doctrinal Foundations

The inherent tension at the source of this article arises from three—and here, opposing—doctrinal foundations of arbitration.

Arbitration Agreements Should Be Enforced: The first of these core principles is that courts will generally enforce agreements to arbitrate as they are written. This is because the policy behind the FAA is not to enforce arbitration, but rather to enforce agreements to arbitrate. See *Volt Info. Sciences Inc. v. Bd. of Trustees of Leland Stanford Junior University*, 489 U.S. 468, 478 (1989) ("The FAA['s] … passage was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered.")(internal citations and quotations omitted).

As a result, courts hold repeatedly that following the FAA's liberal policy toward enforcing agreements to arbitrate, "a private agreement to arbitrate should be enforced according to its terms." *UHC Mgmt. Co. v. Computer Sciences Corp.*, 148 F.3d 992, 998 (8th Cir. 1998).

Following this policy and the FAA's mandate, courts often view the matter simply and directly. Ninth Circuit courts, for example, ask just two questions: (1) Does a valid agreement to arbitrate exist? and (2) Does the arbitration agreement encompass the parties/present dispute? If the answer is "yes" to both, then the FAA requires that the court enforce the agreement according to its terms. *Monster Energy Co. v. Wil Fischer Distrib. of Kan. LLC*, No. 5:14-cv-02081-VAP(KKx), 2015 BL 490541 (C.D. Cal. Jan. 23, 2015); see *Weyerhaeuser Co. v. W. Seas Shipping Co.*, 743 F.2d 635 (9th Cir. 1984).

The Ninth Circuit is by no means alone or an outlier on this point. The U.S. Supreme Court emphasized that the FAA "leaves no place for the exercise of discretion by a district court, but instead mandates that district courts shall direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218 (1985)(emphasis in original). The Supreme Court more recently recognized this point in *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304 (2013).

Because courts take it as their mandate to enforce agreements to arbitrate strictly according to their terms, this line of cases and the FAA's policy of enforcing arbitration agreements to their terms presents a significant hurdle to the central tenet of this article that certain arbitration clauses should not be enforced by their strict terms. But while at odds with the "strictly enforce" mandate, the authors' position is well supported by the other policies underlying the FAA.

Arbitration Is Meant to Be Efficient: The Supreme Court has explained that the FAA's overarching purpose is "to ensure the enforcement of arbitration agreements according to their terms *so as to facilitate streamlined proceedings*." *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 344 (2011)(emphasis added). The presumed efficiency of arbitration, while subject to increasing debate as arbitration takes on more of the trappings of discovery and motion practice, is still put forward in case and commentary. See Radvany, "Recent Trends in Discovery in Arbitration and in the Federal Rules of Civil Procedure," 34 *Rev. Litig.* 705 (2015); Brian S. Harvey, "Speech," 8 J. *Bus. & Tech. L.* 385 (2013).

Inherent in this thinking is that even if arbitration is not "efficient," it is at least more efficient than court litigation, however low a bar or generous a measuring rod that may be. A policy that in effect searches for ways to take a dispute *out* of arbitration and in the process saddles parties with multiple, overlapping and potentially duplicative proceedings is the opposite of efficiency. It manages to offend both arbitration and litigation principles.

Federal Pro-Arbitration Policy: There is a strong federal policy that favors arbitration. Congress enacted the FAA in 1925 to counter judicial hostility to arbitration agreements. See *AT&T Mobility*, 563 U.S. at 339.

FAA Section 2 is the "primary substantive provision of the Act," *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983), and it renders a written provision in a contract to settle a controversy by arbitration "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

The Supreme Court has explained that FAA Section 2 represents "a congressional declaration of a liberal federal policy favoring arbitration agreements." *Moses H. Cone Mem'l Hosp.*, 460 U.S. at 24. And in this regard, "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability." *Id.* at 24-25.

Federal courts have followed suit and repeatedly reaffirmed the presumption of arbitration, particularly when faced with contractual ambiguity. See, e.g., *Fleetwood Enters. v. Gaskamp*, 280 F.3d 1069, 1073 (5th Cir. 2002); *Verducci v. Coda*, 743 F. Supp. 2d 1182, 1185 (S.D. Cal. 2010)("A court interpreting an arbitration agreement must resolve ambiguities as to the scope of the arbitration clause in favor of arbitration."); *Stein v. Burt-Kuni One LLC*, 396 F. Supp. 2d 1211, 1214 (D. Colo. 2005)("Unlike the general rule that ambiguities in a contract must be construed against the drafter, ambiguities in an arbitration agreement must be construed in favor of arbitration."); *Sacco v. Prudential-Bache Securities Inc.*, 703 F. Supp. 362, 366 (E.D. Pa. 1988)("in light of the Supreme Court's counsel to favor arbitration where the scope of the agreement is ambiguous, we will read the language of the agreement broadly, and direct the parties to arbitrate the claims").

In addition to violating the FAA's pro-arbitration policy, the hypothetical arbitration carve-out considered in this article should be unenforceable as a matter of contract law and public policy. See *Fields v. Thompson Printing Co.*, 363 F.3d 259, 268 (3d Cir. 2004)("It is axiomatic that a court may refuse to enforce a contract that violates public policy."); *Kaplan v. Pavalon & Gifford*, 12 F.3d 87, 89 (7th Cir. 1993).

The Carve-Out Problem

Let's consider how these arbitration principles apply in the following hypothetical. Assume that Company A manufactures washing machines, but has no sales force. It enters into an exclusive five-year distribution agreement with Company B. Things go well in year 1, but in year 2, Company B sees greener pastures, stops selling Company A's machines and instead signs an exclusive distribution agreement with better-selling washing machine Company C. Company A is not only without a distributor, but its sales slow to a standstill and it is without valuable inventory that remains sitting in Company B's warehouse.

Company A decides to take action against Company B for both legal damages—alleged sales that would have

occurred had Company B not breached exclusivity—and for an equitable order that Company B return all of the Company A inventory in Company B's warehouse. The parties' distribution agreement contains the same arbitration provision that appears in the introduction to this article:

Any controversy or claim arising out of or relating to this Agreement or the breach, termination, or validity thereof, except for temporary, preliminary, or permanent injunctive relief *or any other form of equitable relief*, shall be settled by binding arbitration. … (Emphasis added.)

Look at the problem created by the emphasized language: under a strict and literal interpretation of those words, Company A must arbitrate its claim for money damages against Company B, but its equitable claim for return of its inventory ("or any other form of equitable relief ") is not arbitrable and therefore must be resolved in court. The strict reading deprives the arbitration panel of jurisdiction over the equitable claim.

This can lead to inconsistent results, since *both* the court *and* the arbitrator will be required to address the central question of the case: whether Company B breached the distribution agreement. The client is now paying not just for two procedures but, given the potential inconsistency, two procedures which may not resolve the dispute if their results are in opposition.

Unfortunately, this is the result under much of the existing caselaw. For example, in a case involving an arbitration clause similar to our example, the University of Pennsylvania Hospital brought claims for damages and equitable relief against Aetna in court. *Trustees of the Univ. of Pa. v. Aetna Inc.*, No. 3023 EDA 2012, 2013 Pa. Super. Unpub. LEXIS 2781 (Pa. Super. Ct. 2013). Specifically, the hospital brought breach of contract, tortious interference and declaratory claims that Aetna breached the contract by not paying fully on the claims submitted, and sought damages and specific performance for Aetna to stop the practices alleged. The arbitration agreement provided in relevant part as follows:

Any Dispute arising out of or relating to this Agreement or the breach, termination, or validity thereof, except for temporary, preliminary, or permanent injunctive relief or any other form of equitable relief, shall be settled by binding arbitration and administered by the American Arbitration Association (AAA) or American Health Lawyers Association (AHLA) and conducted by a sole Arbitrator [] in accordance with the AAA's Commercial Arbitration Rules.

The Superior Court affirmed the trial court's exercise of jurisdiction over the claims for equitable relief, rejecting Aetna's argument that the hospital only included the equity claims to avoid the arbitration clause. The court noted that the contract "contains a valid agreement to arbitrate" and "[t]he arbitration agreement expressly excludes claims for equitable relief " and found that the trial court's equity jurisdiction was proper on the facts of that case. See also, e.g., *Pbs Coal v. Hardhat Mining*, 429 Pa. Super. 372, 377, 632 A.2d 903, 905 (Pa. Super. Ct. Oct. 20, 1993)("if the agreement or contract clearly includes or excludes particular issues or remedies from arbitration, a court may so hold without submitting these matters to arbitration"); *Haldeman v. Towers, Perrin, Forster & Crosby*, 23 Phila. 427, 432-433, 1992 Phila. Cty. Rptr. LEXIS 3, *10-12, 1992 WL 1071350 (Pa. C.P. 1992)("Arbitrators are limited to the fashioning of those remedies which the agreement itself permits.").

Courts outside of Pennsylvania similarly enforce arbitration provisions similar to the hypothetical in this article according to their literal terms. See e.g. *Starnes v. Harrell Indus. Inc.*, No. 0:13-cv-01109-JFA-KDW, 2013 BL

424063 (D.S.C. Aug. 30, 2013)(recommending that an arbitrator rule on the legal claims and that the plaintiff should file a motion in court following the arbitration proceeding to seek any equitable remedies); *KWD River City Invs. LP v. Ross Dress for Less Inc.* 288 P.3d 929 (Okla. 2012)(denying a motion to compel arbitration where the provision excluded equitable remedies from arbitration); *Weiner v. Firm Inc.*, No. B166766, 2004 BL 14241 (Cal. App. 2d Dist. May 07, 2004)(denying a motion to compel arbitration because the court interpreted a claim for restitution as an equitable claim that was excluded from arbitration).

Supporting Arbitration

Carve-outs should be interpreted in favor of arbitration.

While many courts have concluded that they are obligated to enforce the literal terms of an arbitration agreement regardless of the consequences of that decision, other courts have acknowledged this inherent tension.

In doing so, some courts, in particular the District Court for the Southern District of New York, have reached the conclusion advocated in this article, that equitable carve-outs to arbitration clauses should only be enforced to carve out temporary and emergent equitable relief.

"[W]here a contract has both a broad arbitration clause and a clause permitting the parties to seek injunctive relief before a court, courts in this District have construed the latter clauses as permitting the parties to seek *'injunctive relief … in aid of arbitration, rather than … transforming arbitrable claims into nonarbitrable ones depending on the form of relief prayed.'*" *Baldwin Tech. Co. v. Printers' Serv., Inc.*, No. 15 Civ. 07152 (GBD), 2016 BL 22555, at * 3, n. 4 (S.D.N.Y. Jan. 27, 2016)(quoting *Remy Amerique Inc. v. Touzet Distribution, S.A.R.L.*, 816 F. Supp. 213, 218 (S.D.N.Y. 1993)) (emphasis added).

In *WMT Investors v. Visionwall Corp.*, the parties' License Agreement contained an arbitration clause that provided that "any dispute or controversy arising under, out of, in connection with or in relation to this Agreement shall be resolved by final and binding arbitration…" and also contained a provision that "in the event of a breach or threatened breach … [the party] shall have the right to equitable relief, including but not limited to the issuance of a temporary or permanent injunction or restraining order, by any court of competent jurisdiction." 2010 U.S. Dist. LEXIS 65869 *4, (S.D.N.Y. June 28, 2010).

WMT filed a complaint in New York's Southern District seeking declaratory and injunctive relief, and Visionwall moved to compel arbitration. The court found that the gateway question of arbitrability should be decided by the arbitrator but that even assuming that the question of arbitrability was before the court, it would likely find that WMT's claims should be arbitrated.

In so finding, the court explained that "if there is a reading of the various agreements that permits the arbitration clause to govern, the court will choose it." Id. (citations omitted). The court also pointed to case law in which parties were prohibited from attempting to circumvent a broad arbitration clause by disguising their claims as seeking equitable relief. Id. at *10.

The court reasoned that the agreement is susceptible of the interpretation that the equitable relief provision relates to preserving the status quo between the parties pending the outcome of the arbitration. Id. The court found that its

conclusion was “buttressed by Plaintiff ’s … assertion that an arbitrator should determine the validity and enforceability of the License Agreement.” Id. at *11. The court ultimately compelled arbitration. Id.

In *DXP Enters. v. Goulds Pumps Inc.*, the Texas Southern District federal court concluded that the parties’ agreement and use of the word “notwithstanding” in the carve-out created an ambiguity that warranted a decision in favor of arbitrating the Plaintiffs’ claims for permanent injunctive and declaratory relief. *DXP Enters. v. Goulds Pumps Inc.*, 2014 U.S. Dist. LEXIS 156158 (S.D. Tex. Nov. 4, 2014). There, the agreement and carve-out read:

Any controversy or claim arising out of or related to this Agreement or the breach thereof shall … be finally settled by conciliation or arbitration … Notwithstanding the foregoing, either Manufacturer or Distributor may apply to a court of competent jurisdiction for the imposition of an equitable remedy (such as a Restraining Order or Injunction) upon a showing of the elements necessary to sustain such a remedy.

The court found that “[t]he injunction provision, while stating that a party may apply to a court of competent jurisdiction to obtain equitable relief ‘notwithstanding’ the requirement to arbitrate, does not explicitly except claims for equitable relief from the scope of the broad arbitration clause.” Id. at *10-11.

In the court’s view, there was not a “*positive assurance* that the parties’ arbitration clause is not susceptible of an interpretation that covers the asserted dispute.” Id. at *11 (quotation marks and citation omitted; emphasis in original).

The court distinguished between the use of the word “notwithstanding” in the clause before it and cases that it perceived to involve more forceful language. Id. at *15-18. It ultimately concluded that the “notwithstanding” language “is closer to the provisions courts have held allow litigation only of applications for [a] temporary restraining order or preliminary injunctions needed to preserve the status quo pending arbitration of the merits, not attempts to displace the arbitration by allowing litigation of the merits through a permanent injunction.” Id. at *18. According to the court, “[t]he strong policy and presumption favoring arbitration weigh [heavily] against such a result.” Id.

Two recent decisions also reached the same conclusions that the equitable carve-outs are only to be interpreted to aid in arbitration and not to remove a case or claims from the proper jurisdiction of the arbitrator. In *Davis v. SEVA Beauty LLC*, the arbitration agreement was broad, and carved out many claims from arbitration: “any action for declaratory or equitable relief, including, without limitation, seeking preliminary or permanent injunctive relief, specific performance, [or] other relief in the nature of equity to enjoin any harm or threat of harm to such party’s tangible or intangible property, brought at any time, including, without limitation, prior to or during the pendency of any arbitration proceedings initiated hereunder.” No. C17-547 TSZ, 2017 BL 322579, at *3-4 (W.D. Wash. Sept. 13, 2017).

The court held that even though the plaintiffs brought equitable claims seeking rescission, those claims belonged in arbitration because they were not brought “in aid of arbitration.” Id. at *4. “A party may not, however, circumvent the arbitration clause by simply seeking equitable remedies for claims that are squarely within the scope of matters to be arbitrated. This interpretation brings the arbitration provision and the exception at issue into harmony with each other and the federal policy favoring arbitration.” Id.

Similarly, in *Info. Sys. Audit & Control Ass'n v. TeleComm. Sys. Inc.* the court interpreted a facially broad carve-out to only except from arbitration claims for "temporary equitable relief once a dispute has been submitted to arbitration" or "as authorizing courts to enforce arbitral awards once arbitration is complete." No. 17 C 2066, 2017 BL 216900, at *5-6 (N.D. Ill. June 23, 2017).

The court also explained that interpreting the clause in any broader way "would permit a party to obtain from a court essentially the same relief as that otherwise reserved for the arbitrator."

DXP Enters., *Davis and Info. Sys.* get to the right result, but have to work too hard to get there.

Those courts feel compelled to state that they are "interpreting" the arbitration clause in such a way as to permit the arbitrator to hear the equitable claims. They should not have to so strain. They could, and should, have focused on (1) the lack of any emergency or (2) that the equitable claims were not brought somehow in aid of the arbitration. As a result, they should have held that the parties have to arbitrate all of their claims.

Where parties have a mandatory arbitration clause and a non-emergent situation, cases should not be split, irrespective of whether the case presents a non-emergent equitable claim.

The most that courts should be permitted to do in cases with a mandatory arbitration provision is enter an injunction that freezes the status quo ante in order to prevent irreparable injury until such time as the merits are determined by the arbitrator.

A party that agreed to arbitrate its disputes should not be able to circumvent that very agreement by artfully pleading its claims to include equitable relief. Any other result compromises arbitration, increases party expense, and overburdens the court system—all in favor of enforcing a contract term contrary to public policy.