



Houston Lawyer  
January/February, 2005

### Feature

## \*10 ARBITRATION CLAUSES FOR ONGOING RELATIONSHIPS

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### \*11 Introduction

Binding **arbitration** is becoming increasingly commonplace. Contracts routinely contain clauses requiring the parties to waive their right to litigate in favor of **arbitration**. While no longer new, the phenomenon continues to gain strength at an amazing pace.

Because parties can be compelled to arbitrate disputes only if there is an agreement to do so, it is critical to draft the clause to ensure it achieves the scope intended by the parties. [\[FN1\]](#) There has been scant attention paid to temporal considerations in drafting **arbitration** provisions, even though that issue is critical when, as often happens, a contract with an **arbitration** clause is executed during an ongoing relationship, in which earlier contracts do not contemplate **arbitration**.

This article discusses the relevant temporal issues to be considered in negotiating and drafting **arbitration** clauses during ongoing commercial relationships.

#### Does your client want retroactive application?

The answer to this question will determine the wording of the **arbitration** clause. A broad **arbitration** clause will govern all disputes "arising out of or related to" the contract. [\[FN2\]](#) This can include some claims arising out of conduct that predates the formation of the contract, such as a claim that the contract was fraudulently induced. [\[FN3\]](#)

However, the question of retroactively applying an **arbitration** clause is a much less clear and, as of now, less frequently litigated issue in **arbitration** jurisprudence. The few courts that have faced this issue have held that, except under specific circumstances, even a broad **arbitration** clause will not reach back in time to embrace disputes arising under an earlier contract that did not contain such a clause, even if (as is often the case) the dispute also "relates to" the later contract with the **arbitration** clause. [\[FN4\]](#)

This rule of interpretation is often critical and yet counterintuitive. In many industries, the parties often develop long-term relationships governed by a series of contracts. Even in shorter-term relationships, parties frequently enter into one contract to establish the parameters of a particular project, and then enter into another contract by which the

project will actually proceed. Frequently, business relationships have existed for decades and may involve a mix of older contracts predating the widespread popularity of commercial **arbitration** and more recent "follow-on" contracts containing, for the first time in the relationship, an **arbitration** provision.

When a contract with an **arbitration** provision is introduced to an ongoing relationship, the question to consider is whether the new **arbitration** clause governs only disputes arising under the contract containing the clause, or whether the clause governs disputes arising from an earlier portion of a project or relationship, under a predecessor contract that has no **arbitration** clause.

#### **A standard clause is insufficient to arbitrate disputes under an earlier contract**

Courts recognize two different forms of **arbitration** clauses: narrow and broad. [\[FN5\]](#) The prototypical narrow **arbitration** clause encompasses only those disputes "arising under" the contract. [\[FN6\]](#) A broad **arbitration** clause captures disputes "arising under or relating to" the contract. [\[FN7\]](#) More importantly, for an **arbitration** clause to require **arbitration** of disputes arising under or relating to contracts that pre-date the clause, the agreement must expressly and unequivocally contemplate such retroactivity. [\[FN8\]](#)

A recent engineering malpractice case highlights the practical effect of failing to address temporal issues in express language. A mining company had entered into a contract with a global engineering and construction firm. Under the contract, \*12 the engineering firm would produce a feasibility study to recommend whether the mining company should proceed with a specific project. The contract did not have an **arbitration** clause. Ultimately, the feasibility study recommended proceeding with the project, so the mining company engaged the engineering firm to construct the project under a separate follow-on contract. The follow-on contract contained the prototypical "broad" clause mandating **arbitration** of all disputes "arising under or relating to" the follow-on contract.

Sometime later, the mining company sued the engineering firm and alleged flaws in the feasibility study and misdiagnosis of the project's viability. In response, the engineering firm tried to invoke the follow-on contract's **arbitration** provision. The mining company opposed, contending that its claims arose under the earlier contract, which had no such provision. The trial court denied the engineer's motion to compel **arbitration**. Following the majority of courts, [\[FN9\]](#) the court held that an **arbitration** clause in a later contract does not cover disputes relating to earlier contracts unless the **arbitration** clause expressly and unequivocally mandates **arbitration** of disputes arising under the earlier contract. [\[FN10\]](#) The Nevada Supreme Court affirmed this holding, despite that the parties could end up litigating some of the same complex fact issues that were subject to **arbitration**. [\[FN11\]](#)

#### **Ways of achieving - or avoiding - retroactivity**

Achieving an all-encompassing, retroactive effect requires careful attention to the language in an **arbitration** clause. On the other hand, parties who want to limit the scope of an **arbitration** clause will want to reject the provisions discussed below.

##### **A. Expressly agreeing to retroactivity**

The clearest and easiest way to ensure arbitrating all disputes that arise under all of the parties' existing contracts is to include an **arbitration** provision that says so. [\[FN12\]](#) For example, a clause specifying that \*14 all disputes arising under or relating to existing contracts between the parties constitutes an agreement to arbitrate.

However, as shown below, there are other, less direct ways to negotiate and obtain that result. Depending on the circumstances, negotiating these less direct clauses may be more appropriate.

##### **Entire relationship clauses**

By tailoring an **arbitration** clause to expressly cover the "entire relationship" between the parties, retroactivity can be achieved. Courts have permitted retroactively applying **arbitration** clauses to disputes that arose while performing under an agreement that preceded the contract containing the clause, but only when the clause expressly covers the parties' entire relationship, not just the contract that calls for **arbitration**. [\[FN13\]](#) But absent expression

of the parties' intent to cover their entire relationship, courts have refused to apply even a broad **arbitration** clause to claims involving the parties' ongoing relationship where the dispute arose from facts or acts predating the contract with the **arbitration** clause. [\[FN14\]](#)

### Specific incorporation clauses

**Arbitration** clauses have also been allowed to reach back in time when the clause expressly refers to and incorporates the earlier agreement not containing an **arbitration** provision. [\[FN15\]](#) For example, one court addressed a 1995 licensing and distributorship agreement containing an **arbitration** clause that expressly referred to and subsumed the parties' previous agreements. More specifically, the contract's merger clause stated that the 1995 agreement "constitutes the entire understanding and agreement. Any other previous negotiations, discussions, and/or written or oral agreements between the parties on the subject matter of this Agreement are superseded hereby." [\[FN16\]](#) The court held that claims under the earlier contracts were subject to the 1995 contract's **arbitration** clause because the prior contracts were expressly subsumed by this broad and explicit merger clause. [\[FN17\]](#)

\*15 While most garden-variety merger clauses do not go as far as that in the case above, modifying a contract's generic merger clause is one way to achieve retroactive application of the **arbitration** agreement.

### Superseding contract clauses

Retroactive application of an **arbitration** clause also has been permitted where an earlier short-form or preliminary agreement was superseded or encompassed within a later definitive agreement that contained an **arbitration** clause and covered the same subject matter. For example, in *Pennzoil Exploration & Production Co. v. Ramco Energy Limited*, the parties had entered into a series of agreements allocating the potential development rights in Azerbaijani oil fields. [\[FN18\]](#) Because the Azerbaijan government was unstable, the development rights were modified repeatedly to take into account the government takeover of various oil fields and the introduction of new partners into the government-driven allocation scheme. [\[FN19\]](#) Early letter agreements between Ramco and Pennzoil, without **arbitration** clauses, expressly specified that definitive agreements would follow. Detailed, definitive agreements did follow, and they contained **arbitration** clauses. After signing three of the definitive contracts with **arbitration** clauses, Ramco attempted to sue Pennzoil on one of the earlier letter agreements. [\[FN20\]](#)

Affirming the district court's decision, the Fifth Circuit compelled **arbitration** of the claims brought under an earlier agreement that did not contain an **arbitration** clause. In so doing, the Court focused on three facts. First, each of the agreements between the parties simply modified the terms of the original agreement, in light of the changed political landscape. In fact, the later agreement "regulated the relation of the parties in the exercise of their rights and obligations under" the earlier contract. [\[FN21\]](#) Second, the earlier agreements expressly stated that subsequent definitive agreements would follow. [\[FN22\]](#) Finally, the Court noted that the later agreements expressly referenced the earlier ones. [\[FN23\]](#)

To achieve the broadest possible application of an **arbitration** clause in situations where business is based on one or more "interim" agreements that will eventually be supplanted by a more definitive agreement, practitioners should consider designing the interim agreements to expressly recognize the forthcoming definitive agreement.

### The key is express and unequivocal retroactivity

The case law indicates several paths to retroactively applying an **arbitration** clause. To ensure the best chance that an **arbitration** clause will be retroactively applied to disputes arising under an earlier contract without an **arbitration** provision, the parties should expressly and unequivocally indicate their intent. Whether the merger clause is modified, \*16 the **arbitration** clause is broadened to cover the parties' "entire relationship," earlier agreements are specifically incorporated into later ones, or language is added elsewhere in the contract to indicate retroactivity, the key is to make clear that the **arbitration** clause is intended to reach back in time.

### Conclusion

As sophisticated clients and counsel become more adept at defining the scope of an **arbitration** clause to be as

(Cite as: 42-FEB Hous. Law. 10)

broad as possible, it would serve them well to consider the seemingly overlooked issue of retroactivity. There are a number of approaches to increase the likelihood that an **arbitration** clause will be applied retroactively, even to require **arbitration** of disputes arising under prior contracts without **arbitration** clauses. Knowing that the law will not, absent such language in the parties' contract, require **arbitration** of such disputes will allow counsel to negotiate and draft agreements that express and carry out their clients' intent.

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[\[FN1\]](#). [EEOC v. Waffle House, Inc., 534 U.S. 279, 289, 293 \(2002\)](#) ("[I]t is the language of the contract that defines the scope of disputes subject to **arbitration**. \* \* \* The FAA ... does not require the parties to arbitrate when they have not agreed to do so."); see also [AT & T Tech. Inv. v. Communications Workers of Am., 475 U.S. 643, 648 \(1986\)](#) (stating that a "party cannot be required to submit to **arbitration** any dispute which he has not agreed to submit").

[\[FN2\]](#). [Collins & Aikman Prods. Co. v. Bldg. Sys., Inc., 58 F.3d 16, 20 \(2d Cir. 1995\)](#) ("The clause in this case, submitting to **arbitration** '[a]ny claim or controversy arising out of or relating to th[e] agreement,' is the paradigm of a broad clause"); [Ferrari N. Am., Inc. v. Ogner Motor Cars, Inc., No. 02-Civ.-7720SAS, 2003 WL 102839, at \\* 3 \(S.D.N.Y. 2003\)](#) ("the prototypical broad **arbitration** provision" is one that makes arbitrable "[a]ny dispute, controversy or claim arising under or in connection with [an agreement]"); [Brown v. Coleman Co., Inc., 220 F.3d 1180, 1184 \(10th Cir. 2000\)](#) (explaining that **arbitration** clause covering "all disputes or controversies arising under or in connection with this Agreement" is broad form).

[\[FN3\]](#). See, e.g., [Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395, 398 \(1967\)](#); [Large v. Conseco Fin. Serv. Corp., 292 F.3d 49, 53 \(1st Cir. 2002\)](#) ("As we have explained, a broad **arbitration** clause will be held to encompass **arbitration** of the claim that the contract itself was induced by fraud"); [Garten v. Kurth, 265 F.3d 136, 143 \(2d Cir. 2001\)](#).

[\[FN4\]](#). [Hendrick v. Brown & Root, Inc., 50 F.Supp.2d 527, 533-34 \(E.D. Va. 1999\)](#) (refusing retroactive application of **arbitration** clause because "the contractual language [arising under or relating to] does not evince an agreement to arbitrate pre-existing disputes"; rather, such language "speaks in the present tense or connotes the future"); [Sec. Watch, Inc. v. Sentinel Sys., Inc., 176 F.3d 369, 372 \(6th Cir. 1999\)](#) (refusing to apply **arbitration** clause in shipping agreement to dispute based on conduct occurring under prior shipping agreements, absent some temporal language indicating the parties intended retroactive application); [Choice Sec. Sys., Inc. v. AT&T Corp., No. 97-1774, 1998 WL 153254, at \\*1 \(1st Cir. Feb. 25, 1998\)](#) (noting that no provision of the later agreement even "remotely intimate[d] that the parties ever contemplated so radical a retroactive renegotiation of their earlier agreements," in holding that an **arbitration** provision did not apply to disputes relating to earlier products).

[\[FN5\]](#). See [New River Mgmt. Co., L.L.C. v. Henry Schein, Inc., No. 00-1946, 2001 WL 565244 \(4th Cir. May 25, 2001\)](#) (comparing broad and narrow form **arbitration** clauses); [McDonnell Douglas Fin. Corp. v. Pa. Power & Light Co., 858 F.2d 825, 832 \(2d Cir. 1988\)](#) (distinguishing "between 'broad' clauses that purport to refer all disputes arising out of a contract to **arbitration**, 'narrow' clauses that limit **arbitration** to specific types of disputes"); [Sedco v. Petroleos Mexicanos, 767 F.2d 1140, 1145 n.10 \(5th Cir. 1985\)](#) (comparing broad and narrow **arbitration** clauses).

[\[FN6\]](#). See, e.g., [Am. Recovery Corp. v. Computerized Thermal Imaging, Inc., 96 F.3d 88, 92-93 \(4th Cir. 1996\)](#) (collecting cases and noting that courts label "narrow" **arbitration** clauses limiting **arbitration** to disputes "arising under" or "arising hereunder" the contract); [Pennzoil Exploration and Prod. Co. v. Ramco Energy Ltd., 139 F.3d 1061, 1067 \(5th Cir. 1998\)](#) (clauses that "only require **arbitration** of disputes 'arising out of' the contract are narrow); [Tracer Research Corp. v. Nat'l Envtl. Servs. Co., 42 F.3d 1292, 1295 \(9th Cir. 1994\)](#) ("arising out of" language means **arbitration** clause is narrow form).

[FN7]. See note 2 supra.

[FN8]. See note 4 supra.

[FN9]. See note 4 supra; see also [Peerless Importers, Inc. v. Wine, Liquor & Distillery Workers Union Local One](#), 903 F.2d 924, 928 (2d Cir. 1990) (holding that **arbitration** clause did not reach back to cover employment dispute that was based on conduct occurring prior to signing **arbitration** agreement; **arbitration** agreement "may not be used to reach back to cover disputes arising before the agreement was executed, unless such preexisting disputes are brought within the scope of the clause"); [Nordin v. Nurti/System, Inc.](#), 897 F.2d 339, 344 (8th Cir. 1990) (finding that broad-form **arbitration** clause in settlement agreement with employee did not retroactively cover disputes arising from non-compete agreement); [In re Hops Antitrust Litig.](#), 655 F. Supp. 169, 172-73 (E.D. Mo.), (denying **arbitration** of disputes predating **arbitration** clause; "[t]he record reflects no agreement by the parties to amend earlier contracts to provide for **arbitration** of disputes") app. disp., 832 F.2d 470 (8th Cir. 1987); [George Washington Univ. v. Scott](#), 711 A.2d 1257, 1260-61 (D.C. 1998) (concluding that conduct that occurred before **arbitration** clause took effect was not arbitrable); [Kenworth v. Bruner](#), 745 So.2d 271, 276 (Ala. 1999) (holding that **arbitration** clause in invoice for buyer's purchase of reflectors for truck did not relate back to buyer's claims arising from original purchase of truck; "retroactive agreements to arbitrate require closer scrutiny than agreements calling for **arbitration** of disputes relating to future activities. \* \* \* [I]f the **arbitration** clause contains retroactive time-specific language, e.g., a phrase reading 'this agreement applies to all transactions occurring before or after this agreement,' then we may apply the **arbitration** provision to disputes relating to past events").

[FN10]. Order on Motion to Compel **Arbitration**, Equatorial Tonopah Inc. v. Kvaerner U.S. Inc., No. CV-16392 (5th Jud. Dist. of Nye County, Nev., Mar. 27, 2002).

[FN11]. Order of Affirmance, Kvaerner U.S. Inc. v. Equatorial Tonopah Inc., No. 39571 (Nev. Oct. 21, 2003).

[FN12]. [Hendrick](#), 50 F.Supp.2d at 533-34 (refusing retroactive application of **arbitration** clause because "the contractual language does not evince an agreement to arbitrate pre-existing disputes"); [Security Watch](#), 176 F.3d at 372 (temporal language indicating **arbitration** clause applies to prior existing contracts necessary); [Choice Sec. Sys.](#), 1998 WL 153254, at \* 1 (**arbitration** clause did not apply to prior existing contract because provision did not say it would).

[FN13]. [Zink v. Merrill Lynch Pierce Fenner & Smith, Inc.](#), 13 F.3d 330, 331-33 (10th Cir. 1993) (enforcing **arbitration** agreement as to dispute arising out of contested transaction that predated execution of the **arbitration** clause, because the clause provided for **arbitration** of any controversy arising out of "your business or this agreement") (emphasis added); [Belke v. Merrill Lynch Pierce Fenner & Smith, Inc.](#), 693 F.2d 1023, 1028 (11th Cir. 1982) (allowing **arbitration** of pre-agreement dispute under a clause that covered not only disputes arising out of the agreement, but also any controversy between the parties "arising out of [their] business").

[FN14]. [Church v. Gruntal](#), 698 F.Supp. 465, 469 (S.D.N.Y. 1988) (holding that **arbitration** clause did not apply retroactively to claims arising prior to the date of the contract, because the clause only covered matters arising out of or related to the contract and did not explicitly cover all matters relating to the relationship between the parties); [Necchi S.p.A. v. Necchi Sewing Mach. Sales Corp.](#), 348 F.2d 693, 698 (2d Cir. 1965) (concluding that **arbitration** clause did not reach back to cover earlier disputes relating to the parties' relationship; the clause covered only matters concerning the contract containing the **arbitration** clause, rather than the working relationship between the parties).

[FN15]. See, e.g., [Simula, Inc. v. Autoliv, Inc.](#), 175 F.3d 716, 722-23 (9th Cir. 1999).

[FN16]. *Id.* at 723.

[FN17]. *Id.*

[FN18]. 139 F.3d 1061 (5th Cir. 1998).

[\[FN19\]](#). [Id. at 1062-64.](#)

[\[FN20\]](#). Id.

[\[FN21\]](#). Id. at 1064.

[\[FN22\]](#). Id.

[\[FN23\]](#). Id.

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