



## Illinois Supreme Court Rejects Arbitration Clause Due to Unavailability of Designated Arbitrator

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On February 3, 2011, the Supreme Court of Illinois upheld the Illinois Appellate Court's ruling that the unavailability of the designated arbitrator in a sales contract's arbitration clause made the arbitration clause unenforceable. (*Carr v. Gateway, Inc.*, No. 109485) Defendant Gateway had argued that the court had the power under Section 5 of the Federal Arbitration Act (FAA) to appoint a substitute arbitrator if the designated arbitrator was unavailable. The Supreme Court disagreed.

The underlying litigation arose from the 2001 purchase of a computer which had allegedly been misrepresented as to its speed. Gateway moved to dismiss plaintiff Carr's suit and compel arbitration based on the sales contract's arbitration provision under which any dispute "will be resolved exclusively and finally by arbitration administered by the National Arbitration Forum (NAF) and conducted under its rules . . ." The trial court denied Gateway's motion on grounds of unconscionability. The appellate court focused on the narrower issue that by the time of the suit, the NAF no longer accepted consumer arbitrations. The appellate court held that the NAF's designation was an "integral" part of the arbitration provision and that, as a result, the FAA could not be used to reform the arbitration provision.

The issue before the Illinois Supreme Court was whether the arbitration provision's designation of the NAF was "integral" or "ancillary" to the parties' agreement to arbitrate. If only ancillary, a court may name a substitute arbitrator under Section 5 of the FAA, which provides that: "if for any other reason there shall be a lapse in the naming of an arbitrator . . . the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require." However, if integral to the parties' decision to arbitrate, the impossibility of that term vitiates the agreement to arbitrate. Importantly, the Supreme Court agreed with Gateway that the mere fact that the parties named an arbitral service and specified arbitration rules does not, standing alone, make that designation integral to the agreement. The Court recognized that where it is possible for a substitute arbitrator to use the rules specified in the agreement, the contract's designation of particular rules to govern the arbitration will not prevent the naming of a substitute arbitrator.

The agreement's specification of the NAF rules was the "rub" for the Court, which opined that it was unclear how any substitute arbitrator could now use those rules. This is because the NAF rules provide that arbitrations must be conducted under the NAF Code applicable "at the time a claim is filed." Since no claim for arbitration had yet been filed, the arbitration would be governed by the current Code (effective Aug. 1, 2008) which restricts the use of the NAF rules to NAF-authorized entities and individuals. Further, the Court did not see how the NAF rules could be used in a consumer arbitration since the NAF no longer accepts consumer arbitrations. Based on this, the Court held that any finding concerning the use of NAF rules by a substitute arbitrator "would be based on speculation." The Court also relied on the fact that the arbitration provision – in a contract drafted by Gateway – provided



penalties for seeking arbitration elsewhere. These factors led the Court to conclude that the designation of the NAF as the arbitral forum was integral to the parties' agreement to arbitrate.

When can a court apply Section 5 of the FAA to appoint a substitute arbitrator? More specifically, will a court find the designation of an arbitrator/forum or governing rules in an arbitration clause to be "integral" or "ancillary?" This issue remains unsettled. The Illinois Supreme Court recognized that different courts have reached different conclusions as to basically the same arbitration clause language. However, some guidance can be gleaned from the ruling.

The *Carr* decision turned on the finding that no substitute arbitrator could apply the designated rules to the dispute because of the unique nature and status of the NAF rules (which *must* be administered by NAF entities; which *no longer* apply to consumer disputes). The decision indicates that a lower court could, under the FAA, appoint a substitute arbitrator if that arbitrator could effectively apply the contract's designated rules (if any) to the dispute. Under this scenario, the contract may designate governing rules only, without naming a specific arbitrator, or it may name a designated arbitrator or service along with the proposed rules. In either case, a court might hold that only the application of the designated rules is "integral" to the decision to arbitrate, and that a court-appointed arbitrator could effectively carry out that function. Thus, the *Carr* holding may be more limited to the specific facts of that case – and less anti-arbitration – than appears at first blush.

That said, other courts have taken the view that if an arbitration clause designates a specific arbitral forum, and if that forum is no longer available, the choice of forum will be held to be integral to the decision to arbitrate. Indeed, the Illinois Supreme Court cited decisions in which other courts have rejected the argument that an arbitration need not take place before the designated entity (the NYSE, for example) as long as that entity's rules govern the arbitration. Per *Carr*, it does not appear that the Illinois Supreme Court would go that far. Still, it is important to note that other jurisdictions have.

Where does that leave parties who want to include an arbitration clause in their contracts? Claims that the *Carr* ruling is anti-arbitration – or at least anti-arbitration in the consumer agreement context – may be a bit premature. That concern is supported by the fact that the trial court ruled against Gateway on grounds that the arbitration provision was not part of the sales contract and that it was unconscionable. The Illinois Appellate Court's and Supreme Court's rulings were not so far-reaching and assumed, for appeal purposes, that a valid agreement to arbitrate existed. Still, the trial court's animus to the arbitration provision itself must be mentioned.

The different conclusions reached by courts highlight that parties to a contract should pay close attention as they draft, discuss and consider an arbitration provision. If the parties want to designate an arbitral forum or governing rules, they should expressly and clearly do so. The provision should also provide an alternative in case the designated forum is neither available nor willing to accept the dispute. Should the parties designate governing rules only, they are increasing the likelihood that a court may find that it can appoint a substitute arbitrator as long as the rules can be effectively employed. Even so, whether a court will determine the contract's stated arbitral choices to be "integral" or "ancillary" to the decision to arbitrate remains an issue in flux.

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