When Mandatory Arbitration Is Optional (2008)

To resolve disputes and avoid costly litigation, many companies are relying on mandatory arbitration clauses in their contracts. Disputes are inevitable and a cost of doing business, and the rising cost of lawsuits has becoming staggering. Against this backdrop, in the context of an otherwise garden-variety software copyright infringement suit, the Sixth Circuit recently bypassed an arbitration agreement in a particularly troubling manner.

The arbitration clause at issue in *NCR Corporation v. Korala Associates LTD, No. 06-3685 (6th Cir. 2008)* read:

Any controversy or claim arising out of or relating to this contract, or breach thereof, shall be settled by arbitration and judgment upon the award rendered by the arbitrator may be entered in any court having jurisdiction thereof. The arbitrator shall be appointed upon the mutual agreement of both parties, failing which both parties will agree to subject to any arbitrator that shall be chosen by the President of the Law Society.
Following the *NCR* decision, however, parties have cause for concern that even with such a broadly drafted arbitration clause, litigation cannot be avoided.

Facts

NCR is one of the world's premier providers of ATM equipment, integrated hardware and software systems, and performers of related maintenance and support services. NCR uses APTRA XFS and S4i software on its ATMs, and on December 15, 1998, entered into a software licensing agreement with KAL, for the latter to develop and license to NCR three software components for NCR's ATMs. The three components would form NCR's Kalypso software.

NCR also loaned KAL an ATM to enable KAL to adapt and support the Kalypso software. According to NCR, KAL then obtained and accessed other NCR ATM's from NCR licensees on which the APRTRA XFS and S4i software was installed and illicitly created KAL's Kalignite Upgrade Solutions.

Despite the arbitration clause, NCR then filed suit in federal court, alleging copyright infringement and related claims. The parties agreed that a valid

agreement to arbitrate existed, but disagreed about whether NCR's claims fell within the scope of the agreement.

Analysis

There is a federal policy that doubts about the scope of arbitration clauses -- particularly where, as here, the clause broadly refers to "any" controversy or claim -- should be resolved in favor of arbitration. The district court held that the arbitration clause "encompasses all claims which touch upon matters covered by the agreement." NCR's amended complaint, the court reasoned, "relates to some part of the Agreement and will require examination and interpretation of the Agreement or an exhibit to the Agreement."

On appeal, however, the Sixth Circuit reversed, holding that the district court's "touches upon" standard was incorrect. Rather, the appropriate standard was whether "an action could be maintained without reference to the contract or relationship at issue. If it could, it is likely outside the scope of the arbitration agreement." Although there is a presumption of arbitrability, the Sixth Circuit said, the cornerstone of the inquiry is whether a court can resolve the matter without reference to the agreement containing the arbitration clause, *unless the intent of the parties indicates otherwise* (emphasis added).

Applying this standard, the appellate court said that NCR could not maintain its APTRA XFS infringement action without referencing the 1998 agreement with KAL, since a court would need to review the agreement to see what rights NCR granted to KAL. For the S4i software, the court reached the opposite result. The 1998 agreement did not address this software, and no reference to the agreement would be necessary for a court to determine whether NCR owned the software or whether KAL licensed or was authorized to access and copy S4i. For the contributory copyright infringement claims related to both software packages, the court held that neither was subject to arbitration, since NCR could maintain such a claim without reference to the 1998 agreement: NCR would have to show that its licensees infringed NCR's copyright when they provided KAL access to the software, and that KAL knew of the licensees' infringing activity and materially contributed to the infringement - no element of which would be based on the terms of the agreement. The tortious interference claim was likewise not arbitrable, for reasons similar to the contributory

infringement claim: no reference to the agreement was necessary for NCR to show that a particular licensee had an agreement with NCR, that KAL knew of the agreement, that KAL acted to procure breach of the agreement, that KAL was not justified in its actions and that NCR was damaged by the licensee's breach. NCR's claim that KAL illegally imported the Kalignite Upgrade Solutions (that embodied portions of the APTRA and S4i software) was arbitrable or not depending upon the relationship between the 1998 agreement and the underlying software. So the APTRA XFS claim was arbitrable for the same reason as the direct infringement claim, while the S4i claim was not subject to arbitration for the same reasons as the direct claim. Finally, the court held that NCR's common law unfair competition claims were subject to arbitration, since NCR was essentially arguing that KAL disregarded the confidentiality provisions of the 1998 agreement and misappropriated trade secrets and proprietary information.

Conclusion

One of the problems that transactional lawyers face is that contract drafting is forward-looking, while litigation looks backward. Here, the intent of the parties at the time the 1998 agreement was drafted was that "any" (read, all) controversies or claims "arising out of or relating to" the agreement would be subject to arbitration. It is impossible to draft an agreement with broader language than "any" or "all," and the common terms "arising out of" or "relating to" are given similar broad scope. It seems fairly clear then that the parties intended that conflicts arising out of or relating to the 1998 agreement would be resolved by arbitration and that litigation would not be permitted, other than to enforce the arbitration.

The Sixth Circuit thus seems to be ignoring the federal presumption in favor of arbitration and the clear intent of the parties, specifically as manifested in the "relating to" contract language. Certainly, although it would be an onerous task, lawyers drafting contracts could look at the precedent in all circuits in which the agreement could potentially be enforced to verify that agreed upon arbitration language would be consistently construed. But here, even if this work were undertaken, there would be no reason that the drafters would suspect that the court would ignore the clear contract language that the parties intended to be bound by.

Arguably, if the parties could resolve a matter without relying on the arbitration provision, the matter may not "arise out of" the agreement. In other words, there could be disputes between the parties relating to another matter: for example, different software or some other more current transaction. But the "relate to" language is an entirely different matter. It is hard to see how any of NCR's claims do not "relate to" the 1998 agreement, which defined the relationship between the parties concerning use of the software. Indeed, the risks of infringement and breach of the 1998 agreement were certainly foreseeable when the parties entered into their relationship; and because of this very risk, it is likely that the parties chose arbitration to minimize their respective exposure. And, logically, that they minimized their potential litigation costs through agreement on the arbitration provision was a material inducement for both parties to enter into the 1998 agreement.

So, going forward, if parties cannot foresee every set of circumstances that could flow from their contractual relationship and that could potentially be resolved without reference to what they have affirmatively agreed upon, how can parties in the Sixth Circuit enforce their chosen arbitration clauses?