Contractual Terms that Impact Future Litigation

Issues pertaining to their validity

By Gary K. August

As litigation costs rise and stories of runaway juries become more truth then legend, parties are including in their contracts terms that seek to control future litigation—arbitration clauses, jury waivers, and forum selection clauses. Still other clauses are used to limit or eliminate a party's right to pursue litigation and potential damages—statute of limitations clauses and waiver of damages clauses. Parties should be aware of the viability of these terms at the outset of contract formation.

Jury Waivers and Arbitration Agreements

Jury waivers forego a jury trial but do not remove the dispute from the court system. Utilization of a jury waiver may best balance the exposure associated with the runaway verdict potential of a jury trial with the risk associated with a non-appealable arbitration.

The right to a jury trial is woven through the fabric of the Common Law. The Seventh Amendment of the United States Constitution preserves the right to jury trial for common law claims exceeding 20 dollars. For matters brought in federal court, the question of right to a jury is governed by federal and not state law.[1] The U.S. Sixth Circuit Court of Appeals in *KMC Co v Irving Trust Co,* held that "parties to a contract may by prior written agreement waive the right to a jury trial."[2] However, the contractual waiver must be made knowingly and voluntarily.[3] If the language of the express jury waiver is clear, the party objecting to a jury waiver carries the burden of demonstrating that its consent was not knowing and voluntary.[4]

The Seventh Amendment's right to a civil jury trial has not been applied to the states by the Fourteenth Amendment.[5] Michigan courts are governed by the jury trial provision of the Michigan Constitution of 1963, Article 1, Section 14.

There is very little case law in Michigan on the issue of whether jury waivers are valid. The Michigan Supreme Court in *McKinstry v Valley Obstetrics-Gynecology Clinic, PC,*[6] upheld a medical malpractice jury waiver by determining that a right to jury trial in a civil action is permissive, not absolute. *McKinstry,* however, focused on the now repealed provisions of the Medical Malpractice Arbitration Act (MMAA),[7] which specifically allowed for the type of medical arbitration agreement at issue in that case. Because of the MMAA, the Michigan Supreme Court held that the defendant did not have the burden to prove that plaintiff knowingly, intelligently, and voluntarily waived this right. Outside of the context of the repealed MMAA, Michigan courts have not addressed whether a "knowingly, intelligently and voluntarily" standard applies to jury waivers, and, if so, which party has the burden to prove or disprove the standard.[8] The Michigan Court of Appeals, however, has stated there does not appear to be any basis to treat jury waivers under Michigan law differently then jury waivers under federal law.[9]

Jury waivers still leave the parties in the judicial system, but arbitration clauses typically remove a matter from the court in its entirety, other than giving the courts jurisdiction to confirm the arbitration award. Despite the significant waiver of a party's rights, including the fundamental right of a jury trial, Michigan courts expressly state that any "doubts regarding the arbitrability of an issue should be resolved in favor of arbitration."[10] In fact, the Michigan Court of Appeals has ruled that an arbitration clause does not even need to be entered into knowingly and voluntarily.[11]

Why are courts more willing to impose standards such as "knowing, intelligent, and voluntary" to jury waivers but not apply these standards to arbitration clauses that by their nature waive a trial by jury? The cynic may argue this is because an arbitration removes the matter from court, while a mere jury waiver keeps the matter in the court system for a bench trial—thereby not reducing in any way congestion on the court docket. In fact, the answer may lie in the statutory pronouncements of legislative public policy for arbitration not found with mere jury waivers.

At both the state and federal level, arbitrations are typically governed by the provisions of the applicable arbitration acts. The Federal Arbitration Act (FAA)[12] governs actions in both federal and state courts involving "a contract evidencing a transaction involving commerce."[13] The United States Supreme Court has held that the FAA Section 2's phrase "involving commerce" is the functional equivalent of the phrase "affecting commerce," which normally signals Congress' intent to exercise the commerce power to its fullest extent.[14] Thus, as a result of the Supremacy Clause,[15] the FAA preempts any state laws or policies that would otherwise invalidate an arbitration provision so long as the transaction merely involves commerce.[16] This is significant due to Section 2 of the FAA, which states that an arbitration clause "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[17]

The significance of the broad reading of the FAA and its preemption of state law is that the FAA is the mechanism used by courts to enforce contractual arbitration provisions otherwise invalid under state law. This is illustrated in recent consumer law decisions.

The Michigan Court of Appeals in *Abela v General Motors Corp,*[18] not only found that arbitration provisions were allowable for claims brought under the federal Magnuson-Moss Warranty

Act,[19] but also that the "FAA surmounts any state law that invalidates agreements to submit claims to binding arbitration."[20] Once this principle was established, the *Abela* court enforced the arbitration provision at issue and dismissed the plaintiff's claim brought under the Michigan Lemon Law, MCL 257.1401, et seq.[21]

The reasoning of *Abela* is certain to be applied to other state consumer statutes that could be read to preclude arbitration agreements. Just six months after the decision in *Abela*, the Michigan Court of Appeals in an unpublished opinion in *Gere v New Millennium Homes, Inc*[22] enforced a binding arbitration clause for claims brought under the Michigan Consumer Protection Act,[23] the Retail Installment Act,[24] and the Michigan Mobile Home Warranty Act.[25] Michigan courts are already enforcing arbitration clauses in the employment and civil rights context.[26] The Michigan Court of Appeals has even enforced an arbitration clause in an attorney retainer agreement despite the agreement's noncompliance with informal ethics opinions interpreting the Michigan Rules of Professional Conduct.[27] It appears that as long as an arbitration clause does not limit the remedies otherwise available to plaintiffs, it will be enforced absent a contractual basis for revocation.

Forum Selection Clauses

Another common clause creeping up in contracts impacting future litigation is the forum selection clause. There are some basic principles to forum selection clauses that impact their validity.

First and foremost, the parties to the contract cannot empower a court to hear a matter over which the court lacks jurisdiction.[28] Second, if the matter is brought in federal court, federal, not state, law determines the enforceability of the forum selection clause.[29] Third, federal courts will consider a forum selection clause as a "significant" but "not dispositive" factor to be balanced under 28 USC 1404(a).[30] Finally, a plaintiff that files in a federal forum different than that agreed to in the contract has the burden to demonstrate that the forum selection clause should not be enforced.[31]

In Michigan, parties to a contract may agree that the State of Michigan, or another state, has jurisdiction over a matter if certain circumstances are met. Pursuant to MCL 600.745(2), Michigan courts will entertain actions brought in Michigan pursuant to an agreement so long as the court has power to hear the case; Michigan is convenient; the agreement was not obtained by misrepresentation, duress, the abuse of economic power, or other unconscionable means; and the defendant is served with process as provided in the court rules. Likewise, pursuant to MCL 600.745(3), Michigan courts will dismiss or stay any action brought in Michigan courts when a clause requires it to be brought in another state unless Michigan courts are statutorily required to hear the matter;

While courts and the legislature more efficient, private parties can of contract terms to control

relief cannot be obtained in another jurisdiction; the other state would be substantially less convenient; the agreement was obtained by misrepresentation, duress, the abuse of economic power, or other unconscionable means; or it would be unfair or unreasonable to enforce the agreement.

While pre-dispute agreements determining jurisdiction are recognized by statute in Michigan, venue agreements are not. In *Omne Financial, Inc v Shacks, Inc*,[32] the three-justice opinion of the Michigan Supreme Court stated that "contractual provisions establishing venue for potential causes of action that may arise after the contract is executed are unenforceable." Three other justices concurred in the result in *Omne Financial*, but would have limited the holding by simply striking the venue selection term at issue under the improper venue statute, MCL 600.1651.[33] Thus, the two opinions of the Michigan Supreme Court in *Omne Financial* illustrate that contractual determinations of venue will not be accorded the statutory deference of agreements involving jurisdiction.

Statute of Limitations

Under Michigan law, the parties to a contract can agree to a limitations period shorter than that proscribed by statute so long as the period of time is "reasonable."[34] "Reasonableness" is defined by the Michigan Supreme Court as enough so "the claimants have sufficient opportunity to investigate and file an action, that the time not be so short as to work a practical abrogation of the right of action, and that the action not be barred before the loss or damage can be ascertained."[35] Where one party has less bargaining power than another, such as employment contracts, the Michigan Supreme Court will apply "close judicial scrutiny."[36]

In *Myers v Western-Southern Life Ins Co*,[37] the United States Sixth Circuit Court of Appeals held a contractually agreed upon six-month limitation period for claims brought under Michigan's Elliott-Larsen Civil Rights Act and the Michigan Handicappers' Civil Rights Act to be reasonable. The Michigan Court of Appeals also upheld a six-month limitation period for these statutes.[38] The Michigan Supreme Court chose not to address this issue.[39] In *Lewis v Harper Hospital*,[40] the United States District Court for the Eastern District of Michigan allowed a six-month statute of limitations for the state law claims while holding that a

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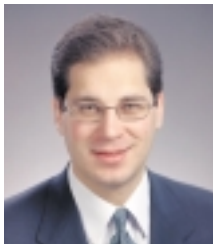
six-month statute of limitations for claims brought under Title VII of the federal Civil Rights Act of 1964 (Title VII) and the federal Family Medical Leave Act (FMLA) were not reasonable due to the EEOC procedure under Title VII and the specific regulations under FMLA.

Limitation of Damages

There are many ways parties can seek to contractually limit damages arising from breach. The most common one is a pre-injury release or limitation on the amount of damages. For such a term to be valid it cannot be substantively unreasonable, such as where the releasee has a monopoly on the services at issue in the contract.[41] Also, Michigan courts will allow a party to be released from its own negligence, but the release will not be enforced if "(1) the releasor was dazed, in shock, or under the influence of drugs, (2) the nature of the instrument was misrepresented, or (3) there was other fraudulent or overreaching conduct."[42] Finally, a party cannot limit its liability for harm caused by its gross negligence.[43]

There are other specialized circumstances where waivers may or may not be allowed. One such circumstance is a liquidated damages provision. This type of provision seeks to fix the damages for breach at the outset of contract formation. Liquidated damage provisions are allowed in situations where actual damages are uncertain and difficult to ascertain or are of a purely speculative nature.[44] Another instance is "no damages for delay clauses" in construction contracts, which will be upheld unless certain specified circumstances exist.[45]

While courts and the legislature strive to make the judicial system more efficient, private parties can effectively utilize these types of contract terms to control future exposure from litigation. ✦



Gary K. August is a shareholder in the law firm of Zausmer, Kaufman, August & Caldwell, P.C. with offices in Farmington Hills and Lansing. Mr. August focuses his practice on construction law, commercial litigation, securities law, and insurance coverage issues.

Footnotes

1. *KMC Co, Inc v Irving Trust Co*, 757 F2d 752 (CA 6, 1985).
2. Id. at 755.
3. Id. at 756. The circuit court noted the distinction between a contractual waiver entered into before any cause of action arose and a procedural waiver under Fed R Civ P 38(d) which could result from mere oversight or inadvertence. Id. at 756–57 n 4, 6; See *Sewell v Jefferson County Fiscal Court*, 863 F2d 461, 464 (CA 6, 1988) (not applying the voluntary and knowing standard to a procedural jury waiver).
4. Id. at 758.
5. *Knubbe v Sparrow*, 808 F Supp 1295, 1302 (ED Mich, 1992).
6. 428 Mich 167, 183; 405 NW2d 88, 95 (1987).
7. MCL 600.5041 et seq., repealed by 1993 PA 78, § 2.
8. The Michigan Supreme Court in *Morris v Metriyakool*, 418 Mich 423; 344 NW2d 736 (1984), also a case under the MMAA, implied in dicta that the burden of avoiding the jury waiver in all contexts would be on the party seeking to avoid it.
9. See *Feinberg v Straith Clinic*, 151 Mich App 204, 214–16; 390 NW2d 697 (1986) ("Although we are not bound by the Seventh Amendment, we are aware of no reason why we should construe Const 1963, art 1, Section 14 differently from its federal counterpart.").
10. *Madison Dist Public Schools v Myers*, 247 Mich App 583, 595; 637 NW2d 526 (2001); *DeCaminada v Coopers & Lybrand*, 232 Mich App 492, 496, 591 NW2d 364, 366 (1999).
11. *DeCaminada*, supra at 500; 591 NW2d at 368 ("an arbitration clause is enforceable, regardless of whether a plaintiff is specifically aware of its scope, unless the plaintiff can show grounds for revocation").
12. 9 USC 1-15.
13. 9 USC 2.
14. *Allied-Bruce Terminex Cos v Dobson*, 513 US 265 (1995). "Interstate commerce" is defined broadly. See *Dempsey v Metropolitan Life Ins Co*, unpublished opinion per curiam of the Michigan Court of Appeals, decided May 4, 1999 (Docket No. 208050); 1999 WL 33445202.
15. US Const, art VI, cl 2.
16. *DeCaminada*, supra at 501; 591 NW2d at 368.
17. 9 USC 2. See Michigan Arbitration Act, MCL 600.5001(2).
18. 257 Mich App 513; 669 NW2d 271(2003).
19. 15 USC 2301, et seq
20. *Abela*, supra at 525.
21. Id.
22. Unpublished opinion per curiam of the Michigan Court of Appeals, decided December 23, 2003 (Docket No. 242473); 2003 WL 23018774.
23. MCL 445.903(1)(t).
24. MCL 445.864(1)(d) and (f).
25. MCL 125.995.
26. See *Rembert v Ryan's Family Steak House, Inc*, 235 Mich App 118, 156; 596 NW2d 208, 226 (1999).
27. *Watts v Polaczyk*, 242 Mich App 600; 619 NW2d 714 (2000).
28. *People v McKinnon*, 139 Mich App 362; 362 NW2d 809 (1984); *Magaloti v Ford Motor Co*, 418 F Supp 430 (D Mich, 1976).
29. *Stewart v Ricoh Corp*, 487 US 22 (1988); *Viron Int'l Corp v David Boland, Inc*, 237 F Supp 2d 812, 818 (WD Mich, 2002).
30. *Viron*, supra at 816.
31. Id. at 815.
32. 460 Mich 305, 319; 596 NW2d 591, 597 (1999) (emphasis in original).
33. Justice Taylor did not participate in the decision since he participated in the decision in the court of appeals.
34. *Camelot Excavating Co, Inc v St Paul Fire & Marine Ins Co*, 410 Mich 118, 127; 301 NW2d 275 (1981).
35. Id.
36. *Herweyer v Clark Highway Services, Inc*, 455 Mich 14, 21; 564 NW2d 857, 860 (1997).
37. 849 F2d 259 (CA 6, 1988).
38. *Timko v Oakwood Custom Coating, Inc*, 244 Mich App 234; 625 NW2d 101 (2001).
39. *Bobo v Thorn Apple Valley*, 587 NW2d 501 (Table) (Mich, October 27, 1998) (denying application for leave to appeal).
40. 241 F Supp 2d 769 (ED Mich, 2002).
41. *Allen v Michigan Bell Telephone Co*, 18 Mich App 632, 640; 171 NW2d 689 (1969).
42. *Xu v Gay*, 257 Mich App 263, 273; 668 NW2d 166, 170 (2003).
43. *Universal Gym Equip, Inc v Vic Tanny Int'l*, 207 Mich App 364, 369 (1995); *Lamp v Reynolds*, 249 Mich App 591; 645 NW2d 311 (2002).
44. *Papo v Algo Restaurants*, 149 Mich App 285, 294; 386 NW2d 177 (1986).
45. Most notably, these include situations where the delay (1) was of a kind not contemplated by the parties; (2) amounted to an abandonment of the contract; (3) was caused by bad faith on the part of the contracting authority; or (4) was caused by the act of interference of the other contracting party. *Phoenix Contractors v General Motors Corporation*, 135 Mich App 787, 792; 355 NW2d 673 (1984).