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# Contractual Agreements to Aribtrate Disputes: Whose Intent Controls - Skewes v. Shearson Lehman Bros.

Eric M. Landoll

# CONTRACTUAL AGREEMENTS TO ARBITRATE DISPUTES: WHOSE INTENT CONTROLS?

*Skewes v. Shearson Lehman Bros.*[1]

## I. INTRODUCTION

With the enactment of the Federal Arbitration Act [hereinafter F.A.A.][2] in 1925, Congress attempted to place arbitration agreements "upon the same footing as other contracts."[3] This Act, later described as a "liberal federal policy favoring arbitration,"[4] creates a presumption in favor of arbitration where ambiguities arise as to the scope of an agreement.[5] Under this interpretation, it appears that the intent of the parties can be overlooked in favor of the federal policy favoring arbitration. This is contrary to general principles of contract interpretation and would appear to be a trap for those unfamiliar with this area of the law.

## II. FACTS AND HOLDING

The dispute in *Skewes* arose out of an employer/employee relationship in which the plaintiff, Blaine Skewes, was a stockbroker for the defendant, Shearson Lehman. Shortly after beginning employment with Shearson Lehman, Skewes and a Shearson agent executed a "Form U-4."[6] The Form U-4 referred certain disputes to arbitration in conformity with the rules of the organizations with which Skewes was registered.[7] In the Form U-4, Skewes indicated that he was to be registered with the National Association of Securities Dealers (NASD).[8] The NASD Code of Arbitration procedures referred any claim, dispute, or controversy

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1. 829 P.2d 874 (Kan. 1992).
2. 9 U.S.C. §§ 1-15 (1988 & Supp. II 1990).
3. H.R. REP. NO. 96, 86th Cong., 1st Sess. 2 (1924).
4. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1982).
5. *Id.* at 24-25.
6. *Skewes*, 829 P.2d at 875. The Uniform Application for Securities Industry Registration form, or Form U-4, is widely used among securities dealers.
7. *Id.* The Form U-4 provided: "I agree to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any other person, that is required to be arbitrated under the rules, constitutions, or by-laws of the organizations with which I register, as indicated in Question 8." *Id.*
8. *Id.*

arising out of or in connection with the business of any member of the Association to arbitration at the instance of any member.[9]

Upon termination of employment by Shearson, Skewes filed suit alleging that Shearson: "(1) breached the employment contract; (2) wrongfully refused to allow his pension rights to vest and to pay him under the pension plan; and (3) discharged him in retaliation for filing a wage claim with the Kansas Department of Human Services."[10] In response, Shearson filed a motion to compel arbitration;[11] Shearson claimed that the action arose out of the employment relationship and that Skewes had agreed in the Form U-4 to arbitrate all such disputes.[12] Shearson further alleged that the Federal Arbitration Act[13] preempts the conflicting Kansas statute, Kansas Statute Annotated (K.S.A.) Section 5-401,[14] which explicitly invalidates arbitration clauses in employment contracts and agreements requiring arbitration of tort claims.[15]

In response, Skewes admitted that his employment involved interstate commerce and that the F.A.A. mandated that the breach of employment and pension rights claims were subject to the arbitration agreement.[16] However,

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9. *Id.* at 875-76. Section 8(a) of the NASD Code of Arbitration Procedures provides:

> Any dispute, claim or controversy eligible for submission under Part I of this Code between or among members and/or associated persons, and/or certain others, arising in connection with the business of such member(s) or in connection with the activities of such associated person(s), shall be arbitrated under this Code, at the instance of: (1) a member against another member; [and] (2) a member against a person associated with a member or person associated with a member against a member . . . .

Section 1, Part I of the NASD Code states:

> This Code of Arbitration Procedure is prescribed and adopted pursuant to Article VII, Section 1(a)(3) of the By-Laws of the National Association of Securities Dealers, Inc. (The "Association") for the arbitration of any dispute, claim or controversy arising out of or in connection with the business of any member of the Association, with the exception of disputes involving the insurance business of any member which is also an insurance company: (1) between or among members; [and] (2) between or among members and public customers, or others.

*Skewes*, 829 P.2d at 876.

10. *Id.* at 875.

11. *Id.* at 876.

12. *Id.*

13. *See supra* note 2. The Federal Arbitration Act provides that:

> [W]ritten provision in any maritime transaction . . . involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be 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 (1988).

14. *Skewes*, 829 P.2d at 876.

15. *Id.* K.S.A. § 5-401(c) provides: "The provisions of subsection (b) shall not apply to: . . . (3) any provision of a contract providing for arbitration of a claim in tort." KAN. STAT. ANN. § 5-401(c) (1991).

16. *Skewes*, 829 P.2d at 876.

Skewes contended that the retaliatory discharge action sounded in tort and was therefore exempted from arbitration by K.S.A. Section 5-401.[17] Skewes further asserted that Kansas courts have held that the F.A.A. does not preempt the Kansas arbitration statute.[18]

The trial court granted the motion to compel arbitration with respect to both the breach of employment contract and pension rights actions, but denied the motion with respect to the retaliatory discharge action.[19] The trial court reasoned that the retaliatory discharge claim was in no way related to the business of selling securities, and thus, it was not within the scope of the arbitration agreement.[20] It further held that "federal law does not preclude a retaliatory discharge state court action because the agreement [to arbitrate] between Shearson and Skewes [was] not intrinsically related to the tort."[21]

On appeal, the Kansas Court of Appeals reversed the trial court with respect to the retaliatory discharge issue and remanded the action.[22] The Court of Appeals first held that the F.A.A. preempted the Kansas law restricting arbitration agreements with respect to tort claims.[23] Then, the court found that the retaliatory discharge action arose out of or in connection with Shearson's business and was therefore within the scope of the arbitration agreement.[24]

On appeal to the Kansas Supreme Court, Skewes argued for the first time that the arbitration agreement was a part of the employment contract between Shearson and him.[25] As such, he claimed that the arbitration agreement was exempt from the F.A.A., which specifically excludes employment contracts involving interstate commerce from mandatory arbitration agreements.[26] Skewes additionally contended that the NASD arbitration agreement was ambiguous in that persons signing the Form U-4 would believe it to relate only to disputes involving securities.[27] Finally, Skewes argued that compulsory arbitration should be allowed in labor disputes only when explicitly stated.[28]

In analyzing the issues, the Kansas Supreme Court first found that the arbitration agreement was in fact an agreement with the securities exchange, not with the employer; it was therefore not an employment contract subject to F.A.A. exclusion.[29] The court then rejected the narrow interpretation advanced by

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17. *Id.*
18. *Id.*
19. *Id.*
20. *Id.*
21. *Id.*
22. *Id.*
23. *Id.*
24. *Id.*
25. *Id.* at 877.
26. *Id.* The F.A.A. contains the following exception: "[B]ut nothing herein contained shall apply to contracts of . . . workers engaged in foreign or interstate commerce." 9 U.S.C. § 1 (1988).
27. *Skewes*, 829 P.2d at 879-80.
28. *Id.* at 880.
29. *Id.* at 877.

Skewes regarding the scope of arbitration and found that the Congressional intent was to foreclose state legislative attempts to limit the enforceability of arbitration agreements.[30] As such, the Kansas Supreme Court found that where the scope of arbitrable issues is unclear, it should be resolved in favor of arbitration.[31]

## III. LEGAL BACKGROUND

Depending on (1) the underlying relationship between parties to arbitration agreements, and (2) the forum in which the dispute concerning the arbitration is litigated, arbitration may be subject to three levels of authority — federal, state, and the individual party agreements contained in the arbitration contract. Individual party agreements are analyzed similarly to any other contract and can alter, to some degree, the overriding state and federal policy objectives. State law concerning arbitration is, in a majority of states, based upon some variation of the Uniform Laws of Arbitration.[32] At the federal level, the Federal Arbitration Act sets forth a liberal policy aimed at the promulgation of arbitration proceedings.[33] For a full understanding of how the federal and state policies interact and how they ultimately affect the interpretation of the particular arbitration agreement, some historical framework is essential.

### *A. Federal Law*

At the federal level, the primary body of law relating to arbitration agreements is contained in the Federal Arbitration Act.[34] Section 1 of the F.A.A. defines commerce[35] and maritime transactions[36] so as to fall within the scope

30. *Id.* at 878.

31. *Id.* at 882.

32. *See infra* note 44.

33. *See Moses Cone*, 460 U.S. at 24. In *Moses Cone*, the Supreme Court announced that the Federal Arbitration Act establishes "that, as a matter of Federal Law, any doubts concerning the scope of arbitration issues should be resolved in favor of arbitration . . . ." *Id. See also* Perry v. Thomas, 482 U.S. 483, 489 (1986).

34. *See supra* note 2.

35. The F.A.A. defines "commerce" as:

> [C]ommerce among the several states or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation . . . .

9 U.S.C. § 1 (1988).

36. Maritime transactions are defined as "charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction . . . ." *Id.*

of the F.A.A. This section further provides an exemption for contracts of employment.[37]

Section 2 of the F.A.A. provides that written provisions within the scope of Section 1 shall be valid, except upon "grounds as exist at law or in equity for the revocation of any contract."[38] The proper application of Section 2 has been the subject of much controversy.[39] Some believe that the intent of the drafters was for this section to be procedural and applicable only at the federal level.[40] This intent, however, has been ignored in light of the current belief that the federal arbitration statutes are substantive, rather than procedural, in nature.[41] Furthermore, the scope of Section 2 has been judicially expanded to include contracts dealing with interstate commerce or maritime transactions in either the federal or state courts.[42] Although the scope of Section 2 of the F.A.A. has been judicially interpreted to apply to both state and federal proceedings, Sections 3 and 4, which concern the staying of court proceedings for actions referable to arbitration and motions to compel arbitration, appear to apply only to federal courts.[43]

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37. *Id.* Specifically exempted from coverage are "contracts of employment of . . . any . . . class of workers engaged in foreign or interstate commerce." *Id.*

38. 9 U.S.C. § 2 (1988).

39. *See* Southland Corp. v. Keating, 465 U.S. 1, 10-12, 25-29 (1983) (O'Connor, J., dissenting).

40. *Id.* at 17 (Stevens, J., concurring in part and dissenting in part), 23 (O'Connor, J., dissenting).

41. Perry v. Thomas, 482 U.S. 483, 489 (1987).

42. *Id.*

43. *Southland*, 465 U.S. at 16 n.10. However, the state courts seem to have recognized that the stay provision of § 3 applies to state as well as federal courts. *See Moses Cone*, 460 U.S. at 26 n.34.

### B. State Law

Since the enactment of the Uniform Arbitration Act in 1955, a majority of states have adopted some version of its basic provisions.[44] Section 1 of the U.A.A. corresponds to F.A.A. Section 2 by providing for validity of arbitration agreements.[45] This section, like its F.A.A. counterpart, provides that arbitration agreements are only revocable upon "grounds as exist at law or in equity for the revocation of any contract."[46]

Kansas adopted a version of the U.A.A. in 1973.[47] K.S.A. Section 5-401 corresponds to Section 1 of the U.A.A. and Section 2 of the F.A.A. concerning the validity of arbitration agreements.[48] Subsections (a) and (b) provide that all

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44. Thirty-five jurisdictions have adopted arbitration statutes patterned after the Uniform Arbitration Act. *See* ALASKA STAT. §§ 09.43.010-.180 (1983); ARIZ. REV. STAT. ANN. §§ 12-1501 to -1518 (1982); ARK. CODE ANN. §§ 16-108-201 to -224 (Michie 1987); COLO. REV. STAT. §§ 13-22-201 to -223 (1987); DEL. CODE ANN. tit. 10, §§ 5701-5725 (1975); D.C. CODE ANN. §§ 16-4301 to -4314 (1989); FLA. STAT. ANN. §§ 682.01-.20 (West Supp. 1989); IDAHO CODE §§ 7-901 to -922 (1979); ILL. REV. STAT. ch. 10 para. 101-23 (1987); IND. CODE §§ 34-4-2-1 to -22 (1986); IOWA CODE ANN. §§ 679A.1-.14 (West 1987); KAN. STAT. ANN. §§ 5-401 to -422 (1982); KY. REV. STAT. ANN. §§ 417.045-.230 (Michie/Bobbs-Merrill Supp. 1988); ME. REV. STAT. ANN. tit. 14, §§ 5927-5949 (1980); MD. CTS. & JUD. PROC. CODE ANN. §§ 3-201 to -234 (1984); MASS. GEN. LAWS ANN. ch. 251, §§ 1-19 (West 1988); MICH. STAT. ANN. §§ 600.5001-5305 (Callaghan 1988); MINN. STAT. ANN. §§ 572.08-.30 (West 1988); MO. ANN. STAT. §§ 435.350-.470 (Vernon Supp. 1989); MONT. CODE ANN. §§ 27-5-111 to -324 (1989); NEB. REV. STAT. §§ 25-2601 to -2622 (Supp. 1988); NEV. REV. STAT. ANN. §§ 38.015-.205 (Michie 1987); N.M. STAT. ANN. §§ 44-7-1 to -22 (Michie 1978); N.C. GEN. STAT. §§ 1-567.1-.20 (1983); N.D. CENT. CODE §§ 32-29.2-01 to -20 (Supp. 1989); OKLA. STAT. ANN. tit. 15, §§ 801-818 (West Supp. 1989); PA. CONS. STAT. ANN. §§ 7301-7320 (Purdon 1982); S.C. CODE ANN. §§ 15-48-10 to -240 (Law. Co-op. Supp. 1988); S.D. CODIFIED LAWS ANN. §§ 21-25A-1 to -38 (1987); TENN. CODE ANN. §§ 29-5-301 to -320 (Supp. 1988); TEX. REV. CIV. STAT. ANN. arts. 224 to 238-6 (Vernon Supp. 1989); UTAH CODE ANN. §§ 78-31a-1 to -18 (1987); VT. STAT. ANN. tit. 12, §§ 5651-5681 (Supp. 1989); VA. CODE ANN. §§ 8.01-581.01-.016 (Michie Supp. 1989); WYO. STAT. §§ 1-36-101 to -119 (1988). *See* Steven R. Leppard, Note, *Arbitration? Sure, But Only on Our Terms: Escape Clauses in Uninsured Motorist Policies*, 1993 J. DISP. RESOL. 193, 198 n.52.

45. UNIF. ARB. ACT § 1, 7 U.L.A. 4 (1978) provides:

> A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract. This act also applies to arbitration agreements between employers and employees or between their respective representatives unless otherwise provided in the agreement.

46. *Id.*

47. KAN. STAT. ANN. § 5-401 to -422 (1991).

48. K.S.A. § 5-401 provides:

> (a) A written agreement to submit any existing controversy to arbitration is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract.
>
> (b) Except as provided in subsection (c), a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable except upon such grounds as exist at law or in equity for the revocation of any contract.

written agreements to submit present or future disputes to arbitration are valid and enforceable "except upon grounds as exist at law or equity for the revocation of any contract."[49] Subsection (c) excepts from the above subsections: (1) contracts for insurance; (2) contracts between an employer and employees; and (3) provisions of contracts providing for arbitration of a claim in tort.[50]

## IV. THE INSTANT DECISION

### *A. The Majority*

The Kansas Supreme Court was faced with two issues in the instant case: (1) whether Section 1 of the F.A.A. preempts K.S.A. Section 5-401, which prohibits the arbitration of tort claims; and (2) whether Skewes' retaliatory discharge action arose out of or in connection with his employer's business, thus becoming subject to arbitration as required in the Form U-4.[51]

In addressing the preemption issue, Justice Six, writing for the majority, first noted that pursuant to past decisions, the arbitration agreement referenced in the Form U-4 was not an employment contract.[52] The court reasoned that the agreement to arbitrate was actually between the NASD and the plaintiff and was thus not exempted from Section 1 of the F.A.A.[53] The court next recognized the Supreme Court decisions holding that Section 2 of the F.A.A. creates a "body of federal substantive law . . . applicable in both federal and state courts."[54] States may not place additional limitations on these federal mandates.[55] As a result, the court acknowledged that the F.A.A. requires state courts to enforce arbitration agreements that are legitimate under the F.A.A. provisions, but that may be contrary to state policy.[56] This reasoning led the court to conclude that the provision of K.S.A. Section 5-401, prohibiting the arbitration of tort claims, was preempted by the F.A.A. and was ineffectual under the facts of the case.[57]

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> (c) The provisions of subsection (b) shall not apply to: (1) Contracts of insurance; (2) contracts between an employer and employees, or their respective representatives; or (3) any provision of a contract providing for arbitration of a claim in tort.

KAN. STAT. ANN. § 5-401 (1991).

49. *Id.*
50. *Id.*
51. *Skewes*, 829 P.2d at 875.
52. *Id.* at 877 (citing Gilmer v. Interstate/Johnson Lane, 111 S. Ct. 1647 (1991)).
53. *Id.*
54. *Id.* at 878 (quoting Southland Corp. v. Keating, 465 U.S. 1, 12 (1984) (citing Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983))).
55. *Skewes*, 829 P.2d at 878.
56. *Id.* at 879.
57. *Id.*

The court next addressed the scope of employment issue.[58] The plaintiff contended that the "arising out of or in connection with the business of any member" language was ambiguous in that persons signing the agreement would understand it to require arbitration only of disputes involving securities.[59] The court rejected this narrow interpretation of the arbitration agreement.[60] In its analysis, the court relied upon *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*[61] in finding that under the F.A.A., any doubts concerning the scope of an arbitration agreement should be resolved in favor of arbitration.[62] Viewing the issue from this perspective, the court noted that the context of the cause of action involved significant aspects of the employer's business activities.[63] Due to this business activity connection, the court stayed Skewes' action and held that submission to arbitration was proper.[64]

### *B. The Dissent*

Justices Lockett and Allegrucci dissented from the majority decision.[65] The dissent first stated that whenever possible, it was the court's duty "to uphold the public policy of the State."[66] The dissent then found that the clear intent of the Kansas Legislature was that parties could not contract to arbitrate claims in tort.[67]

The dissent relied on the reasoning of a recent Alabama Supreme Court decision[68] to highlight the contractual nature of the arbitration agreement.[69] As such, the dissent advocated an analysis that attempted to determine the true intent of the parties. This test emphasized two tasks the court should attempt to resolve: (1) ascertain whether the parties intended the particular dispute to be arbitrated as evidenced by the language contained in the agreement; and (2) when ambiguity appears in the contract, maintain a "healthy regard" for the federal policy favoring arbitration and find in favor of arbitration when doubts exist as to the proper scope of the agreement.[70] This test, the dissent believed, placed reasonable limits on

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58. *Id.*
59. *Id.* at 879-80.
60. *Id.* at 880.
61. 460 U.S. 1, 24-25 (1983).
62. *Skewes*, 829 P.2d at 881.
63. *Id.* at 880. The court noted Shearson's contention that the discharge from employment was a result of unsatisfactory sales performance by the plaintiff. Skewes, on the other hand, contended that the discharge was in retaliation for the earlier filing of a wage claim. The court evidently found the source of the disagreement irrelevant in light of the liberal federal policy in favor of resolving doubts in favor of arbitration.
64. *Id.* at 882.
65. *Id.* at 883-84 (Lockett, J., and Allegrucci, J., dissenting).
66. *Id.* at 883.
67. *Id.*
68. A.G. Edwards & Sons, Inc. v. Clark, 558 So. 2d 358 (Ala. 1990).
69. *Skewes*, 829 P.2d at 883.
70. *Id.* at 884.

the liberal policy in favor of arbitration by excluding matters that "clearly fall outside the scope of the contract or agreement."[71]

## V. COMMENT

The crux of this case revolves around the intent of the parties analyzed in light of what the judge deemed to be the controlling statutory policies. It is apparent that the majority believed that the F.A.A.'s policy toward liberal interpretation of arbitration agreements is controlling,[72] while the dissent felt that the Kansas statutes prohibiting the arbitration of tort actions control.[73] What is less apparent is that the court seems to place less emphasis upon the true intent of the parties once the contract is found to be ambiguous.

In the case at hand, the provision "arising out of business" found in the Form U-4 creates the "ambiguity" which the federal policy capitalizes upon by finding in favor of arbitration.[74] The dissent, however, while finding ambiguity and recognizing the federal policy favoring arbitration, further found that under the particular facts at issue (arbitration of a tort dispute), the state policy should counteract the federal policy and allow resolution within the courts.[75]

What appears odd in this analysis is the apparent predisposition of both the majority and the dissent to find ambiguity in the language of the Form U-4. Both opinions then followed the policy, state or federal, which it believed controlled without resorting to extrinsic evidence.[76] It seems that this analysis fails to give due consideration to the most important element of any contract — party intent. By resorting to overriding policy objectives rather than extrinsic evidence that might clarify ambiguities within the document, the court fails to effectuate the true intent of the parties.

Under accepted contract interpretation principles, clear, unambiguous contracts are not to be made ambiguous by the introduction of extrinsic evidence.[77] However, once ambiguity appears either on the face of the contract or in its application, extrinsic evidence may be introduced to ascertain the true intent.[78] In the case at hand, it appears that no one seriously disputes the fact that ambiguity exists. This is evidenced by both the majority and dissenting

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71. *Id.*

72. *Id.* at 875.

73. *Id.* at 883.

74. *Id.* at 879-80.

75. *Id.* at 884.

76. While Skewes alleged that the parties entering into the contract would never have intended or believed that a retaliatory discharge action would fall within the parameters of this agreement, the majority rejected this in light of the federal policy advocating arbitration. *Id.* at 880, 882.

77. 17A AM. JUR. 2D *Contracts* § 337 (1991).

78. *Id.* § 197.

opinions going beyond the face of the document and resorting to external policies in their analysis of the contract.[79]

It is also a well-settled doctrine that parties are allowed to contract with regard to future events so long as the contract provisions do not violate public policy.[80] In this case, the court found no provision of the contract or intent of the parties which violated public policy. Had they found such a provision or intent, such provisions could be held void.[81] Once a provision of the contract is found void as against public policy, it would *then* seem logical to resort to federal and/or state policy to salvage the agreement. However, this court forgoes the analysis of party intent in order to explore what it believes are more pressing concerns — federal or state policy. This, in effect, ignores the basic contract interpretation principles discussed above and gives effect to policies which were not likely contemplated by the individual parties.

In order to find the true intent of the agreement, it seems that the better policy would be to resort to extrinsic evidence upon finding ambiguity within the contract. If extrinsic evidence still fails to reveal a clear intent, or the intent found runs contrary to public policy, then the courts should concern themselves with these general state or federal policies. To do otherwise would require parties to clearly provide for every conceivable contingency on the face of the document or be subject to policies which may or may not be in their best interests. This is not required in normal contract interpretation.[82]

## VI. CONCLUSION

By allowing individuals to contract with respect to future arbitration, the legislature has given them a margin of control over how future disputes will be resolved. This ability to alter the normal course of dispute resolution is based upon the intent of the parties to the agreement. This intent should not be overlooked merely because it is not clearly expressed on the face of the contract. Instead, long standing principles of contract interpretation should be applied in an effort to ascertain the true intent of the agreement.

ERIC M. LANDOLL

79. *Skewes*, 829 P.2d at 878, 884.
80. 17A AM. JUR. 2D *Contracts* § 257 (1991).
81. *Id.* § 195.
82. *Id.* § 197.