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NOTES

Day’s Pyramid Ignores Sturdy Severability Foundation, Builds Off Granite Rock

Day v. Fortune Hi-Tech Marketing, Inc.¹

I. INTRODUCTION

An exposed pyramid scheme will eventually topple over if it is lacking a financial or proper business foundation. Persons involved in a pyramid scheme are often blind to the overarching pyramid’s purpose; similarly, contracting parties may possess little initial knowledge of an agreement’s terms in their entirety. Arbitration agreements and other contractual obligations can be hidden in the depths of multiple documents, memorialized through simultaneous agreements incorporating the additional terms by various references. After Day, courts may now be required to dig through countless terms to parties’ agreements to determine if a valid contract exists, and if so, which agreement governs the dispute at issue. After sifting through this contractual jungle, courts will be forced to take one of two actions: refuse to uphold the entire agreement for a contractual deficiency, rendering the arbitration clause useless, or sever the unenforceable provisions and compel the remaining terms to arbitration.

II. FACTS & HOLDING

Former independent sales representatives² of a marketing company sought to pursue their class action claims against Defendant Fortune Hi-Tech Marketing, Inc. (FHTM) for allegedly running an illegal pyramid scheme.³ Plaintiffs⁴ were formerly engaged in marketing the services of other companies⁵ to consumers on behalf of FHTM as independent representatives (IRs or IR).⁶ As a term of work-

¹ Day v. Fortune Hi-Tech Mktg., Inc. 536 F. App’x 600, 601 (6th Cir. 2013).
² Independent sales representatives were specifically not referred to as employees but instead were defined as individuals affiliated with FHTM, and were allowed to create and manage their own sales force, composed of other independent-representatives. In essence, each IR would build its sales force by recruiting other IRs, and attempt to market the third party marketing sales FHTM offered. This type of business strategy is also commonly referred to as a “multilevel marketing compensation plan.” Id. at 601.
³ Id.
⁵ These various companies and services included: Dish Network, Frontpoint Home Security, various cell phone providers, and marketers who sold FHTM’s line of health and beauty products.
⁶ Day, 536 F. App’x at 601.
ing as an IR for FHTM, Plaintiffs were obligated to pay an up-front $299 enrollment fee,\(^7\) and fill out an “Application and Agreement” acknowledging they had read the FHTM “Policies and Procedures.”\(^8\)

The complaint alleged that FHTM had promised substantial amounts of income could be earned as commission for selling FHTM’s services.\(^9\) In addition to charging initial enrollment fees, IRs paid annual fees in order to qualify for commissions and bonuses.\(^10\) It soon became clear that it was more lucrative for the IRs to recruit more IRs and collect their enrollment fees than it was to solicit sales from consumers.\(^11\) In its own separate complaint against FHTM, the Federal Trade Commission determined that the majority of FHTM’s IRs actually lost more money than they earned.\(^12\)

The Application and Agreement document purported to incorporate FHTM’s Policies and Procedures by referencing the terms in the Application and Agreement that each IR was required to filled out.\(^13\) The IR Application and Agreement incorporated FHTM’s Policies and Procedures and required that any claim brought under the agreement be submitted to arbitration.\(^14\) Section 8.4 of FHTM’s Policies and Procedures provided that the agreement to arbitrate would survive any termination of the entire agreement and provided that FHTM could modify the agreement at any time, effective after notice was given.\(^15\) Relying on these provisions, FHTM moved to compel Plaintiffs’ class action claims to arbitration.\(^16\)

The district court initially granted FHTM’s motion to compel arbitration, but later rescinded the order and opinion after Plaintiffs moved the court to reconsider its decision in light of the United States Supreme Court’s decision in Granite Rock Co. v. Int’l Broth. Of Teamsters.\(^17\)

In _Day_, the Sixth Circuit noted that _Granite Rock_ clarified which disputes are for the court, and which are for the arbitrator.\(^18\) In so doing, the Sixth Circuit found that a court should only compel a dispute to arbitration if the “court is satisfied that neither the formation of the parties’ arbitration agreement nor its enforceability or applicability to the dispute is at issue.”\(^19\) If a party wishes to contest either issue, the court, not an arbitrator, must resolve the disagreement.\(^20\) In the district court, Plaintiffs argued that FHTM’s ability under the contract to unilaterally amend any part of the Policies and Procedures at any time constituted an illu-

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7. The court did not define what the enrollment fee entailed, but the complaint states FHTM’s Policies and Procedures provides that the $299 fee is for the purchase of an “Optional Special Services Program.” Complaint at 54, _Day_ v. _Fortune Hi-Tech Mktg., Inc._, 536 F. App’x 600 (6th Cir. 2013) (No. 5:10CV00305).
8. _Day_, 536, F. App’x at 601.
9. _Id_. at 602.
11. _Day_, 526 F. App’x at 602.
13. _Day_, 536 F. App’x at 601.
14. _Id_. at 601-02.
15. _Id_. at 602.
16. _Id_. at 601.
17. _Granite Rock Co. v. Int’l Broth. Of Teamsters_, 561 U.S. 287 (2010) (holding that when an arbitration agreement encompasses the dispute at issue and is validly formed, it is legally enforceable absent a provision to the contrary).
18. _Day_, 536 F. App’x at 602.
20. _Id_. at 299-300.
sory promise. The plaintiffs claimed that because the contract was illusory, the arbitration agreement referenced in the Application and Agreement lacked adequate consideration to form a contract, and was therefore unenforceable. The district court agreed with Plaintiffs and denied FHTM’s motion to compel arbitration. FHTM appealed this decision, and the United States Court of Appeals for the Sixth Circuit affirmed on the same basis.

In Day, the Sixth Circuit decided that the ability of one party to unilaterally modify any term of the agreement at any time constituted an illusory promise, and instead of striking the unenforceable provision and upholding the remainder of the agreement, the court held that the entire agreement including the arbitration clause was unenforceable for lack of consideration.

III. LEGAL BACKGROUND

The analysis in the instant decision is built on three separate foundational principles. The first is the framework expressed by the United States Supreme Court in Granite Rock, which determines the proper scope to be used when a court reviews a dispute after one party attacks the formation element of an arbitration agreement. The second examines how parties’ intent to arbitrate is frustrated by the doctrine of incorporation by reference. The last discusses the doctrine of severability and specifically demonstrates how some courts in deciding whether parties have agreed to arbitrate will sever non-arbitrable claims and compel the remainder of the agreement to arbitrate.

A. Granite Rock – Formation Element Opens Doors to Courts, Not Arbitrators

Courts have long interpreted the Federal Arbitration Act (FAA) to require arbitration clauses to be placed “upon the same footing as other contracts.” This statutory directive commands courts to enforce arbitration provisions in most cases. As Granite Rock clarified, the presumption of arbitrability only applies when a validly formed, legally enforceable, arbitration agreement exists, and no provision expressly reserves the question of arbitrability to an arbitrator.

Prior to Granite Rock, lower courts had followed the United States Supreme Court’s precedent, compelling arbitration unless a party to a contract challenged the validity of the arbitration clause itself, not the enforceability of the agreement.

22. Id.
23. Id.
24. Id. at 600, 603.
25. Id. at 604.
27. DeRosa v. Walsh, 541 F. App’x 250, 253 (4th Cir. 2013).
29. Id.
as a whole. The courts interpreting the issue had held that dispute of an entire contract’s validity was to be heard by an arbitrator, not the court.

Prima Paint v. Flood & Conklin Mfg. Co. originally addressed the issue of whether a claim of fraud in the inducement of a contract was to be heard by a court or arbitrator. The disputed arbitration clause provided “any controversy or claim arising out of or relating to [the] Agreement” was to be settled by arbitration. Prima Paint sought to escape this arbitration clause by claiming that the defendant Flood & Conklin (F & C) fraudulently misrepresented its solvency, and could no longer fulfill its contractual obligation, as F & C had filed for bankruptcy. Compelling the parties to arbitration, the Supreme Court held that a federal court could only decide issues “relating to the making and performance of the agreement to arbitrate”; therefore, Prima Paint’s challenge of fraud in the inducement of the contract as a whole and not to the agreement to arbitrate specifically was reserved for an arbitrator, not the courts, to decide.

Continuing to follow Prima Paint, the Supreme Court again addressed the issue of arbitrability in Buckeye Check Cashing, Inc. v. Cardegna, upholding the “relating to the making and performance” standard, applying it to an arbitration clause that was allegedly void for illegality. In Buckeye, borrowers brought a class action against a lender in Florida state court, alleging that the lender made usurious loans violating several state statutes. After the defendant lender sought to compel the class action to arbitrate, the Supreme Court of Florida held that arbitration could not be compelled when the contract is allegedly illegal on its face. The court reasoned that compelling arbitration would violate public policy and contract law.

Despite the Florida Supreme Court’s determination, the United States Supreme Court held “as a matter of substantive federal arbitration law, an arbitration provision is severable from the remainder of the contract.” The Court also held that unless the challenge is aimed at the arbitration clause specifically, and not the illegality of the agreement as a whole, “the issue of the contract’s validity is to be considered by the arbitrator in the first instance.” The plaintiff’s allegations attacked the contract’s validity based on the usurious interest rates, and not the arbitration clause specifically; therefore, the dispute was for an arbitrator to decide. Essentially, the Court refused to sever the illegal portions of the contract which would have rendered the entire agreement unenforceable, and instead determined that the arbitration clause was enforceable apart from the remaining illegal portion of the contract.

33. Id. at 446.
34. Prima Paint, 388 U.S. at 402.
35. Id. at 398.
36. Id.
37. Id. at 404.
39. Id. at 442.
40. Id.
41. Id.
42. Id. at 445.
43. Id. at 445-46.
Granite Rock Co. v. Int’l Broth. Of Teamsters created a new approach when parties had valid agreements to arbitrate under the Buckeye doctrine.\textsuperscript{46} In Granite Rock, an employer sued unions for allegedly violating a no-strike\textsuperscript{47} clause in a collective bargaining agreement (CBA).\textsuperscript{48} The parties had been in the process of negotiating an agreement, a component of which was the no-strike clause at issue.\textsuperscript{49} Because the parties had not yet finalized all the terms of the CBA, the issue was whether preliminary negotiations can give rise to binding arbitration agreements.\textsuperscript{50}

The unions sought to compel arbitration under the agreement, but employer Granite Rock disputed the formation of the CBA.\textsuperscript{51} The United States Supreme Court held that when a dispute over an agreement’s ratification is at stake, it is categorized as a formation dispute: “for purposes of determining arbitrability, \textit{when} a contract is formed can be as critical as whether it was formed.”\textsuperscript{52} The formation date question required judicial resolution because it required the district court to resolve the disputed CBA ratification date in determining whether the parties actually agreed to arbitrate their claims.\textsuperscript{53} In Granite Rock, the Court held that when a party contests either the formation of an arbitration agreement, its enforceability, or its applicability to the dispute, and no valid provision specifically directs such disputes to an arbitrator, the \textit{court} must resolve the disagreement over whether the dispute should go to an arbitrator or not.\textsuperscript{54}

This rule changed the way courts analyze agreements to arbitrate based on the principle of prior arbitration decisions that “[a]rbitration is strictly a matter of consent.”\textsuperscript{55} Under this principle, because employer Granite Rock challenged the ratification date of the agreement, the formation dispute was to first be heard by a district court rather than an arbitrator.\textsuperscript{56}

One recent case from the Eleventh Circuit sought to synthesize Granite Rock, Prima Paint and Buckeye.\textsuperscript{57} Explaining that Granite Rock’s ruling directing courts to inquire whether a contract was formed essentially “precedes \textit{Prima Paint’s} bright-line rule, but does not erase it,” the Eleventh Circuit articulated a two-step process.\textsuperscript{58} First, a court must resolve any challenge to the formation of the contract containing the arbitration clause.\textsuperscript{59} Second, it must determine whether

\begin{itemize}
  \item \textsuperscript{46} Granite Rock Co. v. Int’l Broth. Of Teamsters, 561 U.S. 287 (2010).
  \item \textsuperscript{47} A no-strike clause is a provision in a collective bargaining contract in which the union promises that during the life of the contract the employees will not engage in strikes, slowdowns, or other job actions. \textit{No Strike Definition}, U.S. LEGAL.COM, http://definitions.uslegal.com/n/no-strike-clause (last visited Jan. 3, 2015).
  \item \textsuperscript{48} Granite Rock, 561 U.S. at 287.
  \item \textsuperscript{49} Id.
  \item \textsuperscript{50} Id.
  \item \textsuperscript{51} Id.
  \item \textsuperscript{52} Id. at 289 (emphasis in original).
  \item \textsuperscript{53} Id. at 289.
  \item \textsuperscript{54} Granite Rock, 561 U.S. at 288.
  \item \textsuperscript{55} Id. at 299.
  \item \textsuperscript{56} Id. at 297.
  \item \textsuperscript{57} Solymar Inv., Ltd. v. Banco Santander S.A., 672 F.3d 981, 990 (11th Cir. 2012).
  \item \textsuperscript{58} Eleventh Circuit’s test: “1) Resolution of any formation challenged to the contract containing the arbitration clause, in keeping with \textit{Granite Rock}; and 2) determination of whether any subsequent challenges are to the entire agreement, or to the arbitration clause specifically, in keeping with \textit{Prima Paint}.” Solymar Inv., Ltd., 672 F.3d at 990.
  \item \textsuperscript{59} Solymar Inv., Ltd., 672 F.3d at 990.
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“any challenges exist as to the entire agreement, or to the arbitration clause specifically.”

B. Incorporation by Reference, Multiple Documents Blur Parties’ Intent to Arbitrate

The inquiry into the formation element of parties’ agreements to arbitrate may force courts to analyze a multitude of documents to determine whether a valid agreement exists between parties. Prior to Granite Rock, one scholar lamented that, “courts continue to enforce arbitration agreements where the contract at issue does not contain an arbitration clause,” but instead merely refers to a contract containing an arbitration agreement.61

A recent Sixth Circuit case addressed the issue of party intent in this context and noted that arbitrability can quickly become complex when a court is obliged to examine multiple documents to determine the intent.62 In Dental Associates, P.C. v. American Dental Partners of Michigan, LLC,63 a group of dentists incorporated a business under the name Dental Associates P.C. (Dental).64 Dental brought various claims against their administrator services provider: breach of fiduciary duty, breach of contract, and other contractual claims.65 Dental executed several agreements with American Dental Partners of Michigan LLC (ADPM), a wholly owned subsidiary of American Dental Partners, Inc. (ADPI, collectively, ADP).66

The agreements consisted of an Asset Purchase Agreement and a Service Agreement.67 Under the Asset Purchase Agreement, defendant ADP purchased a large portion of the assets used in the operations of Dental’s profession.68 The Service Agreement provided administrative services to Dental and required Dental to enter into Employment Agreements with ADP.69 ADP sought to compel Dental to arbitrate the claims, but no arbitration clause existed in the parties’ Service Agreement itself.70 In support of their motion to compel arbitration, ADP relied on an integration clause contained in the Asset Purchase Agreement and Service Agreement that incorporated all the agreements by reference.71

60. Id.
63. Id. at 350.
64. Id.
65. Id. at 351. Other claims alleged tortious interference with contract, prospective economic advantage, and unjust enrichment. Id at 349.
66. Id. at 350.
67. Dental Assocs., 520 F. App’x at 350.
68. Id.
69. Id.
70. Id.
71. Id. (the following agreements were present: (1) Asset Purchase Agreement through which ADPI obtained a large amount of the assets used in the Associates’ dental practice; and (2) a Service Agreement whereby ADPM agreed to provide administrative and other non-clinical assistance to the Associates; the Associates entered into Employment Agreements with multiple doctors and dentists employed by the Associates, and although not parties to the Employment Agreement, ADPM and ADPI are mentioned as third party beneficiaries to the agreement).
In a case such as Dental Associates where multiple contracts exist between the parties, the Sixth Circuit determined that a court must first examine whether the claim can be maintained without reference to the agreement containing the arbitration clause. If it cannot, then the court must decide which contract primarily governs the claim that is being disputed. Lastly, a dispute is only arbitrable if the arbitration clause in the related contract “is part of the umbrella agreement governing the parties’ overall relationship.”

An “umbrella agreement” is an agreement that creates an ongoing relationship between the parties, and thus encompasses a dispute arising out of a contract later entered into as part of the relationship. Here, the court determined that the Service Agreement was the parties’ “umbrella agreement.” Because the Service Agreement did not itself contain the arbitration clause, but merely purported to integrate the arbitration clauses by reference, the court found that the parties did not intend to arbitrate their claims.

When examining agreements memorialized in multiple documents the Sixth Circuit articulated that a court must look to the nature of the claim being brought, and then determine which document really governs the gist of the parties’ contractual relationship. If the document containing the arbitration clause encompasses the parties’ ongoing business relationship, and it also fits within the scope of the dispute at issue, the claim may be compelled to arbitration.

The Supreme Court of Appeals of West Virginia in State ex rel. U-Haul Co. of West Virginia v. Zakaib, recently considered another example of how the doctrine of incorporation by reference may distort the way in which parties perceive agreements to arbitrate. The parties in Zakaib executed similar documents to those at dispute in Day. In relation to a transaction with defendant U-Haul, plaintiffs executed a “Rental Contract” via pre-printed form. The rental contract that plaintiffs originally signed referenced a Rental Contract Addendum. The Rental Contract stated that the parties agreed to terms found in the addendum, which contained the arbitration clause. Plaintiffs were only provided a copy of the addendum after executing the rental contract. Plaintiffs then filed a class action, claiming they were charged fraudulent fees on rental bills in connection with using defendant U-Haul’s services. U-Haul asserted that per the

72. Dental Assocs., 520 F. App’x at 352.
73. Id.
74. Id. (quoting Nestle Waters N. Am., Inc. v. Bollman, 505 F.3d 498, 506 (6th Cir. 2007)).
75. Id. (citing Panepucci v. Honigman Miller Schwartz & Cohn LLP, 281 F. App’x 482, 488 (6th Cir. 2008)).
76. Id. at 353-54.
77. Id at 351-52.
78. Dental Associates, 520 F. App’x at 352.
80. Id. at 590.
81. Id.
82. Id.
83. Id.
84. U-Haul, 752 S.E.2d at 591.
85. Id. at 590 (the class action alleged breach of contract, false advertising, fraud, and Consumer Credit Protection Act violations).
86. Id.
addendum, plaintiffs were still obliged to pay the fees and sought to compel arbitration.\textsuperscript{87}

Refuting this argument, the Supreme Court of Appeals of West Virginia held that plaintiffs did not violate the doctrine of severability by challenging the arbitration clause contained in the addendum to the rental contracts.\textsuperscript{88} The doctrine of severability allows a court to consider a challenge to an arbitration clause “only if a party . . . explicitly challenges the enforceability of an arbitration clause within the contract, as opposed to generally challenging the contract as a whole.”\textsuperscript{89} Plaintiffs specifically challenged the enforceability of the addendum by showing that the arbitration clause was never provided to them as a part of the transaction.\textsuperscript{90} The addendum was merely referenced in the rental agreement and the court found that the plaintiffs thus lacked “the requisite knowledge of the contents of the Addendum to establish . . . consent to be bound by its terms.”\textsuperscript{91}

A similar dispute over an incorporated arbitration agreement arose in a recent Missouri state court case, where an admissions director alleged that she was wrongfully terminated by a secondary education institution in violation of the Missouri Human Rights Act (MHRA).\textsuperscript{92} In Johnson v. Vatterott Educ. Centers, Inc., plaintiff executed an arbitration agreement, titled “At Will Employment and Binding Arbitration Agreement” (arbitration agreement), which was found in the employer’s handbook.\textsuperscript{93} Although the separate arbitration agreement delegated a wide variety of employment-related disputes to arbitration, the court found the arbitration agreement “plainly constituted part of the employee handbook.”\textsuperscript{94}

The arbitration agreement was executed separately, but stated that it was subject to the general provisions found in the employee handbook.\textsuperscript{95} The court found that the employee handbook merely articulated guidelines “which were unilaterally modifiable at any time by [employer] Vatterott,” and that no one other than the employer’s president had binding authority to contract on behalf of the employer with employees.\textsuperscript{96} Considering these factors, the Missouri Court of Appeals for the Western District held that because the separately executed arbitration agreement constituted part of the “mere guidelines” of the defendant employer’s handbook, the arbitration agreement was “not a contractual offer which became binding on [plaintiff] Johnson’s acceptance of it.”\textsuperscript{97}

The Sixth Circuit has also addressed arbitration clauses that are illusory for lack of consideration. In Floss v. Ryan’s Family Steak Houses, Inc.\textsuperscript{98} the court found the arbitration agreement to be illusory based on an arbitration clause provided in the employment application documents.\textsuperscript{99} The arbitration clause in Floss

\textsuperscript{87} Id. at 591-93.
\textsuperscript{88} Id. at 598.
\textsuperscript{89} U-Haul, 752 S.E.2d at 598, n.15.
\textsuperscript{90} Id.
\textsuperscript{91} Id.
\textsuperscript{93} Id.
\textsuperscript{94} Id. at 739 (weighing factors such as the location of the Arbitration Agreement in the employee handbook, identical headings used in the handbook and the arbitration agreement, and inconsistencies in relation to the guidelines in the employee handbook).
\textsuperscript{95} Id. at 741.
\textsuperscript{96} Id.
\textsuperscript{97} Vatterott, 410 S.W.3d at 742.
\textsuperscript{98} 211 F.3d 306 (6th Cir. 2000).
\textsuperscript{99} Id. at 310.
failed to provide a definite forum for arbitration, and directed all claims to be heard by a third party employment dispute company.\textsuperscript{100} Defendant employer was listed as a third party beneficiary to the employment application and since no definite forum to arbitrate was provided, the court held, "the fact those [terms] could be unilaterally modified at any time rendered such promises illusory."\textsuperscript{101} Further, the court reasoned that "where a promisor retains an unlimited right to decide later the nature or extent of his performance, the promise is too indefinite for legal enforcement."\textsuperscript{102} Because the employer possessed the unfettered discretion in choosing the nature of the arbitration forum, and retained the right to alter the terms without any obligation to notify plaintiffs, the promise was illusory.\textsuperscript{103}

C. Severability: What’s Enforceable and What’s Not?

If a written agreement contains terms, which a court ultimately deems unconscionable, a court may strike those terms from the agreement and enforce the rest.\textsuperscript{104} Contracts for the sale of goods containing terms that materially alter or surprise the other party might allow a court to refrain from incorporating those terms into the agreement.\textsuperscript{105}

Under the United States Supreme Court’s direction on analyzing arbitration agreements, when a party challenges a provision apart from the arbitration clause, or the contract as a whole, a court is still not prevented from enforcing a specific agreement to arbitrate.\textsuperscript{106}

Although the Sixth Circuit has not strictly adhered to this Supreme Court doctrine,\textsuperscript{107} a recent Fourth Circuit case did follow the principle.\textsuperscript{108} In DeRosa v. Walsh, an assignee of patent rights sought to argue that a claim for patent infringement should be severed from an arbitration agreement and allowed to proceed in court.\textsuperscript{109} The court ultimately compelled all claims to arbitration, but noted that if a court anticipates some of the claims in litigation not to be arbitrable, "the court must sever and compel arbitration of all arbitrable claims and reserve jurisdiction for any non-arbitrable claims."\textsuperscript{110} If a court finds some claims arising out of an agreement containing an arbitration provision do not fall within the scope of the arbitration clause, it may enforce the remainder of the agreement and adjudicate the non-arbitrable claims.\textsuperscript{111}

In essence, the formation element of an arbitration agreement remains a tough analysis, turning first on whether intent to arbitrate is found in the actual arbitration agreement, or if it is found somewhere else, in other agreements that charac-

\textsuperscript{100} Id.
\textsuperscript{101} Day v. Fortune Hi-Tech Mkrg., Inc., 536 F. App’x 600, 604 (6th Cir. 2013).
\textsuperscript{102} Floss, 211 F.3d at 316.
\textsuperscript{103} Id.
\textsuperscript{104} RESTATEMENT (SECOND) OF CONTRACTS § 208, cmt. c (1981); see also RESTATEMENT (SECOND) OF CONTRACTS § 211(3) (1981).
\textsuperscript{105} U.C.C. § 2-207, cmt. 5 (2012).
\textsuperscript{108} See DeRosa v. Walsh, 541 F. App’x 250 (4th Cir. 2013).
\textsuperscript{109} Id. at 252.
\textsuperscript{110} Id. at 253.
\textsuperscript{111} Id.
terize the nature of the parties’ relationship. In order to find this intent, courts may have to analyze many documents. Additionally, the arbitration agreement may be voided if one side has too much power to alter the agreement, and this “power to alter” may be buried in other documents, not just the arbitration agreement.

IV. INSTANT DECISION

After the district court rescinded its decision to compel plaintiffs to arbitration and ordered the claims to proceed to trial, FHTM appealed, asserting that despite the district court finding the agreement lacked consideration, FHTM was still entitled to compel arbitration. Plaintiffs argued that the arbitration clause referenced in the “FHTM Policies and Procedures” lacked consideration because it gave FHTM the sole discretion to modify the terms of the contract at any time.

On appeal, the Sixth Circuit first noted that review of the lower court’s decision would be de novo, and that Kentucky contract formation law would apply in determining the enforceability of the arbitration agreement. Although the court referenced the policy favoring arbitration, it also cited Granite Rock and found that “if the dispute is itself over the validity of the arbitration clause,” the presumption favoring arbitration no longer applies. Granite Rock guided the court to compel arbitration only after determining the parties’ arbitration agreement was validly formed, covered the dispute in question, and was legally enforceable.

Plaintiffs challenged the agreement containing the arbitration clause because of a lack of valid consideration. Under Kentucky law, the contract had mutuality and adequate consideration, and arbitration clauses by themselves do not require independent consideration separate from consideration in general. As long as the contract as a whole is supported by consideration, each clause is considered to be valid unless there is some other defect in validity.

Considering the terms of FHTM’s Policies and Procedures, the court held that because the agreement gave FHTM the unilateral right to modify any terms of the contract at any time, its promises were illusory. The court found that the agreement did not in fact bind FHTM because FHTM could have changed the terms and left Plaintiffs with no available contract law remedy. Without adequate consideration, “the entire contract, including the arbitration clause, [was] void and unenforceable.”

The Sixth Circuit analogized the arbitration agreement at issue with its prior holding in Floss. FHTM attempted to refute the claim for lack of consideration, asserting that despite the power to modify any term of the agreement, no such

113. Id. at 603.
114. Id.
115. Id.
116. Id.
117. Id.
118. Day v. Fortune Hi-Tech Mktg., Inc., 536 F. App’x 600, 603 (6th Cir. 2013).
119. Id.
120. Id. at 604.
121. Id.
122. Id.
123. Id.; see also Floss v. Ryan’s Family Steak Houses Inc., 211 F.3d 306 (6th Cir. 2000).
action had been taken; therefore the contract still had valid consideration, and was not illusory. The court found that regardless of the fact that FHTM maintained the original terms of the agreement, “[n]othing bound defendant to continue its agreement, or even to maintain the same terms.” Further, the court determined that under Kentucky contract law, “[w]ithout a binding obligation, a promise is illusory, and therefore not enforceable as a contract.” FHTM also attempted to argue that since the parties performed under the contract, the court could infer an enforceable agreement existed during that time period, but the court rejected this reasoning: “subsequent performance cannot excuse a want of consideration.”

Finally, FHTM asked the court to enforce the arbitration agreement because it contained survival language, and thus, bound Plaintiffs once they terminated their contracts. Not persuaded by this argument, the Sixth circuit explained, “a sub-clause that was never valid and binding cannot survive the termination of the agreement, because it was never binding in the first place.”

Finally, FHTM pleaded to sever the provision allowing FHTM to amend any part of the agreement at its sole discretion, and enforce the remainder of the contract. Throwing out this argument, the Sixth Circuit claimed no such authority existed, nor any express language would allow them to revise the contract and “cure it of this deficiency.” The Sixth Circuit held that the Defendant’s ability to unilaterally modify any term of the contract at any time was illusory, and thus, the entire agreement, including the arbitration clause, was unenforceable due to lack of adequate consideration.

V. COMMENT

The first part of this discussion touches on the judicial and societal implications that came with the holding in Granite Rock. The next portion will delve into how this new additional part of arbitration foundation will complicate courts’ contractual interpretations when determining the enforceability of arbitration clauses buried in multiple documents. The concluding discussion turns to how the Sixth Circuit neglected to follow the important contractual doctrine of severability.

Day suggests that the Sixth Circuit took Granite Rock as grounds to render entire agreements unenforceable when a single provision is found invalid, despite limitations on a court’s ability to sever an arbitration provision from the remainder of the contract. Day ultimately gives broad discretion to look at various state...
law principles of contract formation, and use specific contractual challenges to throw out entire agreements between parties based on just a few unenforceable terms. Contracting parties now may be forced to cross their fingers instead of their “T’s” in the hope that entire arbitration agreements will not be invalidated for unforeseeable errors.

In Day, the Sixth Circuit rendered a proper decision as it pertained to the new Granite Rock framework because it corrected what many decisions since Buckeye had misplaced. In these misplaced decisions, intent to arbitrate was inferred when parties contested whether a valid agreement had been formed in the first place. The Granite Rock decision directed courts to ask this question before reviewing the nature of a plaintiff’s claim, disputing either the entire agreement, or specifically, the arbitration clause.

Armed with this precedent, courts may now review whether a contract has actually been formed, as opposed to widely compelling arbitration, which can lead to “instances where parties have been compelled to arbitrate disputes despite never having entered an arbitration agreement.” This is precisely what happened in Day on reconsideration: plaintiffs who were duped by a prolific pyramid scheme were allowed to proceed with their claims in court because they challenged an arbitration clause integrated by reference as lacking consideration to the entire agreement. The court looked at the consideration for the contract as a whole, and did not focus on whether there was specific consideration for the arbitration agreement itself.

Employers or other parties with significant bargaining power to these types of agreements may take issue with the holding in Granite Rock as it likely opens the door to more claims making their way into the courts. Issues of existence and validity will arise and courts no longer must look only at the specific arbitration clause; instead, they can look at the agreement as a whole, including other incorporated agreements.

Though this is arguably a positive trend for plaintiffs wishing to take their claims to court, courts may now be required to sift and analyze a plethora of documents to determine whether: (1) a valid agreement had been formed, (2) whether the agreement at issue applies to the dispute, and (3) whether or not a valid provision specifically delegating the question of arbitrability to an arbitrator exists.

Despite the economic judicial costs of delving into this forest of contractual documents, such a method may be the most reasonable one a court can use to find the original intent of the parties. One example of how this might actually be the best result can be found in Zakaib, where the court cautioned: “with the rise of internet commerce and electronic recordkeeping over the last two decades, courts have grappled with electronic forms of transaction.” Courts first struggled with these “shrinkwrap” agreements, but then also found that they had to be analyzed in order to find the intent of the parties. As relationships between parties become more complex, so too will the many agreements between them. Though

135. Boyarsky, supra note 61, at 391.
139. Id. at 594.
courts may have to tear through pages and pages of a transaction’s terms, piecing together a contractual puzzle may prove to be the more just result in deducing the parties true intent of their agreement.

The same is true in the employment context or with modern business transactions. The old fashioned economic costs of providing hard copies for each party to an agreement has been replaced by simple “click and accept” execution. As one commentator explains, “[s]ignificant business relationships are often memorialized in multiple documents—sometimes in the form of multiple simultaneous documents, on other occasions with an intentional sequencing of the documents.”140 On the other hand, “there can be good reasons for using multiple writings.”141 However, “a number of principles of contract construction and enforcement are not well adapted to this style of contracting.”142

The Sixth Circuit in Day refused to sever the unenforceable arbitration agreement, instead invalidating the entire contract. Ultimately this rationale failed to consider contractual and arbitration precedent, but the court also stated “we cannot find any authority . . . that would permit us to revise the contract to cure this deficiency” of the clause it found to invalidate the entire agreement for lack of consideration. Buckeye, along with the Restatement (Second) of Contracts §§ 211, 208 and UCC provision 2-207, grant courts discretion to sever terms they find to be unenforceable, unconscionable, or constitute a surprise that materially alters the contract.143 Further, as Buckeye and Rent-A-Center articulate, a court may choose to sever an arbitration provision from the remainder of the contract.144

The Sixth Circuit may well have had a valid reason for refusing to sever the unilateral modification provision incorporated by reference in FHTM’s policies and procedures, but ultimately failed to articulate any reason for doing so other than the fact that FHTM did not expressly have a severability clause in its terms. It seems likely that even if FHTM had such a provision, the court would have found that provision to be unenforceable as well for lack of consideration. In reaching this conclusion, the Sixth Circuit examined all the materials that were incorporated by reference, which included many documents that governed the complex relationship between the parties. This sets a precedent, which requires courts to spend precious judicial resources sifting through such documents, and also instructs courts that they need not sever unenforceable provisions from the contract as a whole and compel arbitration.

This precedent not only increases economic burdens for courts, but also does so for parties attempting to draft agreements that courts will enforce. The transaction costs of attempting to streamline all of the parties’ agreements into one document will be overwhelming for both the drafter and executor. In addition, many transactions that continue to memorialize agreements with a multitude of documents—whether for economic or efficiency reasons—will face a contractual leap

141. Id.
142. Id.
of faith as to how to structure their terms to ensure they will be later upheld by a court reviewing arbitrability.

VI. CONCLUSION

With this new foundation for addressing arbitration agreements under Granite Rock, if parties truly wish to commit to arbitration, businesses and employers alike must be careful to conform individual agreements to adhere to state law principles of contract formation, else run the risk of having their claims settled in court rather than by arbitration. Under Day, in order to deduce parties’ intent, courts will have to look to all of the agreements in place between parties, which characterizes the overall nature of the relationship. This will create substantial economic burden on parties seeking to reduce transaction costs, but may in fact create a just alternative in assisting the usual victims of contracts of adhesion. Finally, the Sixth Circuit’s failure to discuss any type of severability doctrine leaves contracting parties in the dark as to how a party can form a valid agreement to arbitrate, which would require parties to check and recheck all of the agreements in place between them, lest the arbitration agreement fail for an unrelated reason.

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