SMITH ANDERSON
expectexcellence®

NC FIDUCIARIES HAVE A DUTY TO EXPLAIN ARBITRATION AGREEMENTS IN CONTRACTS

02.14.2017
By Michael W. Mitchell and Andrew Atkins

The Supreme Court of North Carolina recently issued a significant opinion that calls into question the validity of arbitration agreements when a fiduciary relationship exists- particularly in the context of consumer transactions.

In *King, et al. v. Bryant, et al.*, a patient in need of a medical procedure filled out and executed routine patient intake forms prior to treatment. Among those forms was an agreement to arbitrate any disputes arising out of the doctor's medical treatment. Notably, the form stated that execution of the arbitration agreement was not a prerequisite to medical treatment. After executing the forms, Mr. King, the patient, and Dr. Bryant, the doctor, formed a physician-patient relationship. Dr. Bryant performed the needed medical procedure; however, the procedure did not go well and Mr. King suffered complications and alleged injuries as a result. When Mr. King filed litigation in State court, Dr. Bryant moved to stay the litigation and enforce the arbitration agreement. While there was much procedural history, the question before the Supreme Court was whether the arbitration agreement was enforceable against Mr. King.

Typically, the enforceability of an arbitration agreement turns on an analysis of procedural and substantive "unconscionability." However, here the Court departed from the typical analytical framework, stating "this case hinges upon the nature of the relationship that existed between Mr. King and Dr. Bryant at the time that the arbitration agreement was signed." The Court did not focus on whether a physician-patient relationship existed; rather, the Court looked at whether a fiduciary relationship existed separate and apart from the physician-patient relationship. Holding that a fiduciary relationship existed as a result of the relation of trust and confidence between the parties, the Court correspondingly held that Dr. Bryant owed a duty to disclose all material facts to Mr. King. Thus, according to the Court, if Dr. Bryant had failed to disclose all material facts in an effort to benefit himself, then he would have breached his fiduciary duties and committed constructive fraud.

The Court in fact held that was the case: Dr. Bryant breached his fiduciary duty to Mr. King, and therefore the arbitration agreement was unenforceable. The Court noted that no one directed Mr. King's attention to the arbitration agreement, which was included in a stack of other documents, or attempted to explain the ramifications to him. While the Court noted that Mr. King never read the documents, it also noted that he had limited education and little experience interpreting legal documents. Accordingly, the Court held that Dr. Bryant had a fiduciary duty to explain the consequences of the arbitration agreement to Mr. King and that he breached his fiduciary duty by not doing so, for the purpose of obtaining dispute resolution procedures to his benefit.

Two justices dissented, arguing that the majority had abandoned the Court's traditional unconscionability analysis, that it had failed to understand how a fiduciary relationship is formed, that it had failed to acknowledge the preemptive effect of the Federal Arbitration Act, and that it had mischaracterized arbitration as a benefit to only one of the parties to the agreement. One of the dissents also characterized the majority opinion as merely a "rationalization" of State law to avoid arbitration.

While the facts of this case arise out of a physician-patient relationship, the Court's decision is so broad, and is such a departure from State and Federal precedent, that it could apply to many consumer-related transactions. As a result of this decision, if a fiduciary relationship exists at the time an arbitration agreement is signed, the fiduciary has a duty to explain or, at a minimum, bring the arbitration agreement to the other party's attention and then document that the other party has been made aware of the agreement. More litigation is sure to follow, including to what degree the other party's level of sophistication plays in the scope of the fiduciary's duty. There is also likely to be more litigation as to what fiduciary relationships in other industries may be subject to the same standard.

The Court's decision raises a significant risk that existing arbitration agreements could be unenforceable. The decision even has implications outside of the arbitration setting, because it could just as easily apply to other contractual provisions. In fact, the Court expressly stated that its legal analysis would apply to other contractual provisions, not just arbitration agreements.

Careful consideration must be given to whether clients should adopt additional procedures to ensure that their contractual agreements with parties with whom they may have a fiduciary relationship are properly executed and still enforceable, particularly arbitration agreements.

PROFESSIONALS

Andrew P. Atkins

Michael W. Mitchell

PRACTICE AREAS

Litigation