IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MISSOURI
WESTERN DIVISION

NITRO DISTRIBUTING, INC., WEST PALM CONVENTION SERVICES, INC., NETCO, INC., SCHMITZ & ASSOCIATES, INC., and U-CAN-II, INC.,	)	
Plaintiffs,	)	
v.	)	**Case No. 03-3290-CV-W-RED**
ALTICOR, INC., AMWAY CORPORATION, and QUIXTAR, INC.,	)	
Defendants.	)	

ORDER

Pending before the Court are the following: Defendants'[1] Motion to Dismiss, or in the Alternative to Stay the Case and Compel Arbitration (Doc. 11); Suggestions in Support of Motion to Dismiss Case, or in the Alternative to Stay the Case and Compel Arbitration (Doc. 13); Plaintiffs' Suggestions in Opposition to Defendants' Motion to Dismiss Case, or in the Alternative to Stay the Case and Compel Arbitration (Doc. 123); Reply Suggestions to Motion to Dismiss Case, or in the Alternative to Stay the Case and Compel Arbitration (Doc. 129); Supplement Sur-Reply to Motion to Dismiss Case or in the Alternative to Stay the Case and Compel Arbitration (Doc. 138); Sur-Reply to Motion to Dismiss Case or in the Alternative to Stay the Case and Compel Arbitration (Doc. 140). The Plaintiffs' Suggestions in Opposition to Defendants' Motion to Dismiss Case, or in the Alternative to Stay the Case and Compel Arbitration (Doc. 123) and subsequently listed

[1] In the Complaint and other pleadings before the Court, the parties use the terms "Defendants" or "Amway" to collectively refer to all three entities: Amway, Alticor, and Quixtar. For the sake of clarity, "Defendants" and "Amway" shall be used interchangeably herein and shall be considered to refer to all Defendants as they appear for purposes of the pending Motion and this Order and to be one in the same.

documents are filed under seal due to the Protective Order (Doc. 85) issued in this case. For the following reasons, Defendants' Motion to Dismiss Case or in the Alternative to Stay the Case and Compel Arbitration (Doc. 11) is due to be **DENIED**.

I. Factual Background

Defendant Amway and Defendant Quixtar are members of the Defendant Alticor family of companies. Defendants are engaged in multilevel marketing. Quixtar sells similar products, but is engaged primarily in I-commerce.

Amway products are sold by distributors or Independent Business Owners ("IBOs"), the terms are interchangeable. Distributors sell Amway products and in turn sponsor others to sell Amway products. To become an Amway distributor, one has to be sponsored into the Amway company. The sponsor, and the sponsor's sponsor, and so on, are the "upline" for the new distributor. The distributor will then sponsor others into the business, creating a "downline" as those sponsored by the distributor sponsor others, ever increasing the downline. Distributors earn performance bonuses based on the volume of their sales and the volume of the sales of their downline. This is the "products business."

Part of Amway's marketing plan involves motivation of a distributor's downline. In fact, motivation of a downline is required by Amway. However, the motivational tools to be utilized are determined by the respective distributor. Generally, motivational materials can include tapes, lectures, rallies, and other tools to encourage downline members to sell to their highest potential. This requirement for downline motivation, and the demand for more motivational tools, gave rise to the tools business ("tools business"). Amway's rules prohibit an Amway distributor from also operating a motivational tools business, therefore separate entities are created to run the tools

businesses. Often, the same individual will be the principal owner of an Amway products distribution business and a separate tools business. There is an intersection of the products and the tools businesses, as it is not uncommon for the owners of an Amway product distribution business to create and sell motivational tools through a separately owned tools business to their Amway downline distributors. Defendants also create motivational tools to sell, making them a competitor to Plaintiffs in the tools business.

Plaintiffs are involved in the tools business, either by selling motivational products, holding rallies and conventions, or both. Only one Plaintiff was ever in the products business, and that is Plaintiff Netco. Netco claims there was an approximate eight (8) year period during which Netco did not know it was supposed to separate its product distribution business from its tools business. Except for the owners of Netco, the owners of the Plaintiff companies also each own a separate entity that operates an Amway product distribution business. Netco operated as both a tools business and products business from the date of its incorporation in 1991 until 1999.

Ken Stewart is the principal owner of the tools businesses Plaintiffs Nitro and West Palm, and Stewart's product business Stewart & Associates. Plaintiffs Netco and Schmitz & Associates are owned by Charlie and Kimberly Schmitz. Plaintiff Netco was the Schmitz's products business and also did some tools business. Schmitz & Associates has always engaged in the tools business. Schmitz & Associates engaged in functions and conventions within the tools business and Netco engaged in selling other motivational products. Plaintiff U-Can-II, a tools business, is owned by Brig and Lita Hart. The Harts also own B & L Enterprises which is an Amway distributor engaged in the products business.

II. Background of the Pleadings

Plaintiffs' Complaint (Doc. 1) alleges six counts against Defendants. These counts include Antitrust violations by group boycott, illegal allocation of customers, illegal tying arrangement, and conspiracy to monopolize. Also the Complaint states a claim for tortuous interference with a business expectancy and civil conspiracy. All of the allegations in the Complaint concern the operation of Plaintiffs' tools businesses.

Defendants in their Motion to Dismiss, or in the Alternative to Stay the Case and Compel Arbitration, assert that the Plaintiffs are bound to mandatory arbitration in this case. Defendants claim that the underlying dispute arises under the Rules of Conduct for Amway distributors in the products business and therefore is subject to the arbitration requirements for such disputes. In addition, Defendants claim that the Plaintiffs have agreed to bind themselves to the Amway Rules of Conduct, including the arbitration provision therein, by actions of their principals in accepting renewals of their Amway distributor agreements and signing other documents relating to their Amway distributorships. Defendants further claim that some Plaintiffs signed an agreement with ProNet, a non-party company. The Defendants claim the ProNet agreement includes a provision that the parties will be bound to the Amway Rules of Conduct, including the arbitration clause.

III. Discussion

Federal antitrust claims are arbitrable under the Federal Arbitration Act. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 627 (1985). The Federal Arbitration Act ("FAA") "leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed." *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 218 (1985).

Accordingly, the Court's role under the FAA is necessarily limited to a two part determination. 9 U.S.C.§ 2; *Pro Tech Indus., Inc. v. U.R.S. Corp.*, 377 F.3d 868, 871 (8th Cir. 2004). First, the Court must determine if a valid arbitration agreement exists. *Pro Tech*, 262 F.3d at 871 (citing *Gannon v. Circuit City Stores, Inc.*, 262 F.3d 677, 680 (8th Cir. 2001)). Second, if there is a valid agreement, the Court must then determine whether the agreement encompasses the dispute between the parties. *Id*.

Under the first part of the test, the Court finds no valid agreement exists for two reasons. One, the various agreements which Defendants claim bind Plaintiffs to the Amway Rules of Conduct either were not signed by the parties to this suit, did not form valid contracts, or are not applicable to this lawsuit. Two, the portion of the arbitration agreement requiring arbitration with JAMS arbitrators is unconscionable. Having found no applicable arbitration agreement in this matter, the Court need not address the scope of the arbitration agreement.

The Court is aware of Defendants' contention that the underlying dispute in this case arises out of the Amway Rules of Conduct or violations of those rules. The actual source of part or all of the underlying complaint is not the issue on this question of arbitration. Simply stated, the plaintiffs will not be required to participate in Amway's arbitration procedure unless Plaintiffs are found to have agreed to be bound by Amway's arbitration agreement.

A. The ProNet Agreement

As a threshold matter, the Court finds the purported agreements of Nitro, Netco, and U-Can-II with ProNet to be of limited, if any, relevance to this case. ProNet is not a party to this suit. What Defendants allege is that by signing membership agreements with ProNet, some of the Plaintiffs (specifically, Nitro, Netco, and U-Can- II) have agreed to be bound by the arbitration provision

contained in the Amway Rules of Conduct. The Court finds this argument without merit for two primary reasons. One, while ProNet may have adopted the Amway Rules of Conduct, it created its own separate arbitration procedure. Therefore, the Amway arbitration provision contained within the Amway Rules of Conduct was preempted and superceded by ProNet's own separate and different

arbitration procedure. One important distinction to be noted between the two provisions is that the ProNet arbitration procedure does not utilize the Amway trained JAMS arbitrators. As a result, the Amway arbitration procedure was not incorporated into the ProNet membership agreement. Secondly, Amway is unable to enforce these agreements as a third-party beneficiary.

i. Adoption of the Amway Rules of Conduct

The ProNet membership application generally states that as a member, the applicant agrees to be bound by the Amway Rules of Conduct. The Amway Rules of Conduct include Amway's arbitration provision. However, ProNet specifically set forth a dispute resolution clause in the ProNet Terms and Conditions which has a distinctly different arbitration provision from the one set forth in the Amway Rules of Conduct. For example, the ProNet provision requires arbitration in accordance with the rules of the American Arbitration Association, not the Amway arbitration rules which utilize the Amway trained and selected JAMS arbitrators.

Essentially, it appears the Amway Rules of Conduct were referenced as general guidelines, however, Pro Net obviously made a decision to adopt a specific and different arbitration provision. It makes no sense that Defendants can have it both ways, i.e. that a ProNet member would be subject to both the ProNet arbitration procedure and the significantly different arbitration procedure

provided for in the Amway Rules of Conduct. There is nothing in the ProNet terms and conditions or other materials that contemplates this dual possibility.

Instead, by creating their own arbitration agreement, ProNet clearly indicated that it did not intend to adopt the Amway arbitration agreement contained in the Amway Rules of Conduct. It is well established that when general and specific provisions of a contract conflict, the specific provision is generally controlling. *See* Restatement (Second) of Contracts § 203©; *see also, Maas v. Dubuque Packing Co.*, 754 F.2d 287 (8th Cir. 1985), decision clarified on denial of reh'g, 757 F.2d 194 (8th Cir. 1985) (citing text). Additionally, where the first clause is general and the later clause more specific, or if the later clause conflicts with only part of the earlier clause, the later clause may be given full effect and the earlier limited accordingly. WILLISTON ON CONTRACTS § 32:15 (4th Ed. 2004).

Applying these principles to the case at bar, it is clear that the adoption of the Amway Rules of Conduct is a general provision which is limited by the ProNet specific arbitration clause. For this reason, the Amway arbitration clause is not part of the ProNet agreement. Therefore, even if one or more of the Plaintiffs are found to be bound to the ProNet agreement, those Plaintiffs would not be bound to the Amway arbitration provision as part of the ProNet agreement.

ii. Amway as a Third-Party Beneficiary to Enforce the ProNet Agreement

Even if, for purposes of argument, this Court was to find that the Amway arbitration provision was part of the ProNet agreement, ProNet is not a Defendant in this suit and, therefore, the Defendants still could not use the ProNet contract to compel arbitration as Defendants are not third party beneficiaries. The requirements to be a third party beneficiary are similar in most jurisdictions including Michigan, Missouri, and Florida. Defendants cite to a Michigan statute,

M.C.L.A. 600.1405 which states that a person "for whose benefit a promise is made by way of contract . . . has the same right to enforce said promise that he would have had if the said promise had been made directly to him . . .." The statute further clarifies that a promise is made "for the benefit of a person" when the promisor has undertaken to give or to do or refrain from doing something directly to or for the third person." *Id*.

Missouri law is similar, recognizing there are three types of third-party beneficiaries to a contract: donee beneficiaries, creditor beneficiaries, and incidental beneficiaries. "A donee beneficiary is one upon whom the promisee intends to confer the benefit of performance of the contract although such performance will not discharge a preexisting duty or obligation to the beneficiary." A creditor beneficiary is "one upon whom the promisee intends to confer the benefit of the performance of the contract and thereby discharge an obligation or duty the promisee owes the beneficiary." An incidental beneficiary is one "who will be benefitted by performance of a promise but who is neither a promisee nor an intended beneficiary." Only donee and creditor beneficiaries have enforceable rights under a contract. *OFW Corp. v. City of Columbia*, 893 S.W.2d 876, 879 (Mo.App. W.D.1995); cited in *State ex rel. E.A. Martin Machinery Co. v. Line One, Inc*., 111 S.W.3d 924, 930 -31 (Mo. App. 2003).

Florida law also holds a similar view of third party beneficiaries, upholding the distinction with regard to incidental beneficiaries. "A non-party is the specifically intended beneficiary only if the contract clearly expresses an intent to primarily and directly benefit the third party or a class of persons to which that party belongs. To find the requisite intent, it must be established that the parties to the contract actually and expressly intended to benefit the third party; it is not sufficient to show only that one of the contracting parties unilaterally intended some benefit to the third party."

(internal citations omitted) *Biscayne Inv. Group, Ltd. v. Guarantee Management Services, Inc.*, 903 So.2d 251, 254 (Fla. App. 3 Dist. 2005).

Under any of the states' schemes, Nitro, U-Can-II, Netco and ProNet would have had to intend to benefit the Defendants in some way when they created the membership agreement for the Defendants to now enforce that agreement. Defendants cite *Cochran v. Ernst and Young*, 758 F. Supp. 1548, 1558 (E.D. Mich. 1991). In *Cochran*, the parties to the contract agreed that they would not sue a third party. The court held that this contract was clearly to benefit the third party because it gave indemnity, and therefore, the third party was a beneficiary of the contract.

The ProNet contract was not to benefit Defendants, but to benefit the individual businesses that comprised the members and founders of ProNet. The only reference to Defendants is the reference to the Amway Rules of Conduct. In the absence of any other involvement or consideration of Defendants, the adoption of the Amway Rules of Conduct did not confer a benefit on Amway, but rather merely served to adopt those rules as a model to be followed. The Pro Net membership application states the purpose is to "promote the common business interests of members engaged in distribution of Amway products." Amway is not a member of Pro Net. Further, the listed benefits of membership are specifically only available to the members.

The nature of the ProNet business is to provide motivational materials and tools. While it may be said that Amway could receive a benefit in increased sales by any successful motivational efforts of ProNet members with product distributors, this benefit to Amway is merely incidental. The stated purpose and intent of the ProNet organization is to benefit the independently owned and operated tools businesses that are the members and founders of ProNet. Accordingly, none of Defendants are third party beneficiaries to the contract and Defendants as claimed third party

beneficiaries cannot now attempt to enforce it. The Court is not deciding the validity of the agreement between ProNet and Nitro, Netco, or U-Can-II. The Court merely finds, as a preliminary matter, the Defendants in this action have no standing to enforce that agreement, assuming the agreement adopted the Amway arbitration procedure and was binding on Plaintiffs in the first place. It is also noted that for Defendants to claim they are third party beneficiaries of the ProNet agreement would be totally contrary to Defendants' stated position of being absolutely separated from the tools business. The desire of Defendants to maintain a separation between Defendants' distribution business and the Plaintiffs' tools businesses is discussed later in this Order.

Nitro, Netco, and U-Can-II have also raised an issue regarding whether they are even bound by the ProNet agreement. These Plaintiffs argue that they were not eligible for membership and that their applications for membership were never accepted by ProNet. All of this may be true. This Court has simply assumed for purposes of the above discussion that said Plaintiffs were bound by the ProNet Agreement and for the reasons stated finds that Defendants are not able to compel arbitration on the basis of the ProNet Agreement. Obviously if Plaintiffs were never members of ProNet and, therefore, not bound by the ProNet membership agreement, it would be another reason why Defendants would have no claim for arbitration via the ProNet Membership Agreement.

B. Validity of the Amway Arbitration Agreement

Arbitration is only a matter of contract, and a "party cannot be required to submit [to arbitration] any dispute which he has not agreed so to submit." *AT&T Tech., Inc. v. Comm. Workers*, 475 U.S. 643, 648 (1986). Plainly stated, arbitration is a matter of "consent not coercion." *EEOC v. Waffle House, Inc.*, 122 S. Ct. 754, 764 (2002). In this case, Defendants claim different agreements bind distinct Plaintiffs to arbitration therefore each Plaintiff will be discussed separately.

Agreements relied upon by Defendants include application forms for the products business, and the "automatic renewal" forms for the products business which include not only an annual distributorship renewal, but an agreement to be bound by Amway's rules as they are "set out from time to time." In 1998, one of the new rules "set out" was the arbitration provision at issue in this dispute. The agreements also include the Acknowledgment of Distributor Changes form and the Add the Quixtar Business form. None of the Plaintiffs or persons purporting to act on their behalf actually signed any of these forms. Some of the previously mentioned forms were signed by owners of product businesses (distributors) who also happened to be owners of the Plaintiffs (tools businesses). Defendants use an agency theory to argue that the non-signatory Plaintiffs are bound to these forms.

Although Defendants now have a Business Support Materials Arbitration Agreement ("BSMAA") which specifically mentions arbitration for tool business disputes, none of the Plaintiffs or their owners have signed a BSMAA. Therefore, the arbitration provision found in the Amway Rules of Conduct is the only arbitration provision at issue.

The Court must first determine if any Plaintiff is bound to the arbitration provisions in the Amway Rules of Conduct through theories of agency or by signing in its own capacity. The Court finds that Plaintiffs are not so bound. The second issue is if the arbitration agreement mandating an Amway procedure that includes Amway trained and selected JAMS arbitrators is unconscionable. The Court finds that the arbitration agreement, to the extent that arbitration before Amway trained and selected JAMS arbitrators is mandatory, is unconscionable.

i. Signatories to the Agreements to Arbitrate Under the Amway Rules of Conduct

a. Nitro Distributing, Inc.

Nitro Distributing Inc. ("Nitro") is a Missouri Corporation based in Springfield, Missouri and is in the tool business as described above. Ken and Donna Stewart created Nitro, as well as West Palm Convention Services, Inc. ("West Palm"), and Stewart & Associates. Stewart & Associates is the Stewart's Amway products distribution business, and West Palm (discussed *infra*) is engaged in the tool business like Nitro.

Nitro does not operate an Amway products business and likewise never signed an application to be a distributor for the products business nor any form for the automatic renewal of the products business. Ken Stewart, as President of Stewart & Associates, signed the automatic renewal form on behalf of Stewart & Associates, his Amway products business, and likewise signed an Acknowledgment of Distributorship Changes form, which included the arbitration agreement. Nitro can only be bound to the Stewart & Associates agreements under a theory of agency, as none were directly signed by Nitro.

Defendants allege that Stewart was acting as an agent for Nitro when he signed the Agreement for Automatic Renewal for Stewart & Associates and when he signed the Distributor Changes form. Under this theory, Defendants assert Nitro should be considered to have signed the agreement since Stewart signed it. To be an agent of Nitro, Stewart must have actual or apparent authority to be signing in his Nitro capacity.

"A corporate officer's actual authority derives, on the one hand, from statute or from the articles and by-laws of the corporation, or on the other hand from the officer's exercise of functions on behalf of the corporation, long tacitly acquiesced in by the board of directors." *Gaar v. Gaar's Inc.*, 994 S.W.2d 612, 617 (Mo.App.1999) (*citing Parks v. Midland Ford Tractor Co.*, 416 S.W.2d 22, 26 (Mo.App.1967)). In contrast, apparent authority comes into existence by the corporation's

creation of an appearance of affairs which would cause a reasonable person to believe that the officer had actual authority to do a particular act, upon which appearance a third person relies. *Holtmeier v. Dayani*, 862 S.W.2d 391, 401 (Mo. App.1993), *cited in Rice v. Bol*, 116 S.W.3d 599, 608 -09 (Mo. App. 2003). Actual authority looks to the relationship of the corporation to its purported agent, while apparent authority looks to the relationship of the agent to a third party.

There can be no argument of actual or apparent authority for Stewart to bind Nitro by either the signed Distribution Authorization or the Automatic Renewal form. The Authorization and Automatic Renewal forms were both signed in 1985, but Nitro was not incorporated until 1988. Therefore, Stewart could not have received actual authority from an entity that did not exist and there could be no apparent authority because a reasonable person could not have believed Stewart was signing on behalf of an entity that did not exist.

The Acknowledgment of Distributor Changes form was signed in 1997, after Nitro came into existence. However, Defendants still cannot show actual authority or apparent authority for Stewart to have been acting as a Nitro agent when he signed the Acknowledgment on behalf of his Amway Distributorship, i.e. Stewart & Associates. The Defendants' assertion of actual authority is based on the close relation between the tools businesses and the products businesses. Defendants assert that Stewart appeared in Nitro functions in his capacity as a Stewart & Associates distributor. There is no question that the nature of Defendants' business causes a muddling of the respective roles of the principles who own both a distribution/products business and a tools business. There is one thing for certain, however, and that is that nobody understood the respective roles and the separation to be kept between them better than Defendants.

Defendants also mention letters written to Amway from Stewart alleging harm to his tools business. The letters written to Amway occurred after the Distributor Changes form was signed and, thus, could not have given actual authority at an earlier time. The letters do raise another factor to consider on this issue. Amway's response to Stewart's letters, written in his capacity as president of his tools business, and regarding a lawsuit filed in Greene County, Missouri, was to state that "it was not clear" whether Nitro or West Palm "are required to resolve their claims in accordance with the Quixtar Rules of Conduct." This statement stands in stark contrast to the Defendants' position in the case at bar.

Moreover, as to apparent authority, no reasonable person would believe Stewart was acting on behalf of Nitro, a tools business, when he signed the form (prepared by Amway) for Stewart & Associates to agree to Distributor Changes. The form is for changes to the product business distribution, as noted in its title. The arbitration provision itself mentions that it covers "my Amway distributorship." Stewart's Amway distributorship is Stewart & Associates. It is illogical to conclude that Stewart by signing this form as President of Stewart & Associates (his product business) was somehow obligating Nitro (his separate tool business), to the arbitration provision. Indeed, the mailing address from Defendants supports this conclusion as it was sent to Stewart & Associates, the products business.

Defendants have been very specific about requiring separate entities for the products businesses and tools businesses and cannot now assert they reasonably were confused and thought Stewart was acting on behalf of his tool business when he, at Defendants' request, was acting on behalf of his products business. By Defendant's own rules, Stewart & Associates could not operate a tools business. It would have been contrary to Defendants' own rules of separation for Stewart

to adopt the arbitration agreement on behalf of Nitro by signing the form for changes to his distribution agreement, on behalf of Stewart & Associates. The form is clearly drafted by Amway for the products business and the only reasonable inference is that Amway expected Stewart to be signing on behalf of his products business alone. Amway clearly had an understanding that Stewart was signing on behalf of Stewart & Associates when he signed the form. Nitro is not bound by the Acknowledgment of Distributor Changes Form signed by Stewart on behalf of Stewart & Associates. b. West Palm Convention Services, Inc.

West Palm was likewise created by Ken Stewart. The analysis above regarding Nitro is equally applicable to West Palm. West Palm was created in 1996. Therefore only the Acknowledgment of Distributor Changes Form was signed by Stewart after West Palm was created. Any agreements prior to the creation of West Palm cannot establish apparent or actual authority for the same reasons articulated in the Nitro analysis, *supra*. The Acknowledgment of Distributor Changes Form likewise does not bind West Palm for the same reasons Nitro was not bound, i.e., the form was created for the Amway distributor, not the tools business. Stewart clearly signed the form on behalf of his products business, and therefore did not bind West Palm to the arbitration provision contained in the form.

c. Netco, Inc.

Charlie and Kimberley Schmitz are the officers, directors, and shareholders of Netco, Inc. ("Netco"). Netco was incorporated in 1990. In 1991 the Schmitzes transferred their Amway products business to the Netco corporation. The Schmitzes also operated a tools business from the same entity. Before Netco was created, Charlie Schmitz operated an individually owned Amway distributorship. In 1985 he signed the Automatic Renewal for this distributorship in his individual

capacity. The Netco corporate application to take over the distributorship contained no arbitration agreement, but did state that Netco would comply with the Amway Rules of Conduct, as they were set out from time to time. However, at that time (1990), the Amway Rules of Conduct did not contain an arbitration provision. Netco never signed an authorization for automatic renewal of its distribution component, but Defendants continued to automatically renew the distributorship apparently pursuant to Charlie Schmitz's individual automatic renewal that was signed in 1985.

Netco never challenged the automatic renewal of its Amway distributorship. It is obvious Netco received benefits to its Amway distributorship because of the renewal. Therefore, Netco could be argued to have ratified the agreement and, in doing so, agreed to comply with the Amway Rules of Conduct, particularly in regard to conflicts related to the distribution business. The further argument is that Netco likewise is bound for conflicts related to its tools business.

This logic raises a question in the case of Netco because Netco was operating both a products distribution business and a tools business. One can understand that if you accept the benefit of a renewal of your distribution business, you also accept the rules and regulations that attach to that business. Therefore, issues related to your distribution business should be resolved in accordance with the applicable rules. This logic does not carry over to matters in dispute related to your tools business, particularly since Amway insisted on maintaining a separation between the two types of businesses.

The Amway rules required the products and tools businesses to be kept separate. Netco should have split its business into two separate entities. The record includes several demonstrations of Defendants' insistence in refusing to address tools business disputes through the Rules of Conduct. The reason given for said refusal was Amway's position that Amway was in the products

business, and acted as a competitor in the tools business, and could not, therefore get involved in disputes or requests for assistance from tools businesses. Amway does not get to have it both ways. Based on the separation Amway has insisted on between the tools businesses and the products businesses, Amway cannot now claim that somehow a tools business dispute is bound by the Amway arbitration requirement in the Amway Rules of Conduct.

d. Schmitz & Associates, Inc.

Schmitz & Associates is also owned by Charlie and Kimberly Schmitz. In contrast to Netco, Schmitz & Associates never operated in the Amway products business. Instead, it was solely formed for the tools and function business, organizing and facilitating seminars and conventions. Schmitz & Associates was formed in 1992. Schmitz & Associates never signed an Automatic Renewal Form or any other form agreeing to arbitration, it did not engage in any conduct that could be argued to be a ratification of forms signed by Charlie Schmitz individually. Schmitz & Associates was created after the Schmitzes signed the Automatic Renewal and Product business application forms. In accordance with the analysis in regard to Nitro, *supra*, no actual or apparent authority can be found to bind Schmitz & Associates to the Amway Arbitration provision.

e. U-Can-II, Inc.

U-Can-II is a Florida corporation. It was established by John "Brig" Hart and Lita Hart in 1989. The Harts also own B & L Enterprises, Inc., formed in 1989. B & L is the Hart's Amway products distribution business, U-Can-II is the Hart's tools business. The analysis for U-Can-II is similar to the analysis for Nitro, *supra*. The Hart's agreement to join the product distribution business was made in 1978, years before the tools business was even created. Likewise, the automatic renewal form was signed in 1985, also still before their tools business was created.

Therefore, there is little question as to the capacity the Harts signed those forms, and no actual or apparent authority can be established as resulting therefrom. Indeed, the Harts signed the renewal form while still a general partnership, before incorporating as B & L. U-Can-II never signed these various forms, and under the principles of agency described *supra*, cannot be bound to any obligations set forth in the forms.

Similar to Ken Stewart, Defendants also sent a letter to counsel for Brig Hart responding to correspondence between the Harts and the Defendants regarding disputes related to the Hart's tools business. In the letter, Amway was clear in saying that "we remain puzzled as to why you believe that Amway has the legal responsibility to resolve these private disputes, which do not appear to be covered by our Rules of Conduct or by Mr. Hart's Amway distributorship contract." This illustrates that there was no confusion on the Defendants' part. Defendants did not want to acknowledge any legal relationship or status with the tools businesses. When asked to get involved with the tools businesses Defendants refused. It is disingenuous for Defendants to claim in their arguments herein that somehow the tools businesses, despite Defendants' best efforts to keep them separate, are now contractually bound to Defendants' arbitration procedure. Defendants' claims are even more unlikely in consideration of the fact that Defendants' proof is all by inference originating from actions of distributors in regard to their distribution businesses. Again, not one of the Plaintiffs is alleged to have actually signed an agreement to be so bound.

ii. Unconscionability of the Arbitration Provision

The Court also finds that any agreement of Plaintiffs to arbitrate under the Amway Rules of Conduct is not valid for a second reason -- unconscionability. Generally, when deciding whether an arbitration provision is unconscionable, courts apply ordinary state-law principles governing the

formation of contracts. *First Options of Chicago v. Kaplan*, 514 U.S. 938, 944; *see also* 9 U.S.C. § 2 (stating agreements are valid unless grounds "exist at law or in equity for the revocation of any contract.") The parties dispute which state's law should apply in this case.

Plaintiffs contend that they did not sign the arbitration agreement, and therefore the choice of law provision in that agreement (Michigan law) does not apply. However, the Defendants disagree and assert Michigan law is the correct law to apply in this case. For the purposes of this motion, the Court will assume that Michigan law is the correct law to apply to an unconscionability determination of the agreement. Since the Court sits to determine if there is a valid arbitration agreement, it is necessarily looking at the terms of that agreement. As the agreement in question before the Court is one requiring Michigan law, the Court will look at the unconscionability standard of Michigan.[2]

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[2] Plaintiff contends that Missouri and Florida law, as well as Michigan law could be applicable. The standards in these states are all quite similar, and the choice of one over another is more a matter of form over substance.

Florida also follows the distinction of procedural and substantive unconscionablity. A question of no meaningful choice by the parties in the agreement is a procedural unconscionability matter, while onerous specific terms from which a party seeks relief are a substantive matter – such as terms which are unreasonable and unfair. Florida law so closely parallels the Michigan scheme that Florida in *Kohl v. Bay Club Colony Condominium, Inc.*, 398 So.2d 865, 868 (1981) (citing *Johnson v. Mobil Oil Corp*., 415 F. Supp. 264, 268 (E.D. Mich.1967), adopted the reasoning of a Michigan case in determining procedural unconscionability.

The Missouri standard for unconscionability is also quite similar. In *Funding Systems Leasing Corporation v. King Louie International, Inc.*, 597 S.W.2d 624 (Mo.App.1979), unconscionable was found to have application to both the "substantive" or "procedural" aspects of a transaction. *Id.* at 634. Substantive unconscionability refers to undue harshness in the contract terms themselves, whereas procedural unconscionable involves examination of the contract formation process, centering on the pressure exerted by the parties, the fine print of the contract, misrepresentation, or unequal bargaining position. *Id*. at 634.

In Michigan, the examination of a contract for unconscionability involves inquiries for both procedural and substantive unconscionability. *Hubscher & Son, Inc v. Storey*, 578 N.W.2d 701 (Mich. Ct. App. 1998). "Accordingly, there is a two-prong test to determine unconscionability: (1) What is the relative bargaining power of the parties, their relative economic strengths, the alternative sources of supply, in a word, what are their options?; [and] (2) Is the challenged term substantively unreasonable?" *Id*. at 703. The former inquiry relates to procedural unconscionability and the latter to substantive unconscionability. However, "[r]easonableness is the primary consideration in determining whether a contract clause is enforceable." *Rehmann Robson & Co.*, 187 Mich. App. at 44, quoted in *Pack v. Damon Corp*. 320 F. Supp.2d 545, 556 (E.D. Mich. 2004). Under a federal policy favoring arbitration, arbitration agreements are to be enforced unless a party can show that it will not be able to vindicate its rights in the arbitral forum. *Faber v. Menard, Inc.*, 367 F.3d 1048, 1052 (8th Cir. 2004).

a. Procedural Unconscionability

The first question under the Michigan dynamic is with regard to procedural unconscionability. The most important factors in deciding procedural unconscionability are: (1) whether the economically weaker party had an alternative source with which it could contract, and; (2) whether the contract term was in fact negotiated. *Pack*, 320 F. Supp.2d at 556 (quoting *Andersons, Inc. v. Horton Farms, Inc.*, 166 F.3d 308, 322 (6th Cir.1998)). While disparity of bargaining power is not enough to invalidate an arbitration provision, it does call for careful scrutiny of the provisions. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 33 (1991). "Where a contract is prepared by one party and offered for rejection or acceptance without opportunity for bargaining under circumstances in which the party cannot obtain the desired product or service

except by acquiescing in the form agreement, Michigan courts will conclude that the contract is adhesive and therefore procedurally unconscionable." *Lozada v. Dale Baker Oldsmobile, Inc.*, 91 F. Supp.2d 1087, 1100 (W.D. Mich. 2000).

In this case, the Amway arbitration provision was offered in a "take it or leave it" manner. The hallmark of "unequal bargaining position" is clear – to continue to be an Amway distributor, the agreement must be accepted. While Defendants contend that distributors had ample time to review the arbitration provisions before renewing or allowing the automatic renewal to occur, they do not refute that the arbitration provisions were given in a manner that required the distributors to accept the arbitration agreement as written or to quit the business all together. There was no other entity with which Plaintiffs could contract to participate in a similar business.

Moreover, negotiation of the arbitration clause was unheard of. Defendants admit that a distributor could not sign the distribution agreement without the arbitration provision. Defendants' position is that there was only one contract with all of its distributors.

To answer the question posed by the Michigan court as to what options are available, for the Plaintiffs in this case, the answer is very simple, there were no options. Although the renewals were automatic, i.e., no new agreement signed, it is undisputed that if the issue had been discussed, Amway would have insisted that the arbitration provision remain in place as written. The Defendants' business is in a sense exclusive, once the distributors had built up their business of selling products, they needed to annually renew their agreement with Defendants to keep the business going. This set up is not one where there are several competitors in the marketplace and distributors could go get products from another seller to continue their business. The Defendants also made it clear that the arbitration provision was non-negotiable, and had to be included. It is

important to keep in mind that Plaintiffs in this case are tools businesses who happen to have ownerships that have a related Amway distribution business. The above discussion concerns the procedural unconscionability based on the "take it or leave it" option presented to Amway distributors. The Plaintiff tools businesses are one step removed from this procedure as their involvement is vicarious at best. Thus, if Plaintiffs were held to be bound by Amway's arbitration agreement, it would be the result of a procedure where Plaintiffs never had a choice. Accordingly, the arbitration requirement is procedurally unconscionable.

b. Substantive Unconscionability

Even if a contract is procedurally unconscionable, however, "the challenged term is still enforceable if substantively reasonable and not oppressive or unconscionable." *Lozada*, 91 F. Supp.2d at 1102 (quoting *Andersons*, 166 F.3d at 323). The key to substantive unconscionability is that the terms in question are unreasonable and unfair. *Pack*, 320 F. Supp. 2d at 556 (noting substantive unconscionability asks whether the term is substantively reasonable).

In *Rembert v. Ryan's Family Steak Houses, Inc.*, 596 N.W.2d 208, 225 (Mich.App.1999), the Michigan Court of Appeals carefully evaluated Supreme Court precedent and what standards were required to determine whether an arbitration agreement was sufficiently procedurally fair to permit vindication of statutory rights. The Court held that "to be valid, a pre-dispute agreement to arbitrate must not waive rights under the statute and must be fair." *Id.* at 227. The *Rembert* Court further held that to be fair under this definition, the agreement must contain the following minimal procedural protections: (1) clear notice, (2) right to counsel, (3) reasonable discovery, (4) a fair hearing, and (5) a neutral arbitrator. *See id.* at 228. An arbitration agreement which waived

statutory rights or remedies or failed to meet these requirements of procedural fairness was not substantively reasonable and therefore not conscionable. *Id.* at 226 n. 28.

Plaintiffs in this case have raised grave doubts as to the fairness of the hearing they would receive if in arbitration with JAMS and the neutrality of the arbitrators that would be chosen. Mainly, Plaintiffs oppose the selection of the arbitrators by Defendants and the training Defendants provide to the arbitrators. Plaintiffs have submitted videos and DVD's of Defendants' training sessions with the arbitrators and these exhibits show Defendants counseling the arbitrators on the nature of their business. It is this Court's opinion that the procedure utilized by Defendants to screen, train and ultimately hand-pick their panel of arbitrators does not come close to passing any reasonable test of fairness and neutrality required for a legitimate arbitration proceeding.

Amway's "training" covered a two day period and then a third day of "interviews." The training covered subjects including profiles of the people who started and now run Amway, the benevolent and independent culture of Amway, procedures to the utilized in arbitration, and a summary of various complaints the arbitrators could anticipate. The arbitrator candidates even participated in some "role playing" as successful Amway distributors. Also included throughout the two days were assurances that Amway was not a pyramid scheme and that the business was legitimate. Defendants claim, however, that the training was not out of the ordinary nor improper as the panel was not specifically told how to resolve possible issues they would see. On the videos, the Defendants state they will not discuss the meaning of the Rules of Conduct that are not absolutely "black and white."

It was most interesting that the issue presently before this court was included in a particular "training" discussion at one point, complete with diagrams from Defendants' counsel regarding what

was appropriate and inappropriate in the scenario. The videos run almost ten (10) hours, but suffice it to say that it appears clear to this court that the training atmosphere and content of the discussions was designed to produce a very favorable view of Defendants. Coupled with the training session was the selection process being utilized by Defendants, both to select its initial group for training, then after personal interviews, to pick the final panel of arbitrators from which all arbitrators for Amway disputes would be chosen.

While there can be basic education of arbitrators regarding specialized subject matter, there is a point where basic education can be extended to subtle manipulation on issues which could be expected to be considered by the arbitrators. This limit has been passed by Amway's preparation of the arbitrators at JAMS. While JAMS may be a respected organization, the Defendants have called the neutrality of this particular arbitration arrangement into question. Also telling is the fact that Defendants have never lost in arbitration, with the exception of a few counterclaims. The record shows that when Defendants are defending in arbitration, the process takes much longer than when they are the Plaintiffs in arbitration, and longer than JAMS arbitrations in general. Michigan law also requires reasonable discovery in arbitration agreements to avoid a finding of unconscionability. In the Amway agreement, discovery is not guaranteed, instead it is for the arbitrator to choose if discovery should be allowed.

Defendants are choosing the arbitrators in a hand-picked selection process, training them, and then requiring the arbitration process with no exceptions. Other courts have found the hand-picking of arbitrators to be a significant factor in determining unconscionability. *See Hooters of America v. Phillips*, 39 F. Supp.2d 582 (S.C. 1998) (finding the "Hooters arbitration scheme fails miserably to satisfy even the most basic requirements of a commercially reasonable arbitration

scheme" and is a "spectacle of *Gilmer* gone mad.") When the *Hooters* case was taken on Appeal to the Fourth Circuit, the Court noted that the arbitration scheme was one where the company had "unrestricted control" over the panel of arbitrators. *Hooters v. Phillips*, 173 F.3d 933, 939 (4th Cir. 1999). Similar to the Amway system, the employees and employer could each choose an arbitrator, but they could only choose from a selected list, created and maintained by the employer. *Id*. While the arbitration agreement at issue in *Hooters* involved other evidence of unconscionability not before the Court in the Case at bar, it is important to note that experts in the *Hooters* case found that the "'most serious flaw' was that the 'mechanism [for selecting arbitrators] violates the most fundamental aspect of justice, namely an impartial decision maker.'" *Id*. Like the arbitration provision in *Hooters*, the Amway system undermines the neutrality of the proceedings. While the parties are allowed to choose their own arbitrators, the pool of candidates for this choice is limited by Defendants to those arbitrators whom Defendants have already pre-selected in a process that involves an initial screening, then training with a heavy dose of goodwill for Defendants and their manner of operation, then after personal interviews, being hand-picked to be on the list of arbitrators (so long as Defendants deem them to be acceptable). Arbitrators are to be neutral, and allowing such training and influence over the arbitrators as Defendants have in this situation is both unreasonable and unfair.

Although this court has found that none of the Plaintiffs have submitted to arbitration, the court also finds that, in the alternative, arbitration with pre-selected JAMS arbitrators as presently set up by Defendants is unconscionable. The Court is aware of Rule 11.5 in the Defendants' arbitration rules which states in part that "[i]f any rule or part thereof is found to be invalid by a court of competent jurisdiction, there rules will be interpreted as through the invalid portion were

not part of these rules." Therefore, if any Plaintiff was found to be bound to Amway's arbitration procedure it would not include the requirement to utilize the current procedure requiring JAMS arbitration. Given the Court's previous discussion regarding the applicability of the arbitration provision to each of the Plaintiffs, the Court does not find it necessary to send any of the Plaintiffs to arbitration.

IV. Conclusion

For the reasons stated above, Defendant's Motion to Dismiss, or in the Alternative, Stay the Case and Compel Arbitration is hereby **DENIED**.

IT IS SO ORDERED.

DATED: September 16, 2005

/s/ Richard E. Dorr
RICHARD E. DORR, JUDGE
UNITED STATES DISTRICT COURT