

1997

Rethinking Appeal of Arbitrability Decisions: When to Review That Which Long Process Could Not Arbitrate - F.C. Schaffer & (and) Associates, Inc. v. Demech Contractors, Ltd.

Brian T. McCartney

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NOTES

Rethinking Appeal of Arbitrability Decisions: When to Review “That Which Long Process Could Not Arbitrate”

*F.C. Schaffer & Associates, Inc. v. Demech Contractors, Ltd.*¹

I. INTRODUCTION

Under section 16 of the Federal Arbitration Act² (“FAA”), arbitrability is a question for the federal courts.³ However, once an affirmative determination of arbitrability has been made, judicial involvement in the arbitration process is minimized in order to further arbitration’s goals of economy, expediency, and simplicity.⁴ Recently, some critics have suggested that section 16 should be amended to improve its efficiency as a pro-arbitration statute.⁵

In *F.C. Schaffer & Associates, Inc. v. Demech Contractors, Ltd.*, the Fifth Circuit held that a motion which raised the issue of arbitrability within the larger context of a declaratory judgment action did not constitute a final, appealable order confirming an arbitrator’s decision.⁶ Thus, the court of appeals lacked jurisdiction to review the issue of arbitrability until the arbitrator’s final decision had been confirmed or vacated by the district court.⁷ While this holding clearly favors arbitration, it does create one problem. If the district court errs initially in determining arbitrability, a party may be forced to participate in an unwarranted arbitration proceeding.

This Note will proceed in five sections. Section II will set forth the factual framework of the *Schaffer* case and the holding of the Fifth Circuit.⁸ Section III will briefly examine the legal background behind the appeal of arbitrability rulings.⁹ Section IV will explore the analysis and decision of the Fifth Circuit in *Schaffer*.¹⁰ Finally, Section V will comment on the *Schaffer* court’s holding and discuss its

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1. 101 F.3d 40 (5th Cir. 1996).
 2. FEDERAL ARBITRATION ACT, 9 U.S.C. § 16 (1994).
 3. *See infra* notes 28-31.
 4. *See infra* note 131.
 5. *See infra* notes 134-36.
 6. *See infra* note 26.
 7. *See infra* note 27.
 8. *See infra* notes 12-27.
 9. *See infra* notes 28-99.
 10. *See infra* notes 100-130.

policy implications.¹¹ This Note will conclude that 9 U.S.C. § 16 must be carefully examined and refined in order to meet the policy goals of arbitration.

II. FACTS AND HOLDING

On October 29, 1992, Demech Contractors, Ltd. ("Demech") and F.C. Schaffer & Associates ("Schaffer") agreed upon a joint venture (the "agreement") to obtain a contract with the Ethiopian Sugar Company ("ESC") for the construction of an ethanol plant and sugar factory in Finchaa, Ethiopia.¹² The agreement's terms specified that the agreement would expire if ESC awarded the contract to another bidder.¹³ The agreement also included an expiration date of March 31, 1993, but this March date could be extended if both parties assented in writing.¹⁴ The expiration date was extended several times, and the last extension expired on December 31, 1993.¹⁵ Schaffer continued to negotiate with ESC to secure the contract between January 1994 and October 1994, when ESC finally awarded Schaffer the contract.¹⁶

During the negotiation period and for a number of months after the contract was awarded, Demech and Schaffer continued to deal with each other on the supposition that Demech would perform part of the contract work.¹⁷ However, the relationship between Demech and Schaffer began to sour, and Demech was finally shut out of the project.¹⁸ In June of 1995, Demech demanded arbitration pursuant to the agreement¹⁹ and claimed \$4.5 million in damages and lost profits from the project.²⁰ Schaffer responded with an action for declaratory judgment, arguing that because the agreement had expired before the contract was awarded, Schaffer had no obligation to Demech.²¹ Schaffer's pleading requested that the district court issue a preliminary injunction to stay the arbitration instituted by Demech, permanently enjoin Demech from proceeding in arbitration, and issue a declaration that Schaffer had no obligation to Demech under the agreement.²² A magistrate judge, sitting by

11. See *infra* notes 131-44.

12. *Schaffer*, 101 F.3d at 41.

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* Article 24 of the agreement provided:

Any dispute arising in connection with the construction or implementation of this Agreement shall be finally decided under the UNCITRAL Arbitration Rules by one or more arbitrators appointed in accordance with said rules. The arbitrator's decision shall be final and binding upon the Parties and not subject to appeal.

20. *Id.* Specifically, Demech alleged that the lost profits and damages were due to Schaffer's "refusal to allow [Demech] to perform work in accordance with the agreement." *Id.*

21. *Id.*

22. *Id.*

agreement of the parties, heard evidence on Schaffer's motion for the preliminary injunction and then denied Schaffer's motion, staying litigation in the federal district court pending arbitration of the dispute.²³ Schaffer appealed the order to the United States Court of Appeals for the Fifth Circuit.²⁴

On appeal, the Fifth Circuit dismissed Schaffer's motion for a preliminary injunction.²⁵ The Fifth Circuit held that a motion which raises the issue of arbitrability within the larger context of the declaratory judgment action does not constitute a final, appealable order confirming an arbitrator's decision.²⁶ Thus, the court of appeals lacked jurisdiction to review the issue of arbitrability until an arbitrator's final decision had been confirmed or vacated by the district court.²⁷

III. LEGAL HISTORY

The appeal of arbitrability rulings involves two interrelated questions. First, when can an arbitrability ruling be appealed? Second, who makes the final determination on the issue of arbitrability?

A. When Can an Arbitrability Ruling Be Appealed?

Section 16 of the FAA bars the appeal of interlocutory orders which compel arbitration, but it allows the appeal of final decisions which compel arbitration.²⁸ The FAA provides that the issue of arbitrability of a dispute may be litigated initially

23. *Id.*

24. *Id.*

25. *Id.* at 43.

26. *Id.*

27. *Id.*

28. 9 U.S.C. § 16 (1994) provides:

(a) An appeal may be taken from –

(1) an order –

(A) refusing a stay of any action under section 3 of this title,

(B) denying a petition under section 4 of this title to order arbitration to proceed,

(C) denying an application under section 206 of this title to compel arbitration,

(D) confirming or denying confirmation of an award or partial award, or

(E) modifying, correcting, or vacating an award;

(2) an interlocutory order granting, continuing, or modifying an injunction against an arbitration that is subject to this title; or

(3) a final decision with respect to an arbitration that is subject to this title.

(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order –

(1) granting any stay of any action under section 3 of this title;

(2) directing arbitration to proceed under section 4 of this title;

(3) compelling arbitration under section 206 of this title; or

(4) refusing to enjoin an arbitration that is subject to this title.

in a U.S. district court if the parties dispute arbitrability.²⁹ However, should the district court rule in favor of arbitration, the court system will cease all interference and allow the arbitration process to proceed.³⁰ To this end, Section 16 provides that a ruling in favor of arbitration may not be appealed until the arbitration has resulted in a final award.³¹

In *Sphere Drake Insurance PLC v. Marine Towing, Inc.*,³² Marine Towing, Inc. ("Marine") secured protection and indemnity insurance coverage for its marine vessels from a London marine insurer, Sphere Drake ("Sphere"), through Schade & Co. ("Schade").³³ Soon afterwards, one of Marine's insured vessels sank during the policy period but before the policy had been delivered.³⁴ When the policy arrived, Marine discovered a provision which required coverage disputes to be arbitrated in London.³⁵ Notwithstanding the provision, Marine sued both Schade and Sphere in Louisiana state court for a declaration of rights under the insurance policy.³⁶ Sphere then removed the case to the United States District Court for the Eastern District of Louisiana and made a motion to compel arbitration and stay litigation pending the arbitration.³⁷ Marine responded with a motion to remand, which was eventually sustained by the district court.³⁸

However, Sphere also brought a separate action to compel arbitration and stay litigation under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards³⁹ ("the Convention").⁴⁰ Marine replied that the district court lacked jurisdiction and moved for dismissal arguing that the removed case had been remanded and Marine had made no agreement to arbitrate under the Convention.⁴¹ Marine's motion was denied, and the district court ordered arbitration, staying all litigation between the parties.⁴² On appeal, the Fifth Circuit recognized a final order as one that "ends the litigation on the merits and leaves nothing for the court to do

29. *Id.*

30. *Id.* See also David D. Siegel, *Practice Commentary*, 9 U.S.C.A. § 16 (1997 Supp.) at 352.

31. 9 U.S.C. § 16 (1994). See also Siegel, *supra* note 30.

32. 16 F.3d 666 (5th Cir. 1994).

33. *Id.* at 667.

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.* The district court remanded the case due to the fact that Sphere had failed to join all of the defendants in the notice of removal. The court also dismissed as moot Sphere's motions which concerned arbitration. *Id.*

39. June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, reprinted in 9 U.S.C.A. § 201 note (West Supp. 1993). The Convention is an international agreement that requires its signatories to recognize not only arbitration awards from other signatory countries, but arbitration agreements as well. *Id.* See Kenneth-Michael Curtin, *Redefining Public Policy in International Arbitration of Mandatory National Laws*, 64 DEF. COUNS. J. 271, 271 (April 1997).

40. *Sphere*, 16 F.3d at 667.

41. *Id.*

42. *Id.*

but execute the judgment.”⁴³ With this definition, the court held that the district court’s order compelling arbitration of the disputed coverage was final⁴⁴ and then affirmed it.⁴⁵

Although the court had little difficulty in defining a final order, it did note one important consideration of such determinations made in relation to arbitrability disputes – the distinction between embedded and independent proceedings.⁴⁶

When determining whether an order affecting arbitration is interlocutory or final, most courts distinguish between arbitration actions that are “embedded” among other claims and those that are “independent” of other claims.⁴⁷ Generally, when the only issue before a court is the arbitrability of the dispute, the action is viewed as independent, and the court’s ruling on that issue is a final decision.⁴⁸ However, if the case contains other claims for relief, a court’s ruling on arbitrability is considered as only interlocutory and does not end litigation on its merits.⁴⁹

In *McDermott International, Inc. v. Underwriters at Lloyds Subscribing to Memorandum of Insurance No. 10420*,⁵⁰ McDermott International (“McDermott”) held an insurance policy for one of its subsidiaries from Lloyds Underwriters of London (“Lloyds”).⁵¹ The policy provided for arbitration of “[a]ll differences arising out of this contract.”⁵² When the subsidiary sustained property damage in 1989, McDermott submitted a policy claim.⁵³ Coverage was denied by Lloyds, and McDermott filed two actions against Lloyds in state court.⁵⁴ One action was for contract damages, and the other prayed for a declaratory judgment which would block the arbitration sought by Lloyds.⁵⁵ Lloyds invoked the Convention on the Recognition and Enforcement of Foreign Arbitral Awards,⁵⁶ and both actions were

43. *Id.* at 668 (quoting *McDermott Int’l Inc. v. Underwriters at Lloyds Subscribing to Memo. of Ins. No. 10420*, 981 F.2d 744, 747 (5th Cir. 1993) (quoting *Catlin v. United States*, 324 U.S. 229, 233 (1945))).

44. *Id.*

45. *Id.* at 670.

46. *Id.* at 668.

47. *McDermott Int’l, Inc. v. Underwriters at Lloyds Subscribing to Memo. of Ins. No. 10420*, 981 F.2d 744, 747 (5th Cir. 1993). See Siegel, *supra* note 30 at 306.

48. *McDermott*, 981 F.2d at 747.

49. *Id.* (citing *Construction Laborers Pension Trust v. Cen-Vi-Ro Concrete Pipe & Prds. Co., Inc.*, 776 F.2d 1416, 1420 n.5 (9th Cir. 1985); *Langley v. Colonial Leasing Co. of New England*, 707 F.2d 1, 4 (1st Cir. 1983); *Wilson Wear, Inc. v. United Merchants & Mfrs., Inc.*, 713 F.2d 324, 326 (7th Cir. 1983)).

50. *McDermott*, 981 F.2d at 747.

51. *Id.* at 746

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. 9 U.S.C. § 201.

subsequently removed to federal district court and consolidated.⁵⁷ The district court granted Lloyds' motion to compel arbitration and stay litigation pending arbitration in February 1992.⁵⁸

On appeal to the Fifth Circuit, the *McDermott* court first noted that the FAA reflects a liberal federal policy in favor of arbitration.⁵⁹ The court stated that this policy was promoted "by permitting interlocutory appeals of orders favoring litigation over arbitration and precluding review of interlocutory orders that favor arbitration."⁶⁰ However, the Fifth Circuit observed that the FAA does allow appeals from final judgments on arbitration as well as appeals pursuant to a permissive certificate in accordance with 28 U.S.C. Section 1292(b).⁶¹

The Fifth Circuit then explained that Section 16(b) prohibits an appeal from an interlocutory order which grants a stay of any litigation and compels arbitration under Section 3 of the FAA.⁶² The court also noted that Section 16 (a)(3) does allow the appeal of final orders; thus, the initial issue in the case was whether the district court's order had been interlocutory or final.⁶³ In essence, when the only issue facing the court is the arbitrability of the dispute, the action is deemed as independent and the court's decision on that issue is final.⁶⁴ However, if a case contains other claims for relief, the court's ruling on the arbitrability issue is interlocutory and will not end the litigation on the merits.⁶⁵

The Fifth Circuit rejected *McDermott's* argument that the district court's ruling was final in its "judicial context"⁶⁶ since the issue of arbitrability under the Convention was the only jurisdictional foundation for the case's removal to federal court.⁶⁷ Rather, stated the court, "Fifth Circuit precedent firmly establishes that, in pending, nonindependent suits, an order compelling arbitration accompanied by a

57. *McDermott*, 981 F.2d at 746. The district court initially remanded the cases to state court, holding that Lloyds' removal rights had been waived by a service-of-suit clause in the policy. However, the Fifth Circuit vacated that order in *McDermott Int'l v. Lloyds Underwriters of London*, 944 F.2d 1199 (5th Cir. 1991).

58. *Id.* The stay also included claims and parties not subject to arbitration. *Id.*

59. *Id.* (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25 (1991)).

60. *Id.* (quoting *Forsythe Int'l, S.A. v. Gibbs Oil Co. of Texas*, 915 F.2d 1017, 1020(5th Cir. 1990)).

61. *Id.* at 747. In *McDermott*, the Fifth Circuit suggested that a party might rely on § 1292(b) to appeal a decision on arbitrability. However, this remedy is cold comfort for most parties since it is unlikely that a district court will certify its decision on arbitrability to the court of appeals. A writ of mandamus is also an unlikely vehicle for relief, since it is well settled that mandamus "is not to be used as a substitute for appeal." *Id.* at 748. See also *Turboff v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 867 F.2d 1518, 1520 (5th Cir. 1989); *West of England Ship Owners Mutual Ins. Ass'n v. American Marine Corp.*, 981 F.2d 749, 751 (5th Cir. 1993).

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.* *McDermott* quoted Siegel, *Appeals from Arbitrability Determination Under the New § 15 of the U.S. Arbitration Act*, 126 F.R.D. 589, 591 (1989) in support of its "judicial context" argument. (Section 16 was previously numbered as section 15.)

67. *Id.*

stay of the proceedings pending arbitration is not a final decision for purposes of Section 16(a)(3).⁶⁸ The *McDermott* court then held that McDermott's appeal was barred by Section 16(b) of the FAA since the district court's orders were not final, but rather, interlocutory.⁶⁹

Commentators have noted that the distinction between embedded and independent proceedings is of particular importance in arbitrability disputes because Section 16 "fails to address one of the most important of the situations in which the appellate process has been impeding arbitration: the independent proceeding brought into court to test arbitrability."⁷⁰

B. Who Makes the Final Determination on the Issue of Arbitrability?

In *First Options of Chicago v. Kaplan*,⁷¹ the United States Supreme Court addressed the question of what body should govern a determination of arbitrability.⁷² Mr. and Mrs. Kaplan and MK Investments, Inc. ("MKI"), an investment company wholly owned by Mr. Kaplan, owed debts to First Options of Chicago, Inc. ("First Options"), a firm which cleared trades of stock on the Philadelphia Stock Exchange.⁷³ After the stock market crash of October 1987, the Kaplans and MKI entered into a "working out" agreement, manifested in four separate instruments, to "workout" the debts that the Kaplans and MKI owed to First Options as a result of the crash.⁷⁴ MKI had additional losses of \$1.5 million in 1989, prompting First Options to take power over and liquidate specific MKI assets, demand that MKI make immediate payment of its entire debt, and insist that any deficiency should be paid personally by the Kaplans.⁷⁵ First Options' demands were not satisfied, and it sought to have a panel of the Philadelphia Stock Exchange arbitrate the dispute.⁷⁶

MKI, having subscribed to the only one of the four "workout" instruments which contained an arbitration clause, agreed to arbitration.⁷⁷ The Kaplans, however, had not personally signed the instrument with the arbitration clause, and they denied the arbitrability of their dispute with First Options and objected to the arbitration panel in writing.⁷⁸ The panel determined that it did, in fact, have the authority to make a ruling on the merits of the dispute, and it ruled in favor of First Options.⁷⁹ Following the panel's ruling, the Kaplans attempted to have the

68. *Id.* at 748.

69. *Id.*

70. See Siegel, *supra* note 30.

71. 514 U.S. 938 (1995). (Justice Breyer delivered the unanimous opinion of the court.)

72. *Id.* at 940.

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.* at 941.

78. *Id.*

79. *Id.*

arbitration award vacated by the federal district court, and First Options asked that the award be confirmed.⁸⁰ The district court confirmed the award, but on appeal the Court of Appeals for the Third Circuit reversed the district court, holding that the dispute between First Options and the Kaplans was not arbitrable.⁸¹ The Supreme Court granted certiorari in order to consider the standards used by the Third Circuit to determine arbitrability.⁸²

In answering the question of what standard of review to apply to the arbitrators' decision on arbitrability, the Court first recognized the question's narrowness and its practical importance.⁸³ In terms of narrowness, the Court declined to address either the merits of the dispute⁸⁴ or the issue of whether the parties had agreed to arbitrate the dispute.⁸⁵ Rather, the Court stated that it would consider only the question of who has the primary power to decide the arbitrability of the parties' dispute.⁸⁶ The Court suggested that the arbitrator might logically possess this power since the arbitrator's decision on arbitrability is reviewed deferentially by the court.⁸⁷ On the other hand, a court might also logically possess this power because courts reach independent decisions about arbitrability.⁸⁸ Finally, the Court noted that the appropriate standard of review of an arbitrator's decision has great practical importance "because a party who has not agreed to arbitrate will normally have a right to a court's decision about the merits of its dispute."⁸⁹ Conversely, a party who is deemed to have agreed to arbitrate a dispute relinquishes a great deal of the practical value of that right.⁹⁰

This question of who possesses the power to decide arbitrability was seen as "fairly simple" by the Court, which stated that "arbitration is simply a matter of contract between the parties; it is a way to resolve those disputes – but only those disputes – that the parties have agreed to submit to arbitration."⁹¹ Accordingly, the Court held that courts are bound to defer to an arbitrator's decision on arbitrability if the parties had agreed to arbitrate that matter.⁹² However, the Court added that the

80. *Id.*; see 9 U.S.C. § 10 (1994).

81. *First Options*, 514 U.S. at 941.

82. *Id.*

83. *Id.* at 942.

84. *i.e.* whether the Kaplans were personally liable.

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.* The Court noted that an aggrieved party may still ask that a court review the decision of an arbitrator, "but the court will set that decision aside only in very unusual circumstances." *Id.* (citing 9 U.S.C. § 10 – award procured by corruption, fraud, or other undue means; arbitrator exceeded his powers).

91. *Id.* at 943 (citing *AT & T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 649 (1986) (parties may contractually agree to arbitrate arbitrability); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 270-71, (1995); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 626 (1985)).

92. *Id.*

more difficult part of the first question was how a court should go about deciding whether the parties actually agreed to arbitrate the issue of arbitrability.⁹³

First, the Court instructed that courts should generally address the question by applying the governing state law principles of contract.⁹⁴ However, the Court added a considerable qualification: “[c]ourts should not assume that the parties agreed to arbitrate arbitrability unless there is ‘clear and unmistakable’ evidence that they did so.”⁹⁵ This qualification was based on the Court’s hesitancy to force an unwilling party to arbitrate an issue which they might reasonably have thought would be decided by a judge rather than an arbitrator.⁹⁶

Turning to the case at hand, the Court observed that the record before it did not clearly show that the Kaplans had agreed to arbitrate the issue of arbitrability; rather, the Kaplans forcefully objected to the arbitration of their dispute both in writing and in front of the arbitrators.⁹⁷ Additionally, the Court noted that the Kaplans could argue the issue of arbitrability without losing the right to an independent review in court under Third Circuit precedent.⁹⁸ The Court then concluded that, because the Kaplans had not clearly agreed to arbitrate the issue of arbitrability, the Third Circuit had correctly found that the arbitrability of the dispute was subject to an independent review in the courts.⁹⁹

IV. INSTANT DECISION

*A. The Majority Opinion*¹⁰⁰

In *F.C. Schaffer & Associates, Inc. v. Demech Contractors, Ltd.*,¹⁰¹ the Fifth Circuit began its analysis by observing that the FAA bars the appeal of interlocutory orders which compel arbitration but allows the appeal of final orders which compel arbitration.¹⁰² The court then recognized a final order as one that “ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.”¹⁰³ The court noted that most courts, including the Fifth Circuit, distinguish between arbitration actions that are “embedded” among other claims and those that are

93. *Id.* at 944.

94. *Id.*

95. *Id.* (emphasis added and ellipses omitted).

96. *Id.* at 945.

97. *Id.* at 946.

98. *Id.*

99. *Id.* at 947.

100. The per curiam opinion was before Judges Duhe, Jones, and King; Judge Jones filed a concurring opinion.

101. 101 F.3d 40 (5th Cir. 1996).

102. *Schaffer*, 101 F.3d at 41.

103. *Id.* (quoting *Sphere*, 16 F.3d at 666).

“independent” when determining whether an order affecting arbitration is interlocutory or final.¹⁰⁴ The court then stated the rule that:

[g]enerally, if the only issue before the court is the dispute’s arbitrability, the action is considered independent and a court’s decision on that issue constitutes a final decision. If, however, the case includes other claims for relief, an arbitrability ruling does not ‘end the litigation on the merits,’ but is considered interlocutory only.¹⁰⁵

The Fifth Circuit then turned to Demech’s argument that the court of appeals lacked jurisdiction because Schaffer’s motion for a preliminary injunction raised the subject of arbitrability within an embedded proceeding.¹⁰⁶ Demech argued that an embedded proceeding is one in which the issue of arbitrability is raised in a broader context - for example, “an ordinary plenary action on the underlying substantive dispute brought in disregard of the arbitration commitment.”¹⁰⁷ Demech also contended that issue of arbitrability was raised by Schaffer appurtenant to the declaratory judgment action in which, according to Demech, Schaffer sought a declaratory judgment on an underlying substantive issue: whether or not the agreement imposed an obligation to Demech upon Schaffer.¹⁰⁸

The court then examined Schaffer’s argument that the distinction between “embedded” and “independent” proceedings was jurisprudentially created and developed before the Supreme Court’s ruling in *First Options*.¹⁰⁹ Schaffer argued that under *First Options*, the Supreme Court ruled that arbitrability is a threshold issue for a district court to determine.¹¹⁰ Thus, argued Schaffer, the distinction between “embedded” and “independent” proceedings should not be applied in the instant case because the lower court did not make an express decision on the issue of arbitrability.¹¹¹ Schaffer contended that the district court’s opinion lacked discussion of arbitrability; thus, Schaffer suggested that the lower court had abdicated its responsibility under *First Options* to determine if the parties had indeed agreed to arbitrate arbitrability.¹¹² Schaffer then concluded that the court of appeals has jurisdiction to review the decision of the district court on the issue of arbitrability.¹¹³

104. *Id.*

105. *Id.* (quoting *McDermott*, 981 F.2d at 747).

106. *Id.* at 42.

107. *Id.* (citing Siegel, *supra* note 30).

108. *Id.* Demech cited *American Casualty Co. v. L-J, Inc.*, 35 F.3d 133 (4th Cir. 1994), in support of this proposition.

109. *Id.*; see *supra* notes 82-99.

110. *Id.*

111. *Schaffer*, 101 F.3d at 42.

112. *Id.*

113. *Id.*

The Fifth Circuit observed that the district court does have an affirmative duty to decide the issue of arbitrability.¹¹⁴ However, the Fifth Circuit took a different view of when a court of appeals has jurisdiction to review a district court's decision on arbitrability.¹¹⁵ The court stated that "*First Options* does not specifically displace or even allude to the jurisprudence that has developed under the FAA, 9 U.S.C. § 16, limiting appeals of orders to arbitrate."¹¹⁶ Initially, the court noted that *First Options* provides no answer to the question of whether a distinction between "embedded" and "independent" proceedings is a valid way to determine the finality of an arbitration order.¹¹⁷ Rather, the court explained:

First Options places the burden on the district court to look closely at the agreement between the parties and determine whether the parties agreed to arbitrate the issue of arbitrability. Once the district court has made the decision in an "embedded" proceeding that the parties' dispute is arbitrable, [the court of appeals] lacks jurisdiction to review the district court's decision regarding the arbitrability of the parties' dispute until there is an appealable, i.e. final, order.¹¹⁸

The court then added that Schaffer will not be left without a remedy if the district court erred in requiring the issue of arbitrability to be arbitrated.¹¹⁹ The court cited *First Options* for the proposition that a court of appeals does have jurisdiction to conduct a "typical" review of a district court's ruling on the scope of an agreement to arbitrate once a district court has confirmed an arbitration award.¹²⁰

The Fifth Circuit held that a motion which raises the issue of arbitrability within the larger context of the declaratory judgment action does not constitute a final, appealable order confirming an arbitrator's decision; thus, the court of appeals lacked jurisdiction to review the issue of arbitrability at that time.¹²¹ Accordingly, Schaffer's appeal was dismissed for want of jurisdiction.¹²²

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.* at 42-43.

119. *Id.* at 43.

120. *Id.* (citing *First Options*, 514 U.S. at 947-48, which reversed a district court's finding of an agreement to arbitrate arbitrability and ruled that appellate review of a district court's decision on arbitrability "should proceed like review of any other district court decision finding an agreement between parties, e.g. accepting findings of fact that are not 'clearly erroneous' but deciding questions of law *de novo*."); see also *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993, 996 (5th Cir 1995) (The Fifth Circuit "reviews the district court's confirmation of an arbitration award under a *de novo* standard.").

121. *Id.*

122. *Id.*

B. The Concurrence

In a two-paragraph concurrence, Judge Edith H. Jones expressed her dissatisfaction with the appeal's required outcome.¹²³ Judge Jones recognized that the language of 9 U.S.C. § 16 and Fifth Circuit precedent¹²⁴ required the court to conclude that it lacked jurisdiction to entertain an appeal at that time.¹²⁵ The result, however, seemed to Judge Jones to run contrary to the spirit of *First Options*.¹²⁶ Judge Jones quoted language in *First Options* that described arbitration as a remedy employed as "a way to resolve those disputes – but only those disputes – that the parties have agreed to submit to arbitration."¹²⁷

Judge Jones stated that the prerequisite to arbitration is an agreement between the parties, and the question of agreement is thus one for the court under contract law.¹²⁸ However, Judge Jones observed that, in this case, the lower court compelled arbitration based upon a contract which "appears to have expired several months prior to the parties' current business dealings."¹²⁹ Judge Jones then concluded that:

[r]equiring Schaffer to expend its resources now by participating in a potentially unwarranted arbitration proceeding without the benefit of this court's review of the lower court's decision compelling arbitration is an unfortunate result which seems to run against the notion that parties should not be forced to arbitrate disputes when they did not agree to do so.¹³⁰

123. *Id.*

124. Judge Jones cited four cases as precedent: *Ilva (USA), Inc. v. Alexander's Daring M/V*, 10 F.3d 255, 256 (5th Cir. 1993) (ruling that the Fifth Circuit did not have jurisdiction to hear an appeal of an interlocutory order compelling arbitration); *West of England Ship Owners Mut. Ins. Ass'n v. American Marine Corp.*, 981 F.2d 749, 751 (5th Cir. 1993) (same ruling); *McDermott*, 981 F.2d at 748 (same ruling); and *Purdy v. Monex Int'l Ltd.*, 867 F.2d 1521, 1523 (5th Cir. 1989) (same ruling).

125. *Id.*

126. *Id.*

127. *Id.* (quoting *First Options*, 514 U.S. at 943); Judge Jones also quoted *AT&T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 648 for the proposition that arbitration "is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."

128. *Id.*

129. *Id.*

130. *Id.*

V. COMMENT

Section 16 of the Federal Arbitration Act favors arbitration and minimizes judicial involvement in the arbitration process.¹³¹ Accordingly, Section 16 permits the issue of arbitrability to be litigated in a U.S. district court but prohibits appellate review of the district court's decision until an arbitrator's final award has been reached.¹³² Although this scheme is designed to limit judicial interference in the arbitration process, it provides for the possibility of one proceeding before a district court to determine the issue of arbitrability, one proceeding in an appellate court if the action is considered "independent" rather than "embedded," one proceeding in the district court to confirm or vacate an arbitrator's final award, and one proceeding in an appellate court to review the district court's initial ruling on arbitrability. This extension of the arbitration process seems in conflict with arbitration's goals of economy, expediency, and simplicity. Additionally, the distinction between embedded and independent proceedings for the purposes of appellate review of a district court's ruling on arbitrability can produce both confusion and inconsistency.¹³³

One possible solution would be an amendment to Section 16 which would expressly prohibit any appeal from a decision compelling arbitration. David D. Siegel suggests that Section 16 could be amended to add a new subdivision (c), which would resemble the following:

(c) An appeal may not be taken from a decision or order, or that part of a decision or order, final or otherwise, directing or compelling arbitration made under section 4 or section 206 of this title even if made in an independent proceeding, but the decision or order or part thereof barred from immediate appeal by this subdivision may be reviewed as part of an appeal from a post-award decision or order confirming, modifying, correcting, or vacating an award, or refusing to do any of those things. The party seeking such review shall obtain, and shall include as an appendix to

131. See Siegel, *supra* note 30. Section 16 is characterized as "a pro-arbitration statute designed to prevent the appellate aspect of the litigation process from impeding the expeditious disposition of an arbitration."

132. *Id.*

133. See, e.g., *McCarthy v. Providential Corp.*, 122 F.3d 1242, 1245-49 (9th Cir. 1997). Judge Pregerson's dissent argues: (1) embedded proceedings are not necessary interlocutory, and (2) dismissal of an action involving an embedded arbitrability proceeding is an appealable final judgment. Judge Pregerson suggested that the Ninth Circuit should have followed the Sixth and the Tenth Circuit cases which "held that, where the district court dismisses the action upon ordering arbitration, the order is an appealable final decision." *Id.* (citing *Arnold v. Arnold Corp.*, 920 F.2d 1269 (6th Cir. 1990) and *Armijo v. Prudential Insurance Co. of America*, 72 F.3d 793 (10th Cir. 1995)). Judge Pregerson believed that the majority opinion's reliance on *Gammara v. Thorp Consumer Discount Co.*, 15 F.3d 93 (8th Cir. 1994) and *Schaffer*, 101 F.3d 40 (5th Cir. 1996) was misplaced. *Id.*

his or her brief, the relevant portions of the record in the proceeding that directed or compelled arbitration.¹³⁴

Siegel's proposed amendment would have a number of advantages. First, the amendment would remove the second possible step in the aforementioned process – the appeal from a district court's final order on the issue of arbitrability in an independent proceeding. Further, it removes the need for a determination of whether the action is embedded or independent. Both of these advantages save time and money and add certainty.¹³⁵ Another advantage is that appellate review will take place in the court of appeals only after the arbitrator has issued a final award. Appellate review that follows a district court's decision or order on a final arbitration award will benefit from having the full scope of the proceeding to examine. Thus, appellate review should be most efficient at this point in that the court of appeals will have the rulings of the district court before it.¹³⁶

However, Siegel's solution answers only part of the question: why should this additional review be allowed at all if federal policy favors binding and final arbitration? The resulting hybrid of arbitration and litigation, even should Siegel's proposal be incorporated, produces a framework that is much more costly, lengthy, and uncertain than arbitration purists might like. The Fifth Circuit's holding in *Schaffer* provides a possible answer.

In *Schaffer*, Schaffer litigated and lost in the district court on the issue of arbitrability.¹³⁷ Because the court of appeals had to wait for an arbitrator's final award, Schaffer was forced to proceed with what may have been an unwarranted arbitration proceeding.¹³⁸ Under the Fifth Circuit's holding, Schaffer has one course of action if the arbitration award is unfavorable and they hope to keep their cause alive: Schaffer will have to make a motion in the district court to have the arbitrator's award overturned.¹³⁹ Only if a district court confirms the arbitration award may Schaffer finally have the court of appeals review the district court's

134. Siegel, *supra* note 30. The third paragraph of § 16's subdivision (a) would also have to be amended to reflect the addition of Siegel's proposed paragraph (c). Presently, the paragraph permits an appeal from "a final decision with respect to an arbitration that is subject to this title." Siegel proposes that the period be replaced with a comma followed by the phrase "except as otherwise provided in subdivision (c)."

135. *Id.* According to Siegel, his "suggested amendment can easily divest the 'independent' proceeding of what amounts to its present power to impede arbitration in a way no 'embedded' proceeding can." Siegel sees nothing "substantively unique about the 'independent' proceeding that should earn it an expedited appellate review." *Id.*

136. Under Siegel's proposal, the party seeking review "shall obtain [and] include as an appendix to his or her brief, the relevant portions of the record in the proceeding that directed or compelled arbitration." *Id.* According to Siegel, the "appendix seems an ideal way of injecting the prior proceeding's record, and of seeing to it that the expense, or at least the initial expense, of doing so is on the party who wants the prior decision or order reviewed." *Id.*

137. See *supra* notes 105-126.

138. See *supra* notes 129-134.

139. See *supra* note 124.

ruling on the scope of the arbitration agreement.¹⁴⁰ Thus, a party who may never have agreed to arbitrate may be forced to both arbitrate and litigate.¹⁴¹ This unusual possibility would actually increase the cost and time involved in the dispute and run contrary to arbitration's goals of certainty, economy, and efficiency. However, under *Schaffer* the party still has the opportunity for appellate review.

Judge Jones' concurrence in *Schaffer* highlights this problematic possibility and exposes the FAA's potential to require a party to expend resources by "participating in a potentially unwarranted arbitration proceeding without the benefit of [appellate] review of the lower court's decision compelling arbitration."¹⁴² Although Judge Jones suggests that the district court may have erred, she recognizes that the court of appeals would be able to exercise jurisdiction over the case at some later date.¹⁴³ If *Schaffer* were denied this final appellate review of a district court's possibly erroneous ruling, then they would be left entirely without remedy. Consequently, Siegel's compromise is superior to a system that either precludes appellate review entirely or allows appellate review immediately.¹⁴⁴

VI. CONCLUSION

Section 16 of the Federal Arbitration Act is a step in the right direction. By favoring arbitration and allowing for appellate review, the statute recognizes the need for a carefully balanced framework of arbitration and litigation in the area of arbitrability. However, this framework could be improved by the adoption of Siegel's suggested amendment, thereby eliminating the possibility for appellate review until arbitration has produced a final award. Ultimately, however, *Schaffer's* lesson is between the lines of Judge Jones' concurrence: final appellate review should be preserved in the court of appeals. It is better that the issue of arbitrability be resolved more slowly rather than incorrectly.

BRIAN T. MCCARTNEY

140. *Id.*

141. *See supra* note 134.

142. *Schaffer*, 101 F.3d at 43-44. In *Schaffer*, Judge Jones' concurrence suggests that the lower court may have been mistaken to compel arbitration on the basis of a contract which appeared to have "expired several months prior to the parties' current business dealings." Therefore, *Schaffer* was forced to arbitrate a dispute which it had not agreed to and must add the cost of this appeal to their previous costs in the district court and those required for subsequent arbitration. *Id.*

143. *Id.*

144. In fact, the passage of time between the initial arbitrability ruling and the final appellate review of arbitrability may result in a more reasoned decision on the issue.

The extreme parts of time extremely form

All causes to the purpose of his speed,

And often at his very loose decides

That which long process could not arbitrate.

WILLIAM SHAKESPEARE, *LOVE'S LABOURS LOST*, act 5, sc. 2.

