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Preliminary Injunction of Arbitration Proceedings

Six Clinics Holding Corporation, II v. Cafcomp Systems, Inc.[1]

I. INTRODUCTION

The issue presented in *Six Clinics Holding Corporation, II v. Cafcomp Systems, Inc.*, is whether a court is prohibited from issuing a preliminary injunction in a case subject to arbitration.[2] The parties had a private agreement to arbitrate any disputes, but the court enjoined the arbitration in order to determine a federal issue outside the arbitrator's jurisdiction.[3] The defendant argued that the Anti-Injunction Act, which prohibits federal courts from enjoining state court proceedings, was violated.[4] However, the court found a loophole by stating that a private arbitration is not a state proceeding and thus is not governed by the Act.[5] This escape hatch is an all too easy method to avoid the Anti-Injunction Act's purpose and strictly construed exceptions. By allowing a preliminary injunction of an arbitration proceeding, the *Six Clinics* court has diluted the strength and effect of alternative dispute resolution methods like arbitration.

II. FACTS AND HOLDING

Defendant, Cafcomp, Inc. (Cafcomp), is an employee benefits administration company that provides comprehensive cafeteria plan services which permit certain tax exemptions for employees.[6] Six Clinics Holding Corporation II, previously known as American Rehabilitation Network (ARN), is a Michigan corporation that provides several physical and occupational therapy services and facilities in Detroit.[7] In August 1992, Cafcomp's Chief Executive Officer and President, Lenza Reaves, met with ARN and recommended two cafeteria plans.[8] ARN decided to use the Pay+PLUSTM Plan and entered into an agreement with Cafcomp on October 9, 1992.[9] The agreement detailed the plan's services, the two-year term, and included an arbitration clause for any claim arising out of the agreement or breach of the agreement.[10]

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1. 119 F.3d 393 (6th Cir. 1997).
2. *Id.*
3. *Id.* at 396.
4. *Id.* at 397.
5. *Id.* at 398.
6. *Id.* at 396.
7. *Id.* On June 12, 1997, American Rehabilitation Network filed notice of a Change of Name to Six Clinics Holding Corporation, II. The opinion uses ARN since the corporation used this name during the events giving rise to this litigation.
8. *Id.*
9. *Id.*
10. *Id.*

In the fall of 1993, ARN questioned Cafcomp about the legality of the plan and subsequently terminated the agreement on November 22, 1993.[11] On March 3, 1994, Cafcomp filed an arbitration notice with the American Arbitration Association (AAA) for breach of agreement by ARN and sought damages in excess of $250,000.[12] On September 6, 1994, ARN filed an arbitration counterclaim alleging that the cafeteria plan was a violation of the Internal Revenue Code and a breach of Cafcomp's fiduciary duties under the Employee Retirement Income Security Act of 1974 (ERISA).[13] In January 1995, Cafcomp filed a motion for summary disposition to dismiss the ERISA counterclaim and defenses because the arbitration court lacked subject matter jurisdiction.[14]

ARN responded to Cafcomp's motion by filing an action in federal court on February 1, 1995, claiming that Cafcomp had violated its fiduciary duties under ERISA.[15] It simultaneously asked the arbitration panel to stay arbitration until the federal suit was resolved.[16] The arbitration panel refused to delay the proceedings and dismissed ARN's counterclaims on February 6, 1995, stating that it lacked jurisdiction.[17]

On April 11, 1995, ARN filed an action in district court seeking a stay of arbitration or, alternatively, that the proceedings remain open until the federal suit was resolved.[18] On May 10, 1995, the district court concluded that ARN would likely prevail in federal court and granted ARN's motion for preliminary injunction.[19] Cafcomp appealed the district court's decision arguing that the court did not have authority to delay the arbitration action under the Anti-Injunction Act which prohibits federal courts from enjoining state court proceedings.[20] The Sixth Circuit Court of Appeals affirmed the district court's decision to grant a preliminary injunction.[21]

The primary issue on appeal was whether this arbitration proceeding was a state court proceeding in which case the court would be prohibited from ordering an injunction under the Anti-Injunction Act.[22] The Court of Appeals concluded that the Anti-Injunction Act does not apply to arbitration proceedings in that arbitration is a private and voluntary proceeding in which the state courts may never become involved.[23] Therefore, the district court has authority to grant preliminary injunctions

11. *Id.*

12. *Id.*

13. *Id.* The specific statutory rules relating to cafeteria plans and tax exemptions are in the Internal Revenue Code. 26 U.S.C. § 125.

14. *Id.* Under 29 U.S.C. § 1132 (e) (1), the federal court has exclusive jurisdiction of such claims.

15. *Id.* at 397.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* The Anti-Injunction Act provides: "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to protect or effectuate its judgments." 28 U.S.C. § 2283.

21. *Id.*

22. *Id.* at 398.

23. *Id.* at 399.

to stay arbitration proceedings.[24] On secondary issues of whether the preliminary injunction was sufficiently supported, the court held that the district court's reasons were adduced.

III. LEGAL HISTORY

The issue in *Six Clinics Holding Corporation, II v. Cafcomp Systems, Inc.*,[25] is whether a federal court can enjoin an arbitration proceeding. The court determined that it did have authority to order an injunction because the arbitration was not a state court proceeding within the meaning of the Anti-Injunction Act.[26] A discussion of the Act and its historical relation to arbitration proceedings will provide insight to this decision.

The purpose of the Anti-Injunction Act is a "desire to avoid direct conflicts between state and federal courts" by preventing federal courts from interfering with state court actions.[27] The Act was originally a section of the Judicial Code and provided only one specific exception allowing federal injunctions relating to bankruptcy proceedings.[28] The rule was recognized and revised in Title 28 of the United States Code in 1948 to include three general exceptions and labeled as the Anti-Injunction Act.[29] Under the Act, a court of the United States may enjoin a state proceeding if expressly authorized by Act of Congress, necessary in aid of its jurisdiction, or necessary to protect or effectuate its judgments.[30]

Case law indicates that courts have strictly construed the three exceptions to the Anti-Injunction Act. In *Amalgamated Clothing Workers of America v. Richman Brothers*, the court stated that the Act is "not a statute conveying a broad general policy for appropriate ad hoc application" but is clearly defined by specific exceptions.[31] In *Roodveldt v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[32] the court evaluated a request to enjoin a state order and require arbitration to resolve the dispute. The court found that the matter met the third exception under the Anti-Injunction Act, to "protect or effectuate the United States' court judgments," and permitted the district court to enjoin the state order.[33] However, the court added a requirement to the exceptions that "a party must demonstrate sufficient need to be entitled to relief under the relitigation doctrine."[34] The court in *Roodveldt* held that although the exception was met, the plaintiff did not indicate a sufficient need for the

24. *Id.* at 400-402. The court concluded that the district court adequately stated reasons for granting the preliminary injunction by referencing specific evidence "that ARN was likely to succeed on the merits of its claim that Cafcomp was a fiduciary" and that ARN was entitled to a preliminary injunction.

25. *Id.* at 393.

26. *Id.*

27. *Id.* at 518.

28. Amalgamated Clothing Workers of America v. Richman Brothers, 348 U.S. 511, 514 (1955).

29. *Id.*

30. 28 U.S.C. § 2283 (West 1997).

31. *Id.* at 516.

32. 585 F. Supp. 770 (E.D. Pa. 1994).

33. *Id.* at 782 (citing 28 U.S.C. § 2283).

34. *Id.* at 783.

injunction and so it was denied and a separate order was made for the arbitration request.[35]

Case law clearly indicates that the exceptions to the Anti-Injunction Act are strictly construed to prevent federal courts from interfering with state proceedings. In some cases, courts have looked to the nature of the action rather than the exceptions to avoid the Anti-Injunction law. In *Roudebush v. Hartke*,[36] a United States Senator sought an injunction against a state court order for a recount of the election in which he was appointed. In determining the enjoinder issue under the Anti-Injunction Act, the court held that the recount procedure was not a state court proceeding within the meaning of the Act.[37] The court reasoned that "not every state court function involves 'litigation' or 'legal controversies'" and that the Act does not restrict injunctions for proceedings of non-judicial functions.[38]

In another attempt to avoid the Anti-Injunction Act, *Kelly v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[39] found that federal courts have broad injunctive powers to protect their own judgments.[40] This court held that the broad powers included authority to enjoin arbitrations to prevent re-litigation. In addition, the court stated that the Anti-Injunction Act merely creates an exception to the broad injunctive powers rather than "authorizing an exclusive class of injunctions."[41]

Although the Anti-Injunction Act prohibits injunctions for state court proceedings, the exceptions and interpretation of the types of proceedings covered within the Act have enabled courts to escape the mandate against injunctions in certain instances. *Six Clinics* focused on the nature of the arbitrations as in *Roudebush* and *Kelly* to permit the court to enjoin the arbitration at issue.

IV. INSTANT DECISION

Six Clinics recognized the Anti-Injunction Act but determined that it did not restrict injunctions in this case because it only applied to proceedings in a state court.[42] The court relied heavily on *Roudebush v. Hartke,* which held that a non-enjoinable proceeding was one of judicial inquiry as opposed to administrative proceedings and thus not covered under the Act.[43] Following *Roudebush*, the court held that there are state actions which are enjoinable and not covered under the Anti-Injunction Act.[44]

After indicating that the Act only applies to certain state proceedings, the court reasoned that an arbitration proceeding is not the type of proceeding covered under

35. *Id.* at 784.
36. 405 U.S. 15 (1972).
37. *Id.* at 23.
38. *Id.* at 20-21 (citing Prentis v. Atlantic Coast Line R. Co., 211 U.S. 210 (1908)).
39. 985 F. 2d 1067 (11th Cir. 1993).
40. *Id.* At 1069 (citing 28 U.S.C. § 1651 (1994)).
41. *Id.* at 1069.
42. *Six Clinics*, 119 F.3d at 398.
43. *Roudebush*, 405 U.S. at 21.
44. *Six Clinics*, 119 F.3d at 398.

the Act.[45] The court looked at both the policy of the Act and the character of the arbitration proceeding in determining whether or not the Act governed.[46] First, the court explained that the purpose of the Act was to "avoid the inevitable friction between the state and federal courts that ensues from the injunction of state judicial proceedings by a federal court."[47] The court argued that this policy reason for the Anti-Injunction Act does not apply to arbitration proceedings which do not affect the jurisdictional conflicts between state and federal courts. The court also asserted that arbitration is an alternative method to avoid court resolution and thus is not the type of proceeding intended to be governed by the Act.[48]

The second argument asserted by the court was that the character of the proceedings determines whether or not the Act should apply.[49] *Roudebush* provided an example of such a proceeding that was not covered because it was administrative in nature rather than judicial.[50] The court determined that an arbitration is a private proceeding pursuant to a voluntary agreement to arbitrate rather than submit the issues in a judicial setting.[51] Thus, the private nature of this case indicates that it was not a state proceeding.[52]

Because the court determined that the Act did not apply to this case where an arbitration was agreed to by the parties, it did not decide whether an arbitration ordered or acted on by a state court meets the Anti-Injunction Act's definition of an applicable proceeding.[53] In addition, the court did not discuss whether the exceptions of the Act could authorize a federal court to order an injunction on an arbitration proceeding covered under the Act.[54] The court only determined that the Act does not apply "where an arbitration proceeding is private and voluntary, and the state courts have not become involved, and may never become involved."[55]

V. COMMENT

The precedential cases considering the right of federal courts to enjoin state court proceedings indicate that courts are reluctant to allow injunctions unless they meet the strict guidelines of the exceptions to the Act. More recent cases indicate a trend that *Six Clinics* followed that looks to the nature of the proceeding rather than the exceptions in order to find justification for enjoining arbitrations and other non-judicial proceedings. To support this broad interpretation, *Six Clinics* relied on *Roudebush v. Harke,* in which an election recount was enjoined because the proceeding was characterized as administrative rather than judicial.[56] Although

45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. *Roudebush*, 405 U.S. at 20-21.
51. *Six Clinics*, 119 F.3d at 398.
52. *Id.*
53. *Id.* at 399.
54. *Id.*
55. *Id.*
56. *Id.* at 398.

arbitration proceedings are non-judicial and generally involve only administrative roles by state courts like the *Roudebush* recount, arbitrations also involve a contractual agreement between two parties to arbitrate "[a]ny controversy or claim arising out of or relating to this agreement or the breach thereof."[57] The importance of encouraging alternative dispute resolution methods like arbitration depends on the enforcement of such contractual agreements. The consequences of a broad interpretation of the Anti-Injunction Act in *Six Clinics* may adversely impact alternative dispute resolution methods. If the court has unlimited freedom to enjoin arbitration proceedings, the effect of arbitration agreements will be severely diluted.

The Federal Arbitration Act indicates the strong federal policy of enforcing private agreements to arbitrate. The Act "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."[58] In *Dean Witter Reynolds, Inc. v. Byrd*, an investor brought suit against his broker alleging violations of federal securities law and state law.[59] Thus, as in *Six Clinics*, we have a bifurcation of arbitrable and nonarbitrable claims arising out of the same transaction. The Supreme Court in *Dean Witter* held that the district court had erred in refusing to compel arbitration of the state claims.[60] The Court concluded that the plain meaning and federal policy reflected in the Arbitration Act "requires courts to enforce the bargain of the parties to arbitrate, and 'not substitute [its] own views of economy and efficiency for those of Congress'."[61] In addition, the House report accompanying the Arbitration Act clearly states that its purpose was "to place an arbitration agreement 'upon the same footing as other contracts, where it belongs'."[62]

Six Clinics undermines the enforceability of arbitration agreements by stating that they are not judicial proceedings protected under the Anti-Injunction Act. The parties in *Six Clinics* agreed to arbitrate all claims or controversies and incurred any risks that might ensue from this bargained arrangement. By allowing courts to prevent private arbitration agreements from proceeding, the significance of such agreements as valid, irrevocable and enforceable contracts is eroded.

Although the best scenario in *Six Clinics* would be an enforcement of the arbitration proceedings, some courts have used an alternative to an injunction. In *Pensacola Construction Co. v. St. Paul Fire and Marine Insurance Co.*, the court suggested using declaratory judgments as an alternative remedy to the harsh results of injunctions on arbitration proceedings in order to protect a third party to an arbitration agreement.[63] The court stated that "Congress plainly intended declaratory relief to act as an alternative to the strong medicine of the injunction."[64] The court concluded that a declaratory judgment is the best of both worlds in that it does "not

57. *Id.* at 396.
58. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 218 (1985).
59. *Id.* at 214.
60. *Id.* at 223-24.
61. *Id.* at 217 (quoting Dickinson v. Heinold Securities, Inc., 661 F.2d 638, 646 (7th Cir. 1981)).
62. *Id.* at 219 (quoting H.R.Rep. No. 68-96, at 1 (1924)).
63. 705 F. Supp. 306, 309-11 (W.D. La. 1988).
64. *Id.* at 310 (quoting Steffel v. Thompson, 415 U.S. 452, 466 (1974)).

interfere with the arbitration proceedings and it protects the non-arbitrable rights of the parties before this court."[65]

In fact, the "express purpose of the Federal Declaratory Judgment Act was to provide a milder alternative to the injunctive remedy."[66] The Senate report offers insight into the benefits of the declaratory judgment:

> The declaratory judgment differs in no essential respect from any other judgment except that it is not followed by a decree for damages, injunction, specific performance, or other immediately coercive decree. It declares conclusively and finally the rights of the parties in litigations over a contested issue, a form of relief which often suffices to settle controversies and fully administer justice . . . The procedure has been especially useful in avoiding the necessity, now so often present of . . . abandon[ing] one's rights because of a fear of incurring damages.[67]

In addition, the prerequisites for injunctive and declaratory judgment relief are different in that irreparable injury need not be shown in a suit for declaratory relief and the result is merely a "declaration of legal status and rights; it neither mandates nor prohibits state action."[68]

In order to determine whether declaratory relief is permissible, the facts of the case in question must indicate a "substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment."[69] Also, the general rule is that declaratory judgments may only be issued when an injunction may be issued, in other words, when there is no pending state proceeding.[70] Therefore, if an injunction would be barred by the Anti-Injunction Act, declaratory judgments with the same effect would also be barred.[71] The crucial issue in determining whether a declaratory judgment would violate the Anti-Injunction Act is whether a state court proceeding is pending.[72]

The *Six Clinics* court faced the same issue of determining whether arbitration proceedings were state proceedings and thus subject to the Anti-Injunction Act. The court determined that an injunction could be granted because arbitrations pursuant to private agreements are not state court proceedings.[73] According to *Texas Employers' Insurance Association*, if the court allowed an injunction it could also have issued a declaratory injunction.[74]

In evaluating the requirements for declaratory judgment, there must be a substantial controversy between the parties and an immediate need for a declaration of the parties' rights.[75] There was a substantial controversy between Cafcomp and

65. *Id.* at 311.
66. Perez v. Ledesma, 401 U.S. 82, 111 (1971).
67. *Id.* at 112 (quoting S.Rep. No. 73-1005, at 2-3, 6 (1934)).
68. Id. at 124.
69. *Id.* at 102.
70. *Id.* at 116-17.
71. Texas Employers' Insurance Association v. Jackson, 862 F.2d 491, 507 (5th Cir. 1988).
72. *Id.*
73. *Six Clinics*, 119 F.3d at 398-99.
74. *Texas Employers' Ins. Association*, 862 F.2d at 507.
75. Perez v. Ledesma, 401 U.S. at 102.

ARN with a breach of contract claim against ARN and a counterclaim against Cafcomp for violating an Internal Revenue Service Code and fiduciary duties under ERISA. In addition, there was an immediate need for a judgment on ARN's counterclaim because the arbitration panel dismissed the counterclaim for lack of jurisdiction. If the arbitration were to continue without a judgment on the validity of ARN's counterclaim, it would have been precluded by res judicata in future litigation. This indicates a perfect case for declaratory judgment where there are adverse claimants and an immediate need for judgment to avoid a loss of one party's rights.

An injunction is a permissible decision but its harsh results in interfering with the arbitration proceeding could have been avoided by entering a declaratory judgment in this case. The declaratory judgment would resolve ARN's federal non-arbitrable claim. However, it would not interfere with the arbitrable breach of contract claims. In essence, a declaratory judgment does not have the same forceful sting as an injunction, which prevents a contracted arbitration between parties.

VI. CONCLUSION

Six Clinics enjoined a private arbitration agreement by holding that it was not a state court proceeding protected under the Anti-Injunction Act. By evading the Anti-Injunction Act and preventing the enforcement of a valid contract with a technicality, the court undermined the effectiveness of the arbitration process. Even if the court believed that the federal matter should be resolved for equity reasons, a declaratory judgment may have lessened the impact on the arbitration agreement. The real issue in this case should not have been whether or not an arbitration was a state proceeding within the meaning of the Anti-Injunction Act, but rather under what circumstances can a court refuse to uphold a valid contractual right of arbitration.

HEIDI ALBERS