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A Potpourri of Recent Federal Arbitration Cases Involving Domestic and International Arbitration

Daniel E. Murray

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A Potpourri of Recent Federal Arbitration Cases Involving Domestic and International Arbitration

*Daniel E. Murray**

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I. INTRODUCTION

The advantages of arbitration are well-known. Arbitration "is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties" Arbitration also helps to relieve crowded court dockets.¹

There is an irony in the above statement: it was taken from a case wherein the parties went through two arbitrations, a case in a Texas federal district court, a case in a New York district court, and a case in the New York Supreme Court, and finally, an appeal to the Second Circuit Court of Appeals. This tortuous path was hardly "cheaper," and it certainly did not "relieve crowded court dockets." Although this case was unusually litigious, virtually all the cases discussed in this article involved attempted arbitrations, subsequent appeals, and in some cases, a hearing in the United States Supreme Court.

Section 10 of the Federal Arbitration Act gives a very limited number of statutory grounds for vacating an arbitration award:

§ 10. SAME; VACATION; GROUNDS; REHEARING

(a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration —

- (1) Where the award was procured by corruption, fraud, or undue means.
- (2) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (3) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or any other misbehavior by which the rights of any party have been prejudiced.
- (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.
- (5) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

(b) The United States district court for the district wherein an award was made that was issued pursuant to section 580 of title 5 may make an order vacating the award upon the application of a person, other than a party to the arbitration, who is adversely affected or aggrieved by the

1. National Union Fire Ins. Co. of Pittsburgh, Pa. v. Belco Petroleum Corp., 88 F.3d 129, 133 (2d Cir. 1996) (citations omitted).

award, if the use of arbitration or the award is clearly inconsistent with the factors set forth in section 572 of title 5.²

In addition, the United States Supreme Court created the non-statutory ground allowing the vacating of an award for "manifest disregard of the law."

When one reads the annotations under Section 10 of the Federal Arbitration Act it would seem rather clear that a large number of parties who contracted for arbitration in their contracts had no adequate knowledge of the awesome finality of most arbitration awards; it is submitted that any lawyer who advises his/her clients to sign arbitration contracts without adequately advising them of the considerable finality of arbitration awards is guilty of malpractice. In addition, it is submitted that lawyers should advise their clients of the sometimes huge costs which they may incur in arbitration proceedings. Fortunately, it would appear that in most labor arbitrations the employer agrees to defray the costs of arbitration; this is not true in commercial arbitration cases.³

II. JUDICIAL ATTEMPTS TO VACATE ARBITRATION AWARDS

A. Article V of the Convention of and Enforcement of Foreign Arbitral Awards Cannot Be Supplemented by Implied Reasons Such as "Manifest Disregard of the Law" for Vacating an Award.

The Second Circuit Court of Appeals was recently presented with an arbitration award case involving the large American corporation of Toys "R" Us which had granted a limited license to a Kuwaiti business to open Toys "R" Us stores in Kuwait and 13 other Middle Eastern countries.⁴ The Kuwaiti franchisee opened four stores in Kuwait, but in no other country. After the Gulf War, the parties entered into negotiations to alter their arrangement; these negotiations failed and Toys "R" Us attempted to terminate the contract.

Toys "R" Us then contracted with another company to open stores in Kuwait and four other countries included in the contract with the first licensee. Toys "R" Us then initiated arbitration proceedings before the American Arbitration Association in New York.

The single arbitrator awarded the Kuwaiti licensee \$46.44 million for lost profits, plus 9 per cent interest dating from the date of the termination of the contract by Toys "R" Us. The Kuwait licensee then sought to en-

2. Federal Arbitration Act, 9 U.S.C. § 10.

3. See the penetrating discussion by Chief Judge Harry T. Edwards in *Cole v. Burns Int'l Sec. Serv.*, 105 F.3d 1465, 1483-1486 (D.C. Cir. 1997).

4. *Yusuf Ahmed Alghanim & Sons v. Toys "R" Us, Inc.*, 126 F.3d 15 (2nd Cir. 1997).

force the award in the Federal District Court in New York. Toys "R" Us cross-moved in the court to vacate the award under the provisions of the Federal Arbitration Act's implied grounds.

Toys "R" Us asserted that the award in favor of the licensee "was clearly irrational in manifest disregard of the law, and in manifest disregard of the terms of the agreement,"⁵ which are terms implied by the American courts as part of the Federal Arbitration Act.

The district court agreed with Toys "R" Us's position that both the terms of the provisions for vacating or refusing to enforce an arbitration award under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Federal Arbitration Act govern the disposition of this award, which was made in the United States. In accord with scant prior authority, the court held that the "manifest disregard defense is not available under Article V of the Convention or otherwise to a party . . . seeking to vacate an award of foreign arbitrators based upon foreign law."⁶

Toys "R" Us appealed to the court of appeals which noted that this award was between two non-domesticated companies and one United States corporation, and "it principally involved conduct and contract performance in the Middle East."⁷ It was not a domestic award and it was subject to the Recognition Convention. In accord with meager prior authority,⁸ the court held that Article V of the Convention on Recognition of and Enforcement of Foreign Arbitral Awards which articulates the reasons for vacating a foreign award were the exclusive reasons and they could not be supplemented by implied reasons, such as "manifest disregard of the law." Then the court quoted Article V(1)(e) of the Convention which state that enforcement may also be refused if "[t]he award has not yet become binding on the parties, *or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.*"⁹

The Court reasoned that the italicized words in Article V(1)(e) that a suit brought to vacate an award is governed by the domestic law of the rendering state; hence the case law in the United States sanctioning the use of "manifest disregard notion" is part of that law and it can be used to attack the award in this case. Under the court's approach, although the court refused to apply the Federal Arbitration Act (and its case law offspring) directly to the facts, it allowed the case law to apply indirectly through the Convention.

5. *Id.* at 18.

6. *Id.* at 20.

7. *Id.* at 19.

8. *Id.* at 18.

9. *Id.* at 21. (emphasis added).

The court then borrowed a definition of "manifest disregard of the law" from another case. "The error must have been obvious and capable of being readily and instantly perceived by the average person qualified to serve as an arbitrator. Moreover, the term "disregard" implies that the arbitrator appreciates the existence of a clearly governing legal principle but decides to ignore or pay no attention to it."¹⁰

Under this definition, the court held that the arbitrator did not disregard the law of New York regarding the computation of damages and he did not "manifestly disregard the contractual agreement between the parties" even though the court stated: "[w]e will not overturn the arbitrator's award merely because we do not concur with the arbitrator's reading of the agreement."¹¹

The court then affirmed the district court's decision.

It is submitted that the court reached the proper results in upholding the arbitration award, but that the use of the "manifest disregard" notion in international arbitration when the arbitration takes place in the United States will be counterproductive in a number of ways:

1. This "wild-card" award-attacking device will result in increased costs, delay in resolution of disputes, and uncertainty in the finality of awards.
2. Knowledgeable lawyers will insert arbitration clauses which avoid arbitration in the United States on international commercial contracts.
3. In the drafting of arbitration forum selection clauses, lawyers will have to be sure that the forum state's law does not follow the approach of this case.
4. It has been pointed out elsewhere that this utilization of a non-statutory ground such as "manifest disregard of the law" encourages the case-law adoption of other non-statutory reasons to vacate arbitration awards.¹²

10. *Id.* at 24 quoting *Merrill Lynch Pierce Fenner & Smith v. Bobker*, 808 F.2d 930, 933 (2nd Cir. 1986).

11. *Id.* at 25. It has been the rule in the Eleventh Circuit that arbitration awards can be vacated upon the non-statutory grounds that the award is "arbitrary and capricious," or that the "enforcement" of the award would be contrary to public policy. In a very recent case, the Eleventh Circuit has recognized that the New York Convention governing international arbitration awards expressly includes the "public policy" reason for vacating an international award, but does not include the "arbitrary and capricious" reason. As a result, the court expressly held that the "arbitrary and capricious" reason could not be engrafted on the New York Convention as a reason to vacate an award. It is a pity that the Eleventh Circuit did not show similar restraint under the Federal Arbitration Act. See *Industrial Risk Insurers v. M.A.N. Gutehoffnungshutte*, 141 F.3d 1434 (11th Cir. 1998).

12. Stephen L. Hayford, *Law in Disarray: Judicial Standards for Vacatur of Commercial Arbitration Awards*, 30 GA L. REV. 731 (1996).

Of course, all of the above hazards may be avoided if the parties in their commercial contracts elect U.S. law, and waive any possibility of an appeal, and agree that any arbitration award shall be final.

B. If the Arbitration Agreement Provides for the Vacating of an Award, "Where the Arbitrators' Findings of Fact Are Not Supported by Substantial Evidence or Where the Arbitrators' Conclusions of Law Are Erroneous," May the Reviewing Court Use These Standards in Contravention of an Arbitration Statute or Rules?

In *Lapine Technology Corp. v. Kyocera Corp.*,¹³ the parties entered into a commercial contract and agreed to submit any disputes to arbitration under the following clause:

(d) *Manner.* A party desiring to submit a matter to arbitration shall give written notice to the other parties hereto The arbitrators shall decide the matters submitted based upon the evidence presented, the terms of this Agreement, the Agreement in Principle and the laws of the State of California. The arbitrators shall issue a written award which shall state the bases of the award and include detailed findings of fact and conclusions of law. The United States District Court for the Northern District of California may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. *The Court shall vacate, modify or correct any award: (i) based upon any of the grounds referred to in the Federal Arbitration Act, (ii) where the arbitrators' findings of fact are not supported by substantial evidence, or (iii) where the arbitrators' conclusions of law are erroneous.*¹⁴

Arbitration was conducted before a panel of three arbitrators, and the losing party appealed to the district court to overturn the award on the grounds specified in the italicized wording above. The district court held that it could not review the award under the substantial evidence or the error of law standard.

Upon appeal to the court of appeals, it was held by a majority of the court that "[t]his appeal boils down to one major issue: Is federal court review of an arbitration agreement necessarily limited to the grounds set forth in the FAS or can the court apply greater scrutiny if the parties have so agreed?"¹⁵

The court stated that arbitration is a matter of the parties contracting to submit their disputes to arbitration, and that the terms of the contract requiring judicial scrutiny of the arbitrators' findings of fact and law are

13. 130 F.3d 884 (9th Cir. 1997).

14. *Id.* at 886 (emphasis added).

15. *Id.* at 889.

binding on the parties even when the arbitration contract (as in this contract) calls for the application of Article 24 of the Rules of Conciliation for the International Chamber of Commerce which provides for finality of the arbitration award and waiver of judicial review.

A concurring opinion pointed out that this contract did not attempt to confer jurisdiction over this case to the Federal courts, but that the parties' contractual intent should prevail. A dissenting opinion stated that the parties "cannot contract for judicial review of that award."¹⁶

Unfortunately, the opinion gives no hint as to why the parties contracted for judicial review of the facts and the law supporting the arbitration award when the rules of the International Chamber of Commerce expressly waive legal and factual appeals.¹⁷

C. The Difference Between Misconstruing the Law and Disregarding it on the Part of the Arbitrators — Do Not Ask the Arbitrators to Disregard the Law.

It is well established in American arbitration law that an award of arbitrators will be vacated by the courts, if the arbitrators acknowledge the existence of statutory or case law on the point in issue and disregard it.

This view was first articulated by the United States Supreme Court¹⁸ and then expressly followed in all of the circuit courts, except the Fifth Circuit and the Eleventh Circuit.

The Eleventh Circuit Court of Appeals was recently presented with a "manifest disregard of law" challenge in a factually unusual case.¹⁹ A female employee brought suit in a federal district court seeking overtime payments as an employee of Shearson Lehman Bros. Shearson contended that she was an exempt employee under the Fair Labor Standards Act as an administrator or an executive rather than as a wage clerk. The district court referred the case to an arbitration panel which held that the employer did not have to pay overtime pay. The employee petitioned the court to vacate the award; the court denied the petition and she appealed.

Counsel for Shearson Lehman in his opening statement before the arbitration panel stated: "I know, as I have served many times as an arbitrator, that you as an arbitrator are not guided strictly to follow case law precedent. That you can also do what's fair and just and equitable and that is what Shearson is asking you to do in this case." During Shearson's closing argument, its attorney again stated:

16. *Id.*

17. For a similar result under the Federal Arbitration Act for "errors of law," see *Gateway Tech., Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993 (5th Cir. 1995).

18. *Wilko v. Swan*, 346 U.S. 427 (1953).

19. *Montes v. Shearson Lehman Bros., Inc.*, 128 F.3d 1456 (11th Cir. 1997).

You have to decide whether you're going to follow the statutes that have been presented to you, or whether you will do or want to do or should do what is right and just and equitable in this case. I know it's hard to have to say this and it's probably even harder to hear it but *in this case this law is not right*. Know that there is a difference between law and equity and I think, in my opinion, that difference is crystallized in this case. *The law says one thing. What equity demands and requires and is saying is another*. What is right and fair and proper in this? *You know as arbitrators you have the ability, you're not strictly bound by case law and precedent*. You have the ability to do what is right, what is fair and what is proper, and that's what Shearson is asking you to do.²⁰

Judge Barkett responded to Shearson's argument stating:

To manifestly disregard the law, one must be conscious of the law and deliberately ignore it In the case before us, that is precisely what the panel was flagrantly and blatantly urged to do. The arbitrators expressly took note of this plea in their award when summarizing the parties' arguments. There is nothing in the award or elsewhere in the record to indicate that they did not heed this plea. In the absence of any stated reasons for the decision and in light of the marginal evidence presented to it, we cannot say that this is not what the panel did. We conclude that a manifest disregard for the law, in contrast to a misinterpretation, misstatement or misapplication of the law, can constitute grounds to vacate an arbitration decision. We emphasize again that this ground is a narrow one. We apply it here because we are able to clearly discern from the record that this is one of those cases where manifest disregard of the law is applicable, as the arbitrators recognized that they were told to disregard the law (which the record reflects they knew) in a case in which the evidence to support the award was marginal. Thus, there is nothing in the record to refute the suggestion that the law was disregarded. Nor does the record clearly support the award.²¹

In spite of the above language, Judge Barkett stated that there is no requirement in the law for arbitrators to state the facts or give reasons for ruling one way or the other.

One wonders why the counsel for the employer literally invited the arbitrators to disregard the law in light of the general rule that manifest disregard invites the courts to vacate an arbitration award. Perhaps counsel was relying upon the previous conduct of the Eleventh Circuit in not adopting the doctrine. Perhaps, counsel was relying upon the Fifth Circuit's rejection of the rule and the fact that the Eleventh Circuit was spun off from the Fifth Circuit? Counsel won the battle but lost the war. In light

20. *Id.* at 1459.

21. *Id.* at 1461.

of the fact that the court of appeals ordered that this case be re-submitted to a different arbitration panel, it should seem that the parties will have undergone the time and expense of two arbitration panels, one district court appeal and the court of appeals' appeal. This arbitration was neither quick nor inexpensive.

D. If a Statute Mandates an Award of Attorneys' Fees to the Winning Claimant, the Claimant must Clearly State this Mandatory Award Duty to the Arbitrators in Order to Claim to Vacate the Award for Failure to Do So under the "Manifest Disregard" Rule.

In *Dirussa v. Dean Witter Reynolds, Inc.*,²² a branch manager at a stock brokerage firm was allegedly demoted for cause; the manager brought arbitration proceedings against his employer based upon his allegation that he was demoted because of his age. He was 58 years old.

The arbitration panel held in favor of the ex-manager and awarded him substantial damages for wrongful demotion in violation of the Age provisions of the Discrimination in Employment Act of 1967. The arbitrators refused to award attorneys' fees to the ex-manager, although they acknowledged in the award that the ex-manager sought attorneys' fees and costs of suit "pursuant to ADEA and NJLAD."²³ The ex-manager sought to have the award modified, but the district court refused to do so. The ex-manager then appealed to the court of appeals.

The appeals court stated that "Section 626(b) of the ADEA, 29 U.S.C. §626(b), incorporates reference 29 U.S.C. §216(b) of the Fair Labor Standards Act which states . . . "that the court . . . shall, in addition to judgment awarded to the plaintiff, . . . allow a reasonable attorney's fee to be paid by the defendant, and costs of the action."²⁴

The court of appeals also quoted the district court's view on the mandatory nature of the attorney's fees: "The district court found that it is difficult to imagine a more well defined, explicit and clearly applicable provision governing law than the ADEA's mandate that successful age discrimination claimants such as plaintiff recover attorney's fees."²⁵

The court of appeals went on to hold that there was persuasive evidence that the arbitrators actually knew of the mandatory nature of the attorney's fees and that they knowingly disregarded the law. The court clearly stated that the attorney for the ex-manager never articulated the mandatory nature nor the provision of the Act which makes an award mandatory. The attorney's use of the word that his client was "entitled" to the

22. 121 F.3d 818 (2nd Cir. 1997).

23. *Id.* at 818.

24. *Id.* at 822.

25. *Id.* at 822.

award did not clearly inform the arbitrators that it was mandatory to award attorneys' fees. The court also noted that the suit was based upon a New Jersey statute which says that the court or the arbitrators *may* award attorneys' fees. Finally, the court stated that it was not going to infer from the facts of the case that the arbitrators knew of the law and that they manifestly disregarded it.

E. Should a Court Vacate an Arbitration Award for "Manifest Disregard of the Law" When the Decisional Law of the State Is Unclear or in Conflict?

In *Barnes v. Logan*,²⁶ a customer brought arbitration proceedings against his personal securities broker and his employer-security firm for churning, mismanagement of the account, and misrepresentation. An arbitration panel awarded the customer large compensatory and punitive damages. The brokers moved the federal court to vacate the punitive damage award on the grounds that the arbitrators had applied the law of California rather than the law of Minnesota whose law had been expressly adopted in the brokerage contract. The appellate court agreed that the arbitrators were wrong when they applied California law, but that error was harmless. The court looked at seemingly conflicting Minnesota intermediate appellate court decisions wherein one held that punitive damages in Minnesota could be awarded for breach of contract cases involving fraud but no personal injuries, and the other case held that damages could be awarded only in cases involving personal injury. The court then stated: "If, under the current law of the state of the law, a Minnesota intermediate appellate court can conclude that punitive damages are available even though no personal injury is involved, we cannot conclude that the arbitrators acted in manifest disregard of Minnesota law in awarding punitive damages."²⁷

When the decisional law is in an apparent conflict, then whatever choice the arbitrator makes would not seem to be in manifest disregard of the law.

F. Even in Routine Statute of Limitations Cases, it Is Difficult to Vacate the Arbitrator's Award When They Do Not Give Reasons and Allow the Claimant's Claim as Being Timely.

In *Merrill Lynch Pierce Fenner & Smith, Inc. v. Jaros*,²⁸ Mr. Jaros maintained accounts at Merrill Lynch from 1987 to 1990. Mr. Jaros invested \$472,601 with Merrill Lynch and his accounts were down to

26. 122 F.3d 820 (9th Cir. 1997).

27. *Id.* at 823.

28. 70 F.3d 418 (6th Cir. 1995).

\$270,000 when he closed them. Merrill Lynch made 624 trades during the accounts' lifetimes and earned commissions of \$270,000. Jaros was contracted before each trade was made, and he never objected. In November of 1990, Jaros transferred his accounts to another broker. On December 18, 1990, Jaros's son (an attorney) wrote a letter to Merrill Lynch complaining about the way the accounts had been handled. Merrill Lynch responded, and seven months later Merrill Lynch wrote that they had found no wrongful conduct by the company or their agent. Jaros started arbitration proceedings on August 20, 1992, and Merrill Lynch claimed that the one-year federal statute of limitations and the Ohio four-year statute of limitations barred state claims that arose prior to August 20, 1988. The arbitrators (two of the three were attorneys) held in favor of Jaros and awarded him \$250,000. The award did not state any reasons for the award (a "non-speaking" award under U.S. law).

The district court upheld the award. The court of appeals recounted how difficult it was to attack an award when arbitrators do not provide reasons for the award. The court of appeals did say that it would appear that the federal one-year period had elapsed, but that the various claims under the Ohio four-year statute had not all elapsed, and therefore, upheld the district court. The court also noted that there were no facts indicating an equitable estoppel, which might have delayed the running of the statute of limitations.

The conclusion of the opinion is a classical statement about the notion of manifest disregard:

From this vantage point, it is impossible to tell what determination the arbitration panel made with respect to the timeliness of each claim. It is clear that a number of arguments were presented by the parties to the panel. As is permissible, the award fails to set out any explanation of the resolution of these arguments pertaining to the motion to dismiss.

Set within the context of the narrow scope of review for manifest disregard of the law, the court finds that the arbitrators' decision was not so patently contrary to established legal precedents as to necessitate that the award be vacated. Although it is likely that the federal securities claims were not timely brought, there is ample room for reasonable debate as to both those claims and the state law claims. It being improper for a court to go behind the face of an arbitration award and attempt to fathom the resolution of arguments presented to the panel, we must confirm the award as if there is a conceivable rational basis supporting the decision.²⁹

The holding of this case should be utilized by any arbitrator in a "close" case to avoid having the arbitration award upset on appeal. On the

29. *Id.* at 422.

other hand, each party to an arbitration usually desires to learn why he/she won or lost. At the outset of the arbitration the parties may insist upon a "reasoned" award.

G. An Arbitrator's Award "Must Draw its Essence from the Collective Bargaining Agreement" — or it Will Be Vacated by the Courts.

In *Alvey, Inc. v. Teamsters Local Union No. 688*,³⁰ an employee was arrested for having drug paraphernalia in his possession. The employee was promptly fired, and he demanded arbitration proceedings over his discharge. The employee was later tried and found guilty of the charge of possession of drug paraphernalia, but sentence was suspended and he was placed on probation for two years. The findings in the criminal trial were admitted in the arbitration proceedings.

The employer asserted in the arbitration that the employee violated Rule 30 of the employer's rules which prohibited "[t]he use or possession of intoxicating beverages or narcotics on plant premises or working under the influence of either."³¹ In addition to Rule 30 of the employer's work rules, the employer also submitted its drug memorandum sent to all employees:

B. Upon any . . . *criminal drug statute conviction* for a violation occurring either in or outside the workplace, the employee will be subject to disciplinary action *at the sole discretion of the company, up to and including discharge*, depending upon the circumstances.³²

The arbitrator nonetheless . . . refused to consider this policy because:

The Employer's proof shows that [the state court] suspended the imposition of sentence. As of this writing, a suspended imposition of sentence is not a conviction.³³

The district court agreed with this reasoning. . . . On appeal, Alvey renews its contention that the arbitrator impermissibly substituted his discretion for that of the company in interpreting and applying Alvey's work rules. To the limited extent that the arbitrator failed properly to consider the applicability of Section 4.B., we agree.

The Missouri cases cited by the arbitrator and by the district court construed the technical term "conviction" under Missouri criminal law and then applied that construction to a witness impeachment statute and a public employer's manual. Those decisions do not resolve this case. The issue here is the *intended* meaning of the word "conviction" in Sec-

30. 132 F.3d 1209 (8th Cir. 1997).

31. *Id.* at 1211.

32. *Id.* at 1212. (emphasis added).

33. *Id.* at 1213.

tion 4.B. of Alvey's work rule implementing the Drug Free Workplace Act. The arbitrator wholly ignored that issue. Instead of looking at the word in context, taking into account its ordinary meaning and any pertinent plant practices or history, the arbitrator adopted his own, hyper-technical meaning derived from a contextually inapposite source in state law. The result of this misguided approach is a highly suspect conclusion. Although our views on the question are of course not controlling, we think it strains credulity to posit that an employer who defines drug-offenses-warranting-discharge to include "a criminal drug statute conviction" would intend to *exclude* from that category criminal trials that end in findings of guilt and sentences of probation plus the deferred imposition of a more punitive sentence.

At this point, we return to the governing standard of review, whether the arbitrator's award "dr[e]w its essence from the collective bargaining agreement." Is the flaw we have identified simply a mistaken interpretation of the contract that we must uphold, or does it violate the fundamental principle that "an arbitrator is confined to interpretation and application of the collective bargaining agreement; he does not sit to dispense his own brand of industrial justice"? Although the issue is not free from doubt, we conclude it is the latter. An arbitrator may look to outside sources to aid in interpreting a collective bargaining agreement, but he must construe the contract; he may not amend it. Here, the arbitrator effectively wrote a relevant work rule out of the agreement by looking exclusively at an inconclusive outside source. This part of the arbitrator's award cannot be said to draw its essence from the collective bargaining agreement.³⁴

What the court is really saying is that the employer had its definition of the word "conviction" while the Supreme Court of Missouri has another definition.

It is suggested that another arbitrator who hears this case and applies the employer's notion of what a conviction means will have his award attacked on the ground of a "manifest disregard of the law." Sometimes, an arbitrator's lot is not a happy one.

34. *Id.* at 1213 (citations omitted).

H. An Arbitration Panel's Refusal to Continue the Hearings in Order to Allow the Corporate President an Opportunity to Testify May Constitute Fundamental Unfairness and Misconduct Sufficient to Vacate an Award under Section 10(a)(3) of the Federal Arbitration Act.

In *Tempo Shain Corp. v. Bertek*,³⁵ two companies were involved in a controversy before a panel of arbitrators; each party accused the other of fraudulent misrepresentation which induced them to enter into the contract. Each party was represented in the negotiations of the contract by primarily one person, and the alleged fraudulent misrepresentations allegedly occurred during the discussions between the two individuals. One president allegedly wanted to testify, but was unable to schedule hearings because of an unexpected reoccurrence of his wife's cancer. This party then requested a continuation of the hearings until the president was able to testify. The panel did not grant the continuance and stated: "We as arbitrators have to decide does Mr. Pollack have any information that if he was here in person and you fellows are banging him with questions that some new information comes out that we haven't heard or is it going to be a rehash of what we've heard from other witnesses."³⁶

The district court refused to vacate the award. Upon appeal, the court noted that virtually all of the documentary evidence admitted before the arbitration panel consisted of letters, etc., that dealt with efforts to have both parties abide by the contracts, and that the controversy in the arbitration proceedings dealt primarily with alleged fraudulent inducements by both parties. The court then noted that:

These so-called fight letters and reports are not all representative of what Pollock's testimony would likely have been in connection with the fraudulent inducement allegations. The fight letters arose from individual problems that were ongoing at the time, and did not devolve into recriminations about earlier representations. Their focus was not on the inducement to enter the contracts — rather, they were attempts to solve problems which were giving rise to disputes. As Delaney explained, the parties were trying "[t]o keep the relationship going." The reports, like the letters, addressed discrete problems and possible courses of action. While the letters and reports might have been sufficient to represent what Pollock would have testified to in rebuttal of Neptune's breach of contract claims, which we do not decide, there is nothing to suggest that Pollock's intended testimony concerning appellees' fraudulent inducement claim and Bertek's counterclaim for fraudulent inducement was addressed by the documents admitted into evidence.

35. 120 F.3d 16 (2nd Cir. 1997).

36. *Id.* at 18.

Because Bertek's alleged misrepresentations were not documented, appellees' unsupported oral testimony concerning such representations was un rebutted because Pollock, who allegedly made the representations on Bertek's behalf, was not allowed to testify, and he is the only person who could have done so.³⁷

Finally, the court of appeals held that the refusal to continue the hearings amounted to fundamental unfairness and misconduct sufficient to vacate the award under Section 10(a)(3) of the FAA.

I. As a General Rule Arbitrators Are Not Required to Articulate How They Calculated the Amount of Damages Awarded.

In *Conntech Development Co. v. University of Connecticut Education Properties, Inc.*,³⁸ the parties contracted with each other to construct a research and development park on the campus of the University of Connecticut. The contract contained an arbitration clause. The parties each claimed that the other had defaulted, and arbitration proceedings were conducted. The arbitrators entered an award in favor of one party and awarded damages of \$2,413,179. The losing party filed suit to vacate the award on the grounds that the arbitrators exceeded the scope of their authority. The district court affirmed the award and the amount of award, and the loser appealed. The main issue in controversy was the fact that the arbitrators did not disclose how they computed damages of \$2,413,179 which prevented effective judicial review.

The underlying arbitration records showed that both parties cited construction costs ranging as high as six million dollars. The court noted that arbitrators are not usually required to spell out their monetary calculations in the award, however:

Where an arbitrator's award appears to have been reached on the basis of a precise mathematical calculation, it is desirable, and in some cases may be necessary, to know the basis for the calculations underlying the award. A remand for clarification in such circumstances would not improperly require arbitrators to reveal their reasons, but would instead simply require them to fulfill their obligation to explain the award sufficiently to permit effective judicial review.³⁹

In spite of the quoted language, the court held that "[g]iven the expenses incurred by both parties, grounds for the award can be 'inferred

37. *Id.* at 20.

38. 102 F.3d 677 (2nd Cir. 1996).

39. *Id.* at 688.

from the facts of the case,'” and remand for clarification was unnecessary.⁴⁰

It is submitted that the precise nature of the award creates the suspicion that it was achieved by adding the amounts suggested by each of the arbitrators and then dividing the resulting figure by three; shades of a quotient verdict by a lay jury. On the other hand, a similar verdict by a lay jury would have been immune from attack, unless the rule against quotient verdicts had been applied. Surely, an award by sophisticated arbitrators should be as much respected as the finding of a lay jury without any special education.

III. JURISDICTION OF ARBITRATORS, ARBITRATION CLAUSES, ETC.

A. *Commercial Law Lawyers Must Know More than Commercial Law and Arbitration Law.*

In *Avedon Engineering, Inc. v. Seatex*,⁴¹ Twist (a clothing manufacturer) ordered fabric from Seatex, a New York Company, through Seatex's agent by means of telephone calls and facsimile transmissions. Seatex confirmed these purchase orders by facsimile transmittal of its standard sales confirmation forms. The forms mentioned the notion of arbitration on the front page in small print and again on the reverse side in two full clauses. Twist never signed the Seatex forms, but purchased and paid for the fabric in at least three transactions. The fabric allegedly was defective, and Twist filed suit in a Colorado state court. Seatex removed the action to the Colorado federal district court. Seatex sought to have the federal court compel arbitration even though Twist never signed the sales confirmation forms, nor ever sought to protest the inclusion of the arbitration clauses in the Seatex forms.

Both parties submitted that Section 2-207 of the Colorado and New York versions of the Uniform Commercial Codes contained were identical. This section states that non-conforming clauses become part of a contract unless the non-conforming clauses materially alter the other party's form. Twist asserted that Colorado law applied, but the district court held that since Section 2-207 read the same way in Colorado and in New York, it was not necessary to consider the application of any one state's law. In addition, the arbitration clause provided that any arbitration must be brought within one year, and the claim for arbitration came after this one year period had expired.

40. *Id.* at 687.

41. 126 F.3d 1279 (10th Cir. 1997).

The district court held that the arbitration had become a part of the parties's contract, and that the claim of Twist was barred because of the one year time limitation.

The court of appeals held that the arbitration clause might be a material alteration of Twist's purchase order form; that Seatex would have the burden of proving that a trade usage existed in the textile industry to have arbitration clauses in textile sales contracts and that Twist failed to sustain this burden.

The court of appeals noted that Section 2-725(1) of the New York UCC permits the parties to shorten the limitation period for lawsuits to one year, while the Colorado UCC Section 4-2-275(1) does not permit a shortening of the limitation period; hence a Colorado party might well be surprised by the one year clause in this case. Therefore, the one year limitation period might not become part of the sales contract.

Finally, the court rejected a claim by Seatex that the Federal Arbitration Act preempts the application of the one-year rule under state law.

The court reversed the district court by stating:

The district court should have begun its analysis with a choice of law determination. Its failure to do so affected all of the court's subsequent determinations regarding the arbitration term. We therefore reverse and remand for the district court to make the choice of law determination.

We REVERSE the district court's stay of litigation and remand this case for a choice of law determination and for further proceedings consistent with this opinion. Because we reverse the district court's stay pending arbitration, we do not reach the questions of whether arbitration became part of the Twist/Seatex contract as a matter of law or whether the district court properly granted summary judgment to Seatex for Twist's failure to timely arbitrate. We leave those issues to the district court to remand.⁴²

It is difficult to fathom how the district court overlooked the choice of law problems inherent in this case with a contract formed between citizens of different states and jurisdiction based upon diversity. A simple glance at the annotations in the UNIFORM COMMERCIAL CODE REPORTING SERVICE under Section 2-207 and 2-725(1) would easily show the diversity of views about the materiality issue. The attorneys for the Colorado litigant at least claimed that Colorado law applied, although we are not told what the argument was based on. Perhaps, the law schools should go back to the old fashioned required curriculum.

42. *Id.* at 1288.

B. Lawyers Who Draft Employment Contracts Are Warned Not to Forget (or Overlook) What They Should Have Learned in Their First-year Contracts Class — a Binding Contract must Be Supported by Consideration.

In *Gibson v. Neighbor Clinics, Inc.*,⁴³ a female employee left her employment at a company and shortly thereafter she returned for re-employment at the same company. During her absence, the company had prepared a new Associates Policy Manual (the "Manual") and required employees to sign a new "Associates Understanding" (the "Understanding"). The "Understanding" included the following statement: "I agree to the grievance and arbitration provisions set forth in the Associates Policy Manual. I understand that I am waiving my right to a trial, including a jury trial, in state or federal court of the class of disputes specifically set forth in the grievance and arbitration provisions on pages 8-10 of the Manual."⁴⁴

The Manual stated that when an employee alleges a violation of her rights under the Anti-Discrimination Act of Title VII:

THEN IT IS CLEARLY INTENDED AND AGREED THAT THE SOLE AND EXCLUSIVE MEANS FOR THE RESOLUTION OF ALL DISPUTES, ISSUES, CONTROVERSIES, CLAIMS, CAUSES OF ACTION OR GRIEVANCES BY AN EMPLOYEE AGAINST NEIGHBORHOOD HEALTH CLINICS SHALL BE THROUGH THE PROCESS OF ARBITRATION AND PURSUANT TO . . . THE INDIANA UNIFORM ARBITRATION ACT.⁴⁵

When the employee signed the above "Understanding" form, the hiring officer could not find a copy of the Manual for the employee to read; nevertheless, the employee signed the "Understanding." Later that afternoon, the employee was presented with a copy of the "Understanding" but she did not read it at that time.

Subsequently, the employee was allegedly subjected to sexual harassment and when she reported the incidents to management, she was discharged from employment. The former employee sued the company for sexual harassment and failure to comply with the Americans With Disabilities Act ("ADA"). The company moved to dismiss on the grounds that she had agreed to submit to arbitration rather than to sue, and the District Court dismissed the case. The former employee appealed to the Seventh Circuit Court of Appeals.

43. 121 F.3d 1126 (7th Cir. 1997).

44. *Id.* at 1128.

45. *Id.*

In the appeals court, the parties waged battle over the issue whether the waiving of the right to judicial proceedings under the ADA and Title VII requires a knowing and voluntary waiver in light of the fact that the employee never read the "Manual" at the time she signed the "Understanding." The court avoided deciding this issue by focusing attention on whether the waiver of judicial suit rights was supported by consideration.

The court noted that the opening two paragraphs of the "Manual" stated:

Neighborhood Health Clinics reserves the right at any time to modify, revoke, suspend, terminate, or change any or all terms of this Manual, plans, policies, or procedures, in whole or in part, without having to consult or reach agreement with anyone, at any time, with or without notice. . . .

. . . [W]hile Neighborhood Health Clinics intends to abide by the policies and procedures described in this Manual, it does not constitute a contract nor promise of any kind. Therefore, employees can be terminated at any time, with or without notice, and with or without cause.⁴⁶

The employer's attorney "drafted" the employer out of arbitration by saying, in effect, that the employer gave the employee virtually nothing in return for her promise to arbitrate. The employer never promised to continue to employ her, and the employer never bound itself to do anything in return for her promise. If the employer had exchanged its promise to her in return for her promise to arbitrate then the contract would be supported by consideration.

The court also stressed that the arbitration approach was a newly established one which had not been in effect during the employee's prior employment. Too often lawyers think that their labor is over once they have drafted a document. Supervisory employees need education in the use of documents and the timing of their use.

C. Drafters of Guaranties Who Intend That the Guarantors Are to Be Bound by Arbitration Should Insert Words in the Guaranty Clearly Stating That the Guarantors Agree to Be Bound by Arbitration.

In *Grundstad v. Ritt*,⁴⁷ two parties entered into a non-compete agreement. The agreement provided for arbitration as follows: "In the event that any dispute or controversy arises under this Agreement between the parties, then, and in such event, both parties agree to submit the matter to arbitration to be conducted in accordance with the rules of the American Ar-

46. *Id.*

47. 106 F.3d 201 (7th Cir. 1997).

bitration Association, which arbitration shall be held in Springfield, Massachusetts."⁴⁸

Two guarantors signed their names on the Agreement, and immediately below their signatures appeared the language "[w]e hereby guarantee all of the provisions of the within Agreement, and especially the performance of Atlantic hereunder. This 10th day of July, 1981."⁴⁹

Paragraph four of the Agreement referred to the guaranty: "[Atlantic Associates] agrees to obtain the signatures of two of the beneficiaries under a certain trust that holds the shares in [Atlantic Associates], Messrs. H. Joel Rahn and Oddmund Grundstad to this Agreement guaranteeing all of the terms, covenants and provisions as well as the performance of [Atlantic Associates] hereunder."⁵⁰

Atlantic defaulted on its obligation and an assignee of the above contract insisted on arbitration proceedings against Atlantic. He received an award in arbitration, which Atlantic refused to pay. The state court affirmed the award. The assignee then demanded arbitration against the guarantors in order to collect on the guaranty. One guarantor then brought suit in the federal district court to enjoin arbitration. The district court using the general principles of contract law held that the guarantors were bound by the arbitration clause and entered summary judgment against the guarantor.

Upon appeal to the Seventh Circuit Court of Appeals, the court held that the above-quoted language did not clearly indicate that the guarantors unambiguously intended to be bound personally by the arbitration clause, and that summary judgment was reversed and the case was remanded for further proceedings.

In light of this case, it would seem wise for drafters of guaranties who wish that the guarantors be bound by arbitration proceedings to insert words in the guaranty stating clearly that they agree to be bound by arbitration in any matter relative to the carrying out of the guaranty.

D. Claims for Violations of the Americans with Disabilities Act May Be Subject to Arbitration Between the Parents of a Disabled Child and a Private Grammar School.

In *Bercovitch v. Baldwin School Ind.*,⁵¹ the parents of a young boy sued a private school for refusing to admit their son to the seventh grade because the son had a lengthy history (from kindergarten through the sixth

48. *Id.* at 202.

49. *Id.* at 203.

50. *Id.*

51. 133 F.3d 141 (1st Cir. 1998).

grade) of consistent misbehavior. The school demanded arbitration pursuant to a clause in the enrollment agreement. The arbitrators ruled in favor of the school, and the parents sought to vacate the award. The district court vacated the award and ordered the school to modify the school's code of conduct in order to accommodate the child.

The Fifth Circuit Court of Appeals, reversed the district court by holding that the district court exceeded its authority in ordering the school "to suspend its normal codes of conduct in order to tolerate disruptive and disrespectful conduct when that behavior impaired the educational experience of the other students and significantly taxed the resources of the faculty and administration."⁵²

The appeals court added that ADA does not require a school to: "compromise its integral criteria to accommodate a disabled individual."⁵³ The court also noted that Section 12212 of the ADA expressly encourages the arbitration of disputes and that arbitration was proper to enforce claims under the Age Discrimination Act.⁵⁴

E. The Waiver of the Right to Arbitration in an Employee's Employment Contract May Be Contrary to Public Policy and Unenforceable.

In *Thomas James Associates, Inc. v. Jameson*,⁵⁵ Jameson was employed by a stock brokerage firm in 1993. His employment contract with the firm provided that Jameson waived arbitration as a method of settling any disputes with his employer. Jameson allegedly failed to follow instructions from his supervisor, and he was terminated. In addition, the former employer informed people, inquiring about the termination, that Jameson was terminated for cause and there was, at least, an implication of unethical conduct by Jameson. Jameson then brought arbitration proceedings against the former employer and two officers of the employer.

The employer maintained that Jameson, in his employment contract, had waived arbitration as a settlement device. In addition, the brokerage asserted that the National Association of Security Dealers' employment rules denied arbitration to employees.

The brokerage firm then brought suit to obtain a declaratory judgment that employees of stock-brokerage firms were not entitled to arbitration to settle their employment disputes with employers. The district court dismissed the suit, and the brokerage company appealed to the Second Circuit.

52. *Id.* at 152.

53. *Id.*

54. *Id.*

55. 102 F.3d 60 (2nd Cir. 1996).

The court of appeals found that until 1993 the rights of employees to arbitrate their disputes with their stockbroker employers were not clear because of seemingly inconsistent NASD rules. The courts of appeal were divided. However, in 1993, the NASD restated their rules in more precise language, and the rules expressly authorized and encouraged arbitration as a means of settlement. In addition, the new rules stated that "it shall be considered conduct inconsistent with just and equitable principles of trade and a violation of Article 111, section 1 of the NASD's Rules of Fair Practice for a member to require its associated persons to waive the arbitration of disputes arising out of their association with the member."⁵⁶

The court held that the self-regulatory association's rules governed the employment contract at issue and if they prohibit the waiving of arbitration it would be contrary to public policy to enforce the waiver. The parties may not contractually waive arbitration.

*F. "As Long as the Arbitrator's Decision Draws its Essence from the Collective Bargaining Agreement and the Arbitrator Is Not Fashioning His Own Brand of Industrial Justice, We Will Decline to Vacate the Award."*⁵⁷

The above statement (or similar statements) have long been a shibboleth in labor-union-arbitration cases. This statement of law was recited in a recent case⁵⁸ in which the Fifth Circuit Court of Appeals vacated the arbitrators' award.

A female employee asked her supervisor for permission to leave the job for approximately one hour. When the supervisor asked her why she wanted to leave, she said that she had to give her truck to her daughter so that the daughter could go to the doctor. During her absence, her fellow employees told the supervisor that the real reason for the time off was that she had to take cash to the power company or she would be without lights for the ensuing weekend. The supervisor questioned the employee upon her return (45 minutes later), and she confessed that she had lied to him about why she needed time off. The employee was embarrassed because she had failed to pay her light bill, so she misstated the purpose of her absence.

The employee's supervisor terminated her employment after he consulted with higher personnel. The arbitrator, after hearings, reinstated the employee and imposed a ten-day suspension from work. The company

56. *Id.* at 66.

57. *Bruce Hardwood Floors v. UBC, Southern Council of Indust. Workers, Local Union No. 2713*, 103 F.3d 449 (5th Cir. 1997).

58. *Id.*

then sought to vacate the award in the federal district court. The district court affirmed the award, however.

The company appealed to the Fifth Circuit Court of Appeals which reversed the district court. The circuit court cited the provisions of the Collective Bargaining Agreement as justification for terminating the employee:

The pertinent discharge and progressive discipline provisions of the CBA are as follows:

ARTICLE 24, SECTION 2. The Company will take action against an employee based upon conduct which warrants immediate discharge, or for other conduct, while less serious, which initially warrants less severe discipline.

(a) An employee will be discharged immediately without prior warning for the following or similar reasons:

.

(16) Stealing, *immoral conduct*, or any act on the Company premises intended to destroy property or inflict bodily injury.

.

(b) An employee will be subject to progressive discipline for the following or similar reasons:

- (1) Absenteeism.
- (2) Tardiness.
- (3) Inefficiency or poor work performance.
- (4) Abuse of rest periods and lunch periods.
- (5) Neglecting duty or failing to maintain work standards.

SECTION 3. In the case of offenses where the application of progressive discipline would be appropriate as set forth in (b) above, the Company shall endeavor to adhere to the following order:

- (a) Verbal warning with written record of warning for the first incident.
- (b) Written warning for the second incident.
- (c) Disciplinary suspension of three (3) unpaid days for the third incident.
- (d) Discharge for the fourth incident.

In agreeing to the foregoing, however, the Company does not intend to waive the exercise of its right to discipline or discharge without fol-

lowing such order in any case where it determines that the seriousness of the particular offense involved warrants discipline of a different order.⁵⁹

The arbitrator concluded that:

The Grievant's conduct was not such that demands the supreme industrial penalty of immediate discharge. The Company wrongfully attempted to apply the referenced provisions of the Collective Bargaining Agreement to the Grievant's conduct. The parties negotiated a progressive discipline policy which the Company failed to follow.

Considering the evidence adduced at the arbitration hearing, and considering the presentations made by the parties in their post hearing briefs, the Arbitrator has adequate reason to substitute his judgement [sic] for that of Company's management.⁶⁰

The district court judge stated that "the arbitrator confined his decision and remedy to the interpretation and application of the collective bargaining agreement and that the arbitrator provide[d] an award which was within the essence of the collective bargaining agreement."⁶¹

It is submitted that the court of appeals vacated this award and reversed the district court because of, at the worst, a misinterpretation of the facts and law.

As stated by the dissenting Judge:

The arbitrator concluded that the company's attempt to characterize Dixon's conduct as "immoral conduct" within the meaning of Article 24, Section 2(a)(16) of the CBA was unreasonable. That section allows the company to terminate employees immediately for "stealing, immoral conduct, or any act on the Company premises intended to destroy property or inflict bodily injury." The majority erroneously states that "lying" is "specifically covered" by this provision and concludes that this provision is dispositive. Lying is not, however, specifically listed in this provision, nor is immoral conduct expressly defined by the CBA to include lying. Instead the majority's conclusion requires an inferential step, that any lie is "immoral conduct" justifying immediate termination within the meaning of the CBA. In other words, the majority *interprets* the term "immoral conduct" and comes to a conclusion different from that reached by the arbitrator. That is not the court's proper role. In reviewing the arbitrator's construction of the phrase "immoral conduct," the issue is not what we believe to be moral or immoral conduct in the philosophical sense. The issue before the arbitrator was whether Dixon's con-

59. *Id.* at 451 (emphasis added).

60. *Id.*

61. *Id.*

duct rose to the level of "immoral conduct" as that term is used in the CBA.⁶²

When one tries to balance one minor lie and 45 minutes freedom from work against the costs and time expended in an arbitration proceeding, a federal district court case and an appeal to the court of appeals, it would seem obvious that there must have been other unstated factors for the employee's dismissal. The fact that her fellow employees "tattled" to her supervisor indicates that she was not popular with her fellow employees, and perhaps she was not popular with her employer.

In this case, the punishment did not fit the crime.

G. A Construction Development Contract May Lack So Many Terms Agreed upon by the Parties That it May Not Be Subject to Arbitration.

In *Hill's Pet Nutrition, Inc. v. Fru-Con Construction Corp.*,⁶³ the parties to a construction-development contract agreed on many terms in a "master agreement" for plants to be constructed; however, the contract did not adequately cover costs of construction, allocation of costs, etc. The parties continued to operate under the "master agreement" supplemented with oral agreements as the work proceeded in two different states. The parties then attempted arbitration proceedings, but the district court held that lack of agreement on a single term meant there was no contract on any term. The court of appeals affirmed the denial of arbitration, but quarreled with the district court's rationale. The court of appeals held that the lack of "closure" regarding cost overruns which were governed by the oral agreements at a particular plant prevented arbitration of that main issue and these alleged overruns were not covered by the "master agreement." As the court put it:

Thus the arbitration clause, although part of the parties' agreement, does not come into play. Fru-Con is really seeking a form of interest arbitration, under which an arbitrator would decide which party's definition of "costs" should be accepted, what multiplier should be used, and so on. These were issues left open at the bargaining table, issues the parties did not agree to pass to an arbitrator for resolution.⁶⁴

This decision by Judge Easterbrook seems to be technically correct, but let us look at the result. Unless the parties can work out an amicable settlement, the aggrieved party will seek recovery in quantum meruit and a

62. *Id.* at 454.

63. 101 F.3d 63 (7th Cir. 1996).

64. *Id.* at 66.

state or federal judge (with little or no knowledge of construction) will have the "delightful" task of trying to calculate monetary amounts, etc. as compared to arbitrators who are usually chosen because of their expertise in construction costs, procedures, etc.

H. The Affects on Jurisdiction of Narrow Arbitration Clauses ("Any Disputes Arising Hereunder") and Broad Clauses ("Any Disputes Arising out of or Relating To").

In *American Recovery Corp. v. Computerized Thermal Imaging, Inc.*,⁶⁵ the submission to arbitration clause provided that "[a]ny dispute, controversy, or claim arising out of or related to this Consulting Agreement shall be resolved by binding arbitration."⁶⁶

The parties got into disputes and in addition to direct interpretation claims under the arbitration agreement, one party sought arbitration of claims that the other party had induced a consultant to breach fiduciary duties, had committed tortious interference with a consultant's relationship to an aggrieved party, and a quantum meruit claim. The other party denied coverage by arbitration of these claims.

The federal district court held that the claims were not subject to arbitration. The other party appealed, and the court of appeals held that under the broad arbitration clause of "[a]ny disputes arising out of or related to" the arbitration tribunal had jurisdiction to hear and decide the claims. The court noted that the narrow clause of "any disputes arising hereunder" would limit the arbitration to the interpretation and application of the contract and would preclude jurisdiction over these "related" disputes.⁶⁷

If the parties to a contract favor arbitration, they should insist upon a "broad" arbitration clause. Otherwise, any dispute may be subject to a bifurcated approach with simultaneous arbitration and litigation cases, which are time and money wasteful and generally a headache for all parties.

I. A Court May Deny Compulsory Arbitration of an Employee's Claim of Civil Rights Violations under Title VII of the 1991 Civil Rights Act If the Arbitration Panel Is Structurally Biased Against Employees in Favor of Stockbroker-employers.

65. 96 F.3d 88 (4th Cir. 1996).

66. *Id.* at 90.

67. *Compare* *Mediterranean Enter., Inc. v. SS Angyong Corp.*, 708 F.2d 1458, 1464 (9th Cir. 1983); *Sinva, Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 253 F.Supp. 359, 364 (S.D. N.Y. 1966).

In *Rosenberg v. Merrill Lynch*,⁶⁸ the plaintiff, a consultant to a stock brokerage firm, claimed she was sexually harassed by her supervisor, and that she had suffered age and sex discrimination contrary to the federal law. The stock brokerage firm alleged that her claims were subject to arbitration because she had signed the Securities Industry Standard Form U-4 pre-dispute arbitration agreement.

The plaintiff submitted evidence that the system of arbitration was structurally biased against employees, and in favor of management. The federal district court held that:

what is deeply troubling is what I can only describe as a structural bias in the system — the extent to which the NYSE arbitration system is dominated by the securities industry, that is, by the employment side of this dispute. The securities arbitration systems are part of a scheme in which securities industry firms form self-regulating organizations (SROs) to police themselves. . . . The SROs, in turn, run almost every aspect of the arbitration process in which the employees must have their employment discrimination cases resolved.⁶⁹

The court noted that:

Saying the NYSE “cannot meet . . . minimal standards of arbitral independence,” . . . “[f]rom the rules that govern arbitral procedure, through the selection of the arbitrators [drawn from pools appointed by the NYSE chairman], to the details of discovery practice, the system is dominated by the NYSE itself. Merrill Lynch, in turn, helps govern the NYSE.”⁷⁰

It would appear that purchasers of stocks and bonds could make the same bias argument in claims against stockbrokers who demand arbitration, and similar arguments could be raised by employees and consumers in other self-regulated trades and industries.

J. The Preclusive Effect of a Prior Arbitration Award Is Generally a Matter for the Arbitrator in a Subsequent Arbitration Proceeding Between the Same Parties.

In *National Union Fire Insurance Co. of Pittsburgh, PA v. Beclco Petroleum Corp.*,⁷¹ a group of insurance companies jointly insured an oil exploration company in Peru against the risk of expropriation. The Peruvian government did expropriate the oil company’s assets in Peru, and the oil

68. 163 F.3d 53 (1st Cir. 1998).

69. *Id.*

70. *Id.* at 54.

71. 88 F.3d 129 (2nd Cir. 1996).

company sought to recover for its losses. The insurance companies sought to rescind the policies on the grounds of material misrepresentations by the insured. Arbitration proceedings were brought, and the arbitrators ruled against the rescission of the insurance policies and awarded millions of dollars to the insured. Later, a claim was brought against the insurance companies for losses incurred when the Peruvian government expropriated some oil tankers owned by the oil company. The oil company recovered a large settlement from the insurance companies because of this loss. Years later, the insurance companies sought arbitration against the oil company for recovery of monies from the Peruvian government. The oil company, in this second arbitration, claimed that these matters were dealt with in the prior arbitration, and this precluded any recovery in the second arbitration. The insurance companies claimed that this issue was subject to court determination, while the oil company contended that the arbitrators had jurisdiction to determine it.

The court pointed out that the arbitration clause in the marine policy is sufficiently broad to encompass disputes about what was decided in a prior arbitration. The provision covered "all disputes which may arise under or *in connection with this policy*."⁷² The court held that the broad arbitration clause coupled with the view that any ambiguity regarding arbitration should be construed in favor of arbitration required the arbitrators in the second arbitration to decide the preclusive effect of the first arbitration.

K. Arbitrators and Organizations Which Appoint Arbitrators Are Granted to Arbitral Immunity for Their Actions.

In *Olsen v. National Assoc. of Securities Dealers*,⁷³ an employee brought arbitration proceedings against his employer. A panel of arbitrators sponsored by the National Association of Securities Dealers (NASD) held against the employee in his age discrimination action against the employer. After the award, the ex-employee learned that one of the arbitrators had a continuing business relationship with the employer. The employee brought suit in the federal district court to vacate the adverse award. The district court declined, however, the court of appeals vacated the award on the grounds of evident partiality.

The ex-employee then brought suit for damages against the NASD alleging breach of contract, fraudulent misrepresentation, negligent processing of arbitration, gross negligence, breach of warranty, and intentional infliction of emotional distress. The employee also sued the appointed arbitrator.

72. *Id.* at 136.

73. 85 F.3d 381 (8th Cir. 1996).

In accordance with prior authority, the court of appeals held that the arbitrators and the agency that appointed them were immune from suit for damages, even when it is alleged that the appointing authority violated its own rules in making the appointment.⁷⁴

The court justified its decision by stating:

Like judicial and quasi-judicial immunity, arbitral immunity is necessary to protect decisionmakers from undue influence, and the decision-making process from attack by dissatisfied litigants. . . . The courts also agree that to give effect to these underlying policies, arbitral immunity extends beyond arbitrators themselves to organizations that sponsor arbitrations. . . . Without this extension, arbitral immunity would be almost meaningless because liability would simply be shifted from individual arbitrators to the sponsoring organizations. . . . Arbitral immunity protects all acts within the scope of the arbitral process. . . . Olson argues the NASD's appointment of Hentges was not within the scope of the arbitral process because it occurred before the decision-making process began. The appointment of arbitrators is a necessary part of arbitration administration, however, and thus is protected by arbitral immunity. Olson also asserts arbitral immunity does not apply because the appointment of Hentges violated the NASD's own rules. We reject this contention as well. A sponsoring organization is immune from civil liability for improperly selecting an arbitration panel, even when the selection violates the organization's own rules.⁷⁵

It is true that the justice system has to protect judges and arbitrators from claims for damages for official conduct, but here both the arbitrator and appointing authority failed to act properly, and the victim was denied any recovery of attorneys fees incurred, lost-time damages, etc. Surely, it is possible to devise plans to protect the arbitrators and give some remedial relief to the parties harmed by these errors. If there are no sanctions for misconduct, what incentives are there for proper conduct?

L. Section 10(a)(2) of the Federal Arbitration Act Provides That a Court May Vacate an Arbitration Award "Where There Is Evident Partiality . . . in the Arbitrators." Evident Partiality Has Been Found in Non-disclosure Cases and Actual Bias Cases.

As indicated in the discussion of the prior case, if an arbitrator has some hidden relationship with one of the parties, he or she has a duty to disclose this fact to the parties prior to hearing the claim. A failure to disclose creates an impression of bias, sufficient to enable a court to vacate an

74. *Id.*

75. *Id.* at 382.

award and to order a new arbitration. The protesting party does not have any burden to prove bias; it is inferred from the non-disclosure.

On the other hand, an allegation of actual bias places the burden of proving the actual bias upon the protesting party.⁷⁶

M. Third-party Beneficiaries of Contracts Which Contain Arbitration Clauses May Insist upon Exercising the Right to Arbitration.

In *Spear, Leeds & Kellogg v. Central Life Assurance Co.*,⁷⁷ Goodman, a commodities broker in New York, had over 80 trading accounts for his customers with Spear, Leeds of New York. Spear, Leeds would issue monthly reports on these accounts with much of the information furnished by Goodman. Goodman took out life insurance policies on his life payable to a trust for the benefit of his customers. The purpose was to facilitate payment to his customers in the event of his death.

Much of the information about the Goodman accounts was fictitious, and the New York Stock Exchange brought proceedings against Goodman. Goodman died, and the insurance companies paid the life insurance proceeds to Goodman's account holders. The actual credits in the accounts amounted to approximately two million dollars, while the life insurance proceeds amounted to approximately twenty million dollars. Thus, the account holders allegedly received a large windfall.

The insurance companies brought arbitration proceedings against Spear, Leeds for its negligence in maintaining the accounts, records, etc. Spears, Leeds then filed suit in federal court to enjoin the arbitration. The district court found that there was no arbitration contract between the insurance companies and Spear, Leeds.⁷⁸

The insurance companies appealed to the Second Circuit Court of Appeals. The court agreed with the district court that there was no arbitration contract between Spear, Leeds and the insurance companies; however, the court noted that Spear was a member of the New York Stock Exchange, which provides in its Constitution that "any controversy between a member . . . and any other person arising out of the business of such member . . . shall, at the instance of any such party be submitted for arbitration."⁷⁹

In addition Rule 600(a) of the NYSE Arbitration Rules further states: "Any dispute, claim or controversy between a . . . non-member and a member . . . arising in connection with the business of such member . . .

76. *Woods v. Saturn Distrib. Corp.*, 78 F.3d 424 (9th Cir. 1996).

77. 85 F.3d 21 (2nd Cir. 1996).

78. *Id.* at 26.

79. *Id.*

shall be arbitrated under the Constitution and Rules of the [NYSE] as provided by any duly executed and enforceable written agreement or upon the demand of the . . . non-member."⁸⁰

The court held, in light of the stock exchange rules, the contract between the exchange and its members creates a third-party-beneficiary contract in favor of any person who made demands against a member.

Judge Pollack, in a penetrating dissent stated (in part):

We are asked to compel a member of the NYSE to arbitrate a possible tort claim asserted by life Insurers which wrote life insurance on the life of one, Goodman, a customer of SLK, as part of his estate planning, for the benefit of Goodman's customers, payable to a trust for their benefit. The Insurers had no contact or business of any kind with SLK and made no inquiries of SLK. The Insurers wrote the life policies for, and dealt with Goodman, but never transacted any business with SLK. By virtue of joining the NYSE, SLK agreed to arbitrate only the business claims of any person who asserted a claim against SLK in connection with some business conducted by or with SLK by that person.

SLK never came in contact with the Insurers/appellants, never made any representations to the latter, never sent any documents or communications whatsoever to appellants, and had no knowledge of the dealings of Goodman resulting in the life insurance . . .⁸¹

It is to be noted that the judges did not disagree that the arbitration rights may be asserted by third-party beneficiaries; the judges disagreed as to whether the facts of this case indicate the existence of a third-party beneficiary contract. The majority opinion seemingly reflects the liberal New York view favoring the third-party beneficiary contract concept.⁸²

N. An Arbitration Clause, Which Incorporates by Reference the Laws of a Particular State, Forbidding Arbitrators from Awarding Attorney's Fees and Punitive Damages, Might Not Be Effective to Exclude These Types of Awards.

In *PaineWebber Inc. v. Bybyk*,⁸³ the parties had entered into a client agreement which contained the following:

- Arbitration is final and binding on the parties.
- The parties are waiving their right to seek remedies in court, including the right to jury trial.

. . . .

80. *Id.*

81. *Id.* at 32.

82. L. P. SIMPSON, *CONTRACTS* 242-243 (2d ed. 1965).

83. 81 F.3d 1193 (2nd Cir. 1996).

I agree, and by carrying an account for me PaineWebber agrees, that any and all controversies which may arise between me and PaineWebber concerning any account, transaction, dispute or the construction, performance, or breach of this or any other agreement, whether entered into prior, on or subsequent to the date hereof, shall be determined by arbitration. Any arbitration under this agreement shall be held under and pursuant to and be governed by the Federal Arbitration Act, and shall be conducted before an arbitration panel convened by the New York Stock Exchange, Inc., or the National Association of Securities Dealers, Inc. I may also select any other national securities exchange's arbitration forum upon which PaineWebber is legally required to arbitrate the controversies with me, including, where applicable, the Municipal Securities Rule Making Board. Such arbitration shall be governed by the rules of the organization convening the panel. . . . The award of the arbitrators, or of the majority of them, shall be final, and judgment upon the award rendered may be entered in any court of competent jurisdiction.

. . . .
"This agreement and its enforcement shall be construed and governed by the law of the State of New York." PaineWebber drafted the Agreement.⁸⁴

Mr. and Mrs. Bybyk filed claims against PaineWebber with the National Association of Securities Dealers claiming that PaineWebber did not properly supervise their account, and that it breached fiduciary duties. The Bybyks requested arbitration, and PaineWebber went to court to stay the arbitration on the grounds that the six-year period for making claims had run on some of the claims and to prevent the Bybyks from seeking attorneys' fees and punitive damages. The federal district court dismissed PaineWebber's complaint, and PaineWebber appealed.

The court held that the broad wording of the submission to arbitration clause would give the arbitrators power to decide "any and all controversies" including the six-year time limitation, the award of attorneys' fees and punitive damages.

In dissent, Judge Graafeiland stated that the words "and its enforcement" in the choice-of-law clause made it obvious to him that the question of the time limitation would have to be first submitted to the courts for determination and not to the arbitration panel. The dissent did not seem to quarrel with the majority opinion regarding the award of attorneys' fees and punitive damages.⁸⁵

Query: How would the appellate court hold if the case was submitted to arbitration, and the arbitrators chose to uphold the claims in spite of the

84. *Id.* at 1196.

85. *Id.* at 1202.

six-year limitation period provided for in the NASD Rules? Would this be a manifest disregard of the law?

The above decision should be compared with the similar case of *Mastrobuono v. Shearson Lehman Hutton, Inc.*⁸⁶ A customer filed suit in the federal district court against his stockbroker alleging mishandling of the account. The broker asserted that the brokerage agreement provided for arbitration under the rules of the National Association of Securities Brokers (NASD), and that the agreement chose the law of New York for its governance.

The district court agreed with the brokerage house and ordered arbitration. The arbitrators awarded punitive damages to the customers, and the brokerage house asserted, upon moving to vacate the punitive award in the district court, that New York case law did not allow arbitrators to award punitive damages; only New York courts could make this kind of an award. The federal district court and the court of appeals agreed with this view and vacated the award. The United States Supreme Court granted certiorari because the courts of appeal had split on the question as to whether a choice of law clause can be construed to rule out the awarding of punitive damage awards by arbitrators.

The court noted that the brokerage agreement did not expressly exclude the awarding of punitive damages by arbitrators, and an alleged implied exclusion was ambiguous with the result that the contract was to be construed against the drafter — the brokerage house. The court then stated that the rules of the NASD provide that “the arbitrators may award damages and other relief.”⁸⁷ Finally, the NASD supplies arbitrators with manuals that expressly provide for punitive damages. It should be noted that Justice Thomas, in his dissent, fairly demolished this “manual approach.”

The result in this case may be commendable, but the reasoning is quite weak.

O. A Broad Arbitration Clause Which States That it Covers “Any Dispute Between Any of the Parties Which May Arise Hereunder” May Cover Tort Claims.

In *H.S. Gregory v. Electro-Mechanical Corp.*,⁸⁸ controlling stockholders sold their stock to others, and the sales agreement provided that the sales price would be dictated by the net profits of the corporation over a five-year period after the sale. Allegedly the buyers did not use their best efforts to earn significant profits, and the sellers brought arbitration pro-

86. 115 S.Ct. 1212 (1995).

87. *Id.* at 1218.

88. 83 F.3d 382 (11th Cir. 1996).

ceedings alleging that the buyers were guilty of the torts of fraud, fraudulent inducement, deceit, misrepresentation, conversion, breach of good faith and fair dealing, and outrage. The district court held that the tort claims did not arise "hereunder the contract." The court of appeals reversed holding that all of these tort claims arose under the alleged non-performance of the sales contract and were subject to arbitration.⁸⁹

P. In Drafting Choice of Law Clauses in Arbitration Agreements, Lawyers Should Know the Law Governing the Time Limitations in Requesting Arbitration in the Chosen State.

In *Ekstrom v. Value Health, Inc.*,⁹⁰ Pennsylvania residents and former shareholders of a Pennsylvania corporation merged with a Delaware corporation whose principal place of business was in Connecticut. In the merger agreement, the parties chose to be governed by the "internal laws of the state of Connecticut."⁹¹

The merger agreement called for arbitration in the event of disputes between the parties. Disputes arose, and the complaining party demanded arbitration. The arbitration was held, and the aggrieved party waited more than thirty days to file suit to vacate the award, when Connecticut law required the suit to be filed within 30 days. The suit was filed within the 90-day period provided in the Federal Arbitration Act. The court held that the Connecticut statute was jurisdictional and that it was not pre-empted by the FAA limitation period. The court of appeals affirmed by holding that the shorter limitation period in Connecticut law does not conflict with the FAA's "primary purpose" and is not preempted by it.⁹²

Q. When an Arbitration Clause Names Only One Appointing Organization and That Organization Refuses to Appoint Arbitrators, a Court May Decline to Step in and Appoint Arbitrators and the Parties May Be Forced to Litigate.

In *In re Salomon Inc. Shareholders Derivative Litigation v. Gutfreund*,⁹³ shareholders in a stock brokerage firm brought stockholders' derivative actions against some officers of the firm. The officers had previously signed employment contracts with the brokerage firm submitting all disputes to arbitration with the arbitrators to be appointed by the New York Securities Exchange. The Exchange declined to make any appoint-

89. *Id.*

90. 68 F.3d 1391 (D.C. Cir. 1995).

91. *Id.* at 1393.

92. *Id.* at 1396.

93. 68 F.3d 554 (2nd Cir. 1995).

ment of arbitrators on the grounds that arbitration was not appropriately within the mandatory provisions of the NYSE Constitution and that the type of litigation was foreign to the procedures employed by the NYSE.

The defendants asserted that Section 5 of the Federal Arbitration Act provided for the appointment of arbitrators by the federal district court:

If in the agreement provision to be made for a method of naming or appointing an arbitrator or arbitrators or an umpire, such method shall be followed; but if no method be provided therein, or if a method be provided and any party thereto shall fail to avail himself of such method, or if for any other reason there shall be a lapse in the naming of an arbitrator or arbitrators or umpire, or in filling a vacancy, then upon the application of either party to the controversy the court shall designate and appoint an arbitrator or arbitrators or umpire, as the case may require, who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein.⁹⁴

The court refused to apply the "lapse" language in Section 5 to cover a refusal to appoint by the exclusive appointing authority. The court noted that district court cases cited by the parties had used Section 5 in appointing substitute arbitrators, but that none of the cases involved this kind of a factual setting in which there was a choice of an exclusive appointing organization.

R. The Federal Arbitration Act Covers "A Contract Evidencing a Transaction Involving Commerce;" These Words Reach to the Limits of Congress' Commerce Clause Power.

In *Allied-Bruce Terminix Co. Inc. v. Dobson*,⁹⁵ An Alabama couple contracted with a termite exterminator to exterminate in their home. The exterminator sprayed the home and gave the couple a warranty regarding the absence of termites. The couple later sold their home, and the new owners encountered swarms of termites. The new owners sued the sellers who interpleaded the termite company on its warranty. The termite company requested arbitration pursuant to an arbitration clause in the original contract. The Alabama trial court and Alabama Supreme Court invalidated the arbitration clause on the ground that an Alabama statute invalidated predispute arbitration clauses in contracts, and that the Federal Arbitration Act did not cover this transaction because the parties did not "contemplate" substantial interstate commerce. The United States Supreme Court agreed to hear the case.

94. *Id.* at 560.

95. 115 S.Ct. 834 (1995)

The majority of the Supreme Court rejected the "contemplation test" used by the Alabama Court. The court held that the word "involving" should be treated the same as the word "affecting" interstate commerce, and that these words reach to the limits of Congress' commerce clause powers. The one concurring decision and two dissenting opinions expressed the views that the FAA was never intended to cover state arbitration cases, and they opined that the Court should overrule prior case law to this effect.⁹⁶

S. State Law Which Attempts to Regulate Specifically and Solely Arbitration Contracts Conflicts with Section 2 of the Federal Arbitration Act and Is Preempted by Federal Law.

In *Doctor's Assoc., Inc. v. Casarotto*,⁹⁷ a dispute arose between a Subway restaurant franchisee and franchisor, and the franchisee filed suit in Montana state court. The Montana court stayed the suit pending arbitration in accordance with an arbitration clause in the franchise contract. The Montana Supreme Court vacated the stay on the ground that the arbitration clause did not follow Montana law, which required that every arbitration contract contain language that "notice that a contract is subject to arbitration be typed in underlined capital letters on the first page of the contract."⁹⁸ The Montana Supreme Court held against arbitration. The franchisees argued that the Montana statute was invalidated by section 2 of the FAA, but the court refused to adopt this view.

The franchisees appealed to the United States Supreme Court. The Court reversed the Montana judgment and remanded the case. The Montana Supreme Court upon remand persisted in its view, and "[o]n remand, without inviting or permitting further briefing or oral argument,"⁹⁹ the Montana court followed its original ruling. Certiorari was again granted, and the United States Supreme Court overruled the Montana Supreme Court and again ruled that:

Applying § 27-5-114(4) here, in contrast, would not enforce the arbitration clause in the contract between DAI and Casarotto; instead, Montana's first-page notice requirement would invalidate the clause. The "goals and policies" of the FAA, this Court's precedent indicates, are antithetical to threshold limitations placed specifically and solely on arbitration provisions. Section 2 "mandate[s] the enforcement of arbitration agreements," *Southland*, 465 U.S., at 10, 104 S.Ct., at 858, "save

96. *Id.*

97. 116 S.Ct. 1652 (1996).

98. *Id.*

99. *Id.* at 1655.

upon such grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C. § 2. Section 27-5-114(4) of Montana's law places arbitration agreements in a class apart from "any contract," and singularly limits their validity. The State's prescription is thus inconsonant with, and is therefore preempted by, the federal law.¹⁰⁰

It is wondered what would be the result if this Montana statute were amended to add a long laundry list of contractual prohibitions or requirements along with arbitration which would have to be listed on the front page of the contracts? The court seemed to stress that this statute "specifically and solely" singled out arbitration as the fatal step. Of course, a court could find some other reason why the federal act should preempt the state law.

T. A Contract (Containing an Arbitration Clause) Between Two Domestic Corporations Dealing with Performance in a Foreign Country and Which Is Arbitrated in the United States May Be Enforced in a Federal Court in the United States.

In *Lander Co. v. MMP Investments, Inc.*,¹⁰¹ two domestic corporations contracted with each other to manufacture goods in the United States for export to Poland by the distributing corporation. The sales contract had an arbitration clause providing for arbitration in New York under the arbitration rules of the International Chamber of Commerce. These rules provide for binding arbitration and a waiver.

Arbitration proceedings were held in New York, and the manufacturing corporation was awarded more than \$500,000 plus interest. The winner sought to enforce the award in federal district court. The federal district court dismissed the suit on the basis that the New York Convention did not apply to this arbitration contract. The manufacturer appealed and the Seventh Circuit Court of Appeals held that the words that the Convention will be enforced "on the basis of reciprocity [to] declare that it will apply the Convention to the recognition and enforcement of award only in the territory of another Contracting State" did not restrict the enforcement to awards made only in another Contracting State, but the words should be interpreted to mean:

that the United States will enforce pursuant to the Convention only arbitral awards made in nations that also adhere to the Convention. This is the significance of the reference to reciprocity. The United States will not enforce an arbitration award made in a country that, by failing to

100. *Id.* at 1657.

101. 107 F.3d 476 (7th Cir. 1997).

adopt the Convention, has not committed itself to enforce arbitration awards made in the United States. Granted, "a Contracting State" would be clearer, but "another Contracting State" is clear enough in context; it means "another signatory of the Convention, like the United States, as opposed to nonsignatories."¹⁰²

In addition, the court held that the Convention on the Recognition and Enforcement of Foreign Arbitral Awards would not preclude the federal district court's jurisdiction to apply the Federal Arbitration Act under diversity of citizenship jurisdiction.

U. A Non-signatory to an Arbitration Agreement May Suffer a Default by an Arbitrator and Then Later Attack the Award Collaterally When the Winner Seeks to Enforce the Award. The Collateral Attack Is Not Bound by the Three Month Period in Section 4 of the Federal Arbitration Act.

In *MCI Telecommunications Corp. v. Exalon Industries, Inc.*,¹⁰³ a telephone carrier, seeking to enforce an arbitration clause against a commercial customer over a payment dispute. The arbitration agreement was not signed by the customer. The arbitrator entered a default award against the customer. The customer sought to vacate the award on the ground that it did not sign the agreement and the carrier's claim was asserted long after the expiration of the three-month period in Section 4 of the FAA. The district court confirmed the award, and the customer appealed.

The First Circuit Court of Appeals held, in a case of first impression, that the customer was not bound by the default award because it was a non-signatory to the arbitration agreement and the three-month period had run. The court further held that if the customer did not take part in the arbitration, then the duty was on the telephone carrier under Section 12 to enlist the aid of the district court to issue an order compelling arbitration, and that if the customer did not appear, the district court had jurisdiction to enter a default judgment against the customer.¹⁰⁴

V. The "Alternative Dispute Resolution Procedure," Established under the Motor Vehicle Lemon Law in Some States and under the Magnuson-moss Warranty Act, Might Not Be Deemed "Arbitration" under the Federal Arbitration Act.

102. *Id.* at 482.

103. 138 F.3d 426 (1st Cir 1998).

104. *Id.*

In *Harrison v. Nissan Motor Corp. in U.S.A.*,¹⁰⁵ a car buyer sued a car manufacturer for breach of warranty. The manufacturer moved to dismiss because the buyer had not used the alternative dispute resolution procedure established under the Pennsylvania "lemon law" and Magnuson-Moss Act. The federal district court denied the motion, and the manufacturer appealed.

The court of appeals held that the term arbitration as used in the FAA does not encompass the notion found in the lemon law and Magnuson-Moss Act, because there is little expectation that a hearing before a panel will settle or conclude the controversy between the buyer and manufacturer of the car. Further, the court noted, that if the drafters intended arbitration, then they would have explicitly used the term. As a result, there was no denial of the use of arbitration, and the district court (and the appeals court) had no jurisdiction over the matter.¹⁰⁶

W. Under New York Law, an Unconfirmed Appraisal Award Made by a Judicial Umpire May Have Res Judicata Effect Between the Same Parties in Any Future Litigation.

In *Jacobson v. Fireman's Fund Ins. Co.*,¹⁰⁷ a homeowner sued an insurance company for losses allegedly caused by a negligent housepainter. A New York court appointed an umpire who took testimony and made an appraisal of loss under the homeowner's insurance policy which required this procedure. The umpire made findings of fact and law and the insurance company made payment under the appraisal. Later, the homeowner sued the insurance company, which asserted a res judicata defense. The homeowner asserted that the umpire's appraisal had not been confirmed by any court. The federal district court dismissed the lawsuit on res judicata grounds, and the federal court of appeals affirmed.

The federal court of appeals had to make an "Erie guess" as to how the highest court of New York would rule. The court predicted that New York's highest court would hold that an unconfirmed arbitrator's award or an unconfirmed judicial umpire's appraisal would be held res judicata for all issues that were raised or could have been raised under the first award despite the fact the insured stipulated with the insurance company that the insured was not giving up certain delineated claims in any future action. (i.e., the New York "transactional approach to res judicata, barring a later claim arising out of the same factual grouping as an earlier litigated claim

105. 111 F.3d 343 (3rd Cir. 1997).

106. *Id.*

107. 111 F.3d 261(2nd Cir. 1997).

even if the later claim is based on different legal theories or seeks dissimilar or additional relief.”¹⁰⁸

X. Sections 9 and 10 of the Federal Arbitration Act are Deemed to Be Permissive and Not Mandatory as to Venue of Suits Confirming and Vacating Awards.

In *Sutter Corp. v. P&P Industries, Inc.*,¹⁰⁹ arbitration proceedings were conducted in Dallas, Texas. The losing party moved to vacate the award in a federal district court in Oklahoma. Still later, the winning party filed suit in the federal district court in Texas to confirm the award. Section 9 of the Federal Arbitration Act provides that an action for confirmation “may be made to the United States court in and for the district within which such award was made.” Section 10 of the FAA states that “the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration”

The Fifth Circuit Court of Appeals held that Sections 9 and 10 are permissive venue provisions, and that either the Texas or Oklahoma courts would have jurisdiction; the court noted that the Ninth Circuit has held that the language of Section 10 is mandatory, not permissive.

Finally, the court held that under the “first to file rule,” the Oklahoma court should hear the motion, and the Texas court should have transferred the action to the Oklahoma court.¹¹⁰

Y. In Spite of a Franchise Agreement's Choice of New York Law as Governing the Agreement, Arbitrators Might Not Be Bound to Apply New York Law, Which Forbids the Introduction of Evidence Showing That One Party Offered to Settle.

In *Gallus Investments, L.P. v. Pudgie's Famous Chicken, Ltd.*,¹¹¹ a franchisor and franchisee signed a franchise agreement which provided for arbitration of any “dispute with respect to either this Agreement or the adequacy of either party's performance thereunder” and that “arbitration shall

108. *Id.* at 265.

109. 125 F.3d 914 (5th Cir. 1997).

110. *Id.* Note: The Fourth Circuit Court of Appeals has very recently held that Section Nine of the FAA confers permissive rather than mandatory venue upon district courts in the district court in which an arbitration award has been made. *Apex Plumbing Supply, Inc. v. U.S. Supply Co. Inc.*, 142 F.3d 188 (4th Cir. 1998).

111. 134 F.3d 231 (4th Cir. 1998).

be conducted in accordance with the rules promulgated by the American Arbitration Association.”¹¹²

Rule 31 of the AAA provided that “[t]he parties . . . shall produce such evidence as the arbitrator may deem necessary to an understanding and determination of the dispute, and that [t]he arbitrator shall be the judge of the relevance and materiality of the evidence offered, and conformity to legal rules of evidence shall not be necessary.”

During the hearings, the franchisee introduced into evidence letters which contained settlement offers sent by the franchisor’s attorneys. The franchisor objected, and the arbitration panel of three lawyers overruled.

The franchisor submitted that New York law does not permit the introduction of settlement efforts in trials and appealed to the federal district court. The court affirmed the award which was an amount over twice the sum mentioned in the offers of settlement. The franchisor contended that the arbitrators committed error in their receiving and considering the evidence. The court of appeals disagreed stating:

However, to force the panel to apply New York’s (or any other) evidentiary rules would be to reject the parties’ agreement that legal evidentiary rules need not be followed. Fortunately, there is no necessary conflict between the choice-of-law provision and the arbitration clause. The two clauses can easily be reconciled if interpreted to mean that New York law governs the parties’ contractual rights and duties, and that the panel is free not to apply legal rules of evidence from any jurisdiction, New York or elsewhere. Such a reading gives effect to the arbitration clause while in no way undermining the choice-of-law provision.¹¹³

The appeals court held that the consideration of this evidence did not deprive the franchisor of “fundamental fairness” and “due process.” Rather, this evidence was considered in regard to the efforts of the franchisee to mitigate damages. It would appear that the franchisor was flirting with the notion of “manifest disregard of the law,” but never clearly stressed it.

It might be wise to draft a more precise arbitration clause such as: “all the substantive procedural and evidentiary law of New York is being adopted by the agreement.”

Z. Under a Broad Arbitration Clause, (E.g., “Any Dispute, Controversy, or Claims Arising under or in Connection with this Agreement”) a Claim by an Employee That He Was Discharged from His Employment Because He Was a Whistle-blower under the FIRREA, Is Subject to Arbitration.

112. *Id.* at 232.

113. *Id.* at 233.

In *Oldroyd v. Elmira Savings Bank, FSP*,¹¹⁴ Oldroyd was a vice-president and director of Management Information Systems at a bank. He learned that the head of the Consumer Loan Department had been making a series of illegal loans, and he informed senior bank officials of these acts. Allegedly, Oldroyd was told to “keep quiet” about these loans. Oldroyd told the U.S. Treasury Department of Thrift Supervision about these illegal loans. Subsequently, the loan officer was prosecuted and convicted.¹¹⁵

Oldroyd was demoted and eventually discharged. Oldroyd claimed that he suffered a nervous breakdown as a result of harassment received because he was a “whistle-blower.” Oldroyd brought suit for retaliatory discharge and breach of his employment contract. The district court held that the retaliatory discharge claim could not be arbitrated under the arbitration clause in Oldroyd’s employment contract. The bank appealed to the court of appeals.

The court of appeals held that the words “[a]ny dispute, controversy or claim arising under or in connection with this Agreement shall be settled exclusively by arbitration, conducted before a Panel of three (3) arbitrators in Elmira, New York, in accordance with the rules of the American Arbitration Association then in effect” constitute a broad arbitration clause “that justifies a presumption of arbitrability.”¹¹⁶ Oldroyd failed to overcome this presumption. Further, Oldroyd’s contention, that Congress did not intend his claim to be subject to arbitration, was not established.

AA. Consumers Who Order Goods by Telephone, Mail, or the Internet, must Read the Paperwork Which Accompanies the Delivered Goods or They May Be Subject to an Arbitration Clause Contained in the Paperwork.

In *Hill v. Gateway 2000, Inc.*,¹¹⁷ a couple used the telephone to order a new computer. They paid for the computer with a credit card. Later, a box arrived containing the computer and accompanying paperwork. The paperwork contained a warranty and a clause stating that the retention of the computer without protest for thirty days constitutes an acceptance of the terms, which include mandatory arbitration. The couple did not complain within thirty days. They later sued the manufacturer for alleged RICO violations, and the company demanded arbitration.

114. 134 F.3d 72 (2nd. Cir. 1998).

115. *Id.* at 74.

116. *Id.* at 76.

117. 105 F.3d 1147 (7th Cir. 1997).

The federal district court refused to order arbitration, because of the view that the present record "is insufficient to support a finding of a valid arbitration agreement between the parties or that the plaintiffs were given adequate notice of the arbitration agreement."¹¹⁸

The Seventh Circuit Court of Appeals reversed, holding that there was no need for the written paperwork to be in conspicuous print, and that the buyers, by retaining possession without written complaint within the thirty-day period, were bound by the arbitration clause. The court pointed out that the buyers were not informed, in advance of the sale, of the terms of the warranty. Judge Easterbrook was careful to note the reasons for his decision:

Payment preceding the revelation of full terms is common for air transportation, insurance, and many other endeavors. Practical considerations support allowing vendors to enclose the full legal terms with their products. Cashiers cannot be expected to read legal documents to customers before ringing up sales. If the staff at the other end of the phone for direct-sales operations such as Gateway's had to read the four-page statement of terms before taking the buyer's credit card number, the droning voices would anesthetize rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time. And oral recitation would not avoid customers' assertions (whether true or feigned) that the clerk did not read term X to them, or that they did not remember or understand it. Writing provides benefits for both sides of commercial transactions. Customers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simple approve-or-return device. Competent adults are bound by such documents, read or unread.¹¹⁹

BB. Section 9 of the Federal Arbitration Act Requires the Consent of Both Parties Before a District Court Can Confirm the Award While Section 207 of the Recognition of Foreign Arbitration Awards Merely Requires the Consent of One Party; Which Provision Applies to a Foreign Arbitration?

In *McDermott Int'l, Inc. v. Lloyds Underwriters of London*,¹²⁰ Lloyds of London issued an insurance policy in London insuring property located in Louisiana. The policy was physically delivered in London to an agent of the insured. Eventually, a photocopy of the policy was mailed to the insured in Louisiana. The insured property was damaged, and Lloyds denied liability under the policy. Lloyds instituted arbitration proceedings in Lon-

118. *Id.* at 1148.

119. *Id.* at 1149.

120. 120 F.3d 583 (5th Cir. 1997).

don before a panel of three arbitrators. Both parties took part in the proceedings, although the insured denied that the panel had jurisdiction because Louisiana invalidates arbitration clauses inserted into policies of insurance which are delivered in Louisiana.

The Fifth Circuit Court of Appeals held that since this policy was not "delivered" in Louisiana, the Louisiana statute did not apply. The court then held that the district court had jurisdiction to entertain a petition for confirmation of the award. The insured cited Section 9 of the Federal Arbitration Act, which provides that both parties must consent to the judicial confirmation of the award. Lloyds cited Section 207 of the Recognition of Foreign Arbitration Convention, which provides that "any party to the arbitration may apply to any court having jurisdiction under this chapter . . . for an order confirming the award . . . unless it finds . . . grounds for refusal or deferral . . . in the said Convention."¹²¹

The circuit court held that:

Because we have held that the Convention applies to this case, the enforcement provision of the Convention necessarily applies unless §9 of the FAA does not conflict with the Convention. Section 9 clearly does so conflict, so we decline to apply §9's consent to confirmation provision to the arbitration agreement between McDermott and Lloyds.¹²²

It is wondered whether the attorneys for Lloyds' examined the law of Louisiana prior to the mailing of the policy of insurance to London and sending a photocopy to Louisiana; or were they unaware of this quirk in the law and just incredibly fortunate?

CC. What Does the Phrase, "Disputes Involving the Insurance Business," in the NASD Code, Mean?

In *In re Prudential Ins. Co. of America Sales Practice Litigation All Agent Actions v. Prudential Ins. Co. of America*,¹²³ former employees of an insurance company sued the company for alleged retaliation against them for their refusal to take part in the insurance company's alleged sales frauds. The company sought arbitration based on the employees having signed Uniform Application for Securities Industry Registration or Transfer Forms, which adopted the arbitration provisions of the NASD Code. Part 1 Section i of the Code articulates what matters are eligible for arbitration:

121. *Id.* at 588.

122. *Id.*

123. 133 F.3d 225 (3rd Cir. 1998).

[A]ny dispute, claim, or controversy arising out of or in connection with the business of any member of the [NASD], or arising out of the employment or termination of employment of associated person(s) with any member, with the exception of disputes involving the insurance business of any member which is also an insurance company.¹²⁴

The court analyzed the history of the phrase, “dispute involving the insurance business,” and the various ways of defining the words and concluded that:

We ultimately cannot say with positive assurance that the language of Form U-4 and the NASD Code, as well as their drafting histories, indicate the parties’ desire not to arbitrate employment disputes that require the resolution of an insurance business issue. There is only one clear expression of intent here — that employment disputes are subject to arbitration while “intrinsic insurance” claims are not. Because this court cannot say with certainty what is meant by “intrinsic insurance” claims, and whether it embraces employment disputes, our mandate is clear: a presumption in favor of arbitration applies and doubts in construction are resolved against the resisting parties. Thus, we will reverse the district court’s ruling that the insurance business exception exempted the plaintiff’s claims from arbitration in this case.¹²⁵

The court also held that although the insurance company was not a signatory to any written agreement with the employees involving the adoption of the arbitration process, it was a third party beneficiary of the contract between the employees and the NASD.

DD. If the Agreement to Arbitrate Fails to Clearly Indicate Who Has Jurisdiction to Determine the Arbitrability of a Dispute, (the Courts or the Arbitrators) — Then Who Decides?

In *First Options of Chicago, Inc. v. Kaplan*,¹²⁶ stockholders in a small corporation did not sign an arbitration contract with a third party. The third party claimed arbitration between itself, the small corporation, and the two stockholders. The two stockholders denied that arbitration bound them, and the arbitrators held that they were bound to arbitrate with the third person. The district court confirmed the award and the two stockholders appealed to the court of appeals. The court of appeals agreed with the two stockholders and vacated the award because it was not subject to arbitra-

124. *Id.* at 228.

125. *Id.* at 234.

126. 115 S.Ct. 1920 (1995)

tion. The third party petitioned the United States Supreme Court for certiorari, which was granted.

The Supreme Court held that if parties agree to arbitrate the arbitrability of a question, the court's standard of review is the same for arbitrability as any other matter the parties agreed to arbitrate. If the parties did not agree to arbitrate the question of arbitrability, the court should decide the question of arbitrability by looking at principles of contract formation. The reviewing court should not assume the parties agreed to arbitrate arbitrability unless there is clear evidence that they did so.¹²⁷

EE. Why Do Some Employers Persist in the Use of Invalid Arbitration Clauses in Employment Contracts?

In *Paladino v. Avnet Computer Tech., Inc.*,¹²⁸ a woman was employed by a company as a sales consultant. When she was hired she signed a handbook acknowledgment form. The handbook contained a copy of the following consent to arbitration:

IMPORTANT NOTICE: READ
THIS CAREFULLY

.....
CONSENT TO ARBITRATION

I recognize that during the course of my employment differences can arise between the Company and me. To that end, *the Company and I consent to the settlement by arbitration of any controversy or claim arising out of or relating to my employment or the termination of my employment.* Arbitration shall be in accordance with the commercial rules of the American Arbitration Association before a panel of three arbitrators in or near the city where I am principally employed. The Company and I further consent to the jurisdiction of the highest court of original jurisdiction of the state where I am principally employed, and of the United States District Court in the District where the arbitration takes place, for all purposes in connection with the arbitration, including the entry of judgment on any award. *The arbitrator is authorized to award damages for breach of contract only, and shall have no authority whatsoever to make an award of other damages.*¹²⁹

The court noted that the print for this arbitration clause was in smaller type than other print in the handbook. Approximately fifteen months after she was hired, she was fired and she brought suit against the employer for

127. *Id.* at 125.

128. 134 F.3d 1054 (11th Cir. 1998).

129. *Id.* at 1056.

violations of Title VII, a Florida anti-discrimination statute, and Florida's common law. The employer made a motion in the federal district court to stay the action, pending arbitration. The federal district court denied the motion without opinion, and the employer appealed to the Eleventh Circuit Court of Appeals.

A three-judge panel agreed with the district court's refusal to stay the lawsuit pending arbitration, but the judges disagreed on their reasoning. Chief Judge Hatchett held, in a very murky opinion, that the last italicized clause in the above arbitration agreement "completely proscribes an arbitral award of Title VII damages."¹³⁰ It contained that this is fundamentally at odds with the purpose of Title VII . . . therefore, "[g]iven the deficiencies and limited nature of this arbitration agreement, the district court properly declined to compel arbitration of the employee's lawsuit."¹³¹

Judges Cox and Tjoflat agreed that the actions of the district court were proper, but added, "we disagree that the arbitration clause at issue excludes Title VII claims. We hold rather that the clause includes Title VII, but that (as Chief Judge Hatchett observes) it deprives the employee of any prospect for meaningful relief and is therefore unenforceable."¹³²

Judge Hatchett's opinion pointed out that the employer had used the quoted arbitration agreement in another case, and that a federal district court had refused to compel arbitration because of the restriction on damages under Title VII. In fact, in the instant case, the attorney for the employer implored the court to invalidate the offending clause! Why do employers persist in the use of invalid clauses?

FF. In the View of Two Circuit Courts of Appeal, the Words in an Arbitration Contract That Any Award Is to Be Deemed "Final, Binding, and Conclusive," Are Not Sufficient to Give a Federal District Court Jurisdiction to Confirm the Award.

Section 9 of the Federal Arbitration Act provides that a party may apply to the court for confirmation of an arbitration award only "[i]f the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration." In *PVI, Inc. v. Ratiopharm GMBH*,¹³³ a contract provided that certain questions would be referred to a neutral individual for decision. The contract provided that this decision would be "final, binding and conclusive."¹³⁴

130. *Id.* at 1060.

131. *Id.*

132. *Id.*

133. 135 F.3d 1252 (8th Cir. 1998).

134. *Id.* at 1253.

The neutral party found in favor of the party who petitioned the federal district court to confirm the decision. The contract was silent as to the confirmation process. The district court denied confirmation, and the losing party appealed.

The Eighth Circuit Court of Appeals affirmed the district court on the ground that Section 9's language clearly states that only if the parties have agreed to the federal court's confirmation process, does the court have jurisdiction to confirm the award. The court noted that the Seventh and Second Circuits had found that the "final, binding and conclusive" language was enough to show that the parties consented to federal district court confirmation. However, the Tenth Circuit held that these words did not give federal courts power to confirm. The Eighth Circuit expressly followed the Tenth Circuit. The court expressed the view that perhaps state courts could confirm the award.¹³⁵

Attorneys should comply with the Federal Arbitration Act by stating in arbitration agreements that any award should be confirmed by the federal courts.

GG. If a Motion to Compel Arbitration Is "Embedded" in a Substantive Suit, Then the Federal District's Decision to Compel Arbitration on Some or All of the Claims Before it Is Not Considered to Be a Final Decision and Is Not Reviewable in Some of the Federal Courts.

In *McCarthy v. Providential Corp.*,¹³⁶ a number of senior citizens took out reverse mortgages with the Providential Corporation. These senior citizens sued Providential for Truth in Lending Act violations, fraud, etc., under state law. The senior citizens sought a class-action lawsuit, and Providential sought to compel arbitration in accordance with arbitration clauses contained in the reverse mortgages. The district court ordered the plaintiffs to submit to arbitration, and they appealed to the Ninth Circuit.

The court of appeals cited and quoted from a relatively recent prior case:

[I]f the motion to compel arbitration in a given case is the only claim before the district court, a decision to compel arbitration is deemed to dispose of the entire case, and permit appellate review under 9 U.S.C. § 16(a)(3) . . . On the other hand, if the motion to compel arbitration is "embedded" in a substantive suit pending before that court, the district court's decision to compel arbitration of some or all of the claims before it is not considered to be final, and therefore not reviewable.¹³⁷

135. *Id.* at 1254.

136. 122 F.3d 1242 (9th Cir. 1997).

137. *Id.* at 1244 citing from *Prudential Ins. Co. of Am. v. Lai*, 42 F.3d 1299, 1302 (9th Cir.

The court stated that it was expressly following the Eighth Circuit opinion and the majority rule in the United States. The majority opinion concluded with the words: "We stress again that we are not precluding review of the district court's order compelling arbitration; we are merely postponing it until the arbitration proceeding has run its course."¹³⁸

Under this approach, it would appear that the court is trying to avoid deciding the arbitration issue in a bifurcated approach. Rather, it is hoping for one decision which may close the entire case. If the person contesting the arbitration wins the arbitration this person will not appeal. It is an attempt at judicial economy which may not always succeed.

HH. Third-party Beneficiaries of a Promissory Note May Be Deprived of Any Benefits under the Note by an Arbitration Award Even Though They Were Not Parties to the Arbitration Proceedings.

In *Nauru Phosphate Royalties, Inc. v. Drago Daic Interests, Inc.*,¹³⁹ Nauru purchased land from Daic and M-666 for \$5 million in cash and \$8 million in a purchase money promissory note secured by a deed of trust on the land. The note provided it would be paid from profits earned in the development and sale of a large home subdivision, and if there were no profits there would not be any recourse against Nauru. Nauru contracted with Drago for the land's development. The development contract provided for arbitration of disputes. Disputes arose between Nauru and Drago, and the arbitration panel by a 2 to 1 vote ruled in favor of Nauru.

In addition, the arbitration panel decided that Nauru was not liable to the payees of the promissory note because the breach by Drago resulted in no profits and the payment condition in the note was, therefore, not satisfied. The two payees of the note were not parties to the arbitration proceedings. Both the district court and the Fifth Circuit Court of Appeals agreed that the third-party beneficiaries of the purchase money promissory

1994). *Accord* *In re Pisgah Contractors Inc.*, 117 F. 3d 133 (4th Cir. 1997); *Ermenegildo Zegna Corp. v. Zegna*, 133 F.3d 177 (2nd Cir. 1998).

138. *See supra* note 3 at 1244. This analysis has been followed by the majority of courts examining the issue of interlocutory appeals under section 16. *See, e.g.*, *F.C. Schaffer & Assocs., Inc. v. Demech Contractors, Ltd.*, 101 F.3d 40, 42-3 (5th Cir. 1996) (dismissing appeal from district court's order compelling arbitration for lack of jurisdiction); *American Cas. Co. of Reading, Pennsylvania v. L-J, Inc.*, 35 F.3d 133, 135-39 (4th Cir. 1994) (holding that order staying litigation pending arbitration of embedded claims was nonappealable); *Filanto, S.P.A. v. Chilewich Int'l Corp.*, 984 F.2d 58, 60 (2nd Cir. 1993). *But see* *Armijo v. Prudential Ins. Co. of Am.*, 72 F.3d 793, 797 (10th Cir. 1995) (holding that dismissal as a result of order to compel arbitration presents an appealable final decision); *Arnold v. Arnold Corp.*, 920 F.2d 1269, 1276 (6th Cir. 1990) (affirming the district court's dismissal of the complaint in deference to arbitration).

139. 138 F.3d 160 (5th Cir. 1998).

note would be bound by the award, even though they were not formal parties to the arbitration. Judge Higginbotham wrote,¹⁴⁰

Their arguments are not persuasive. At the outset, the provisions of both the Development Agreement and the Promissory Note reveal that the two documents are inextricably intertwined. The first paragraph in the Promissory Note states in relevant part:

The terms of the Earnest Money Contract and the Development Agreement are hereby incorporated into this Note as if fully set forth in this Note.

Not only does it fully incorporate by reference the Development Agreement, the Promissory Note is explicitly referenced throughout the Development Agreement.

The arbitration clause in the Development Agreement provides:

Any dispute, controversy or claim arising out of or in connection with or relating to this Agreement or any breach or alleged breach hereof, shall, upon the request of any party involved, be submitted to and settled by arbitration in Houston, Texas pursuant to the rules then in effect of the American Arbitration Association.

As this court has noted, “[w]hen parties include such a broad arbitration clause, they intend the clause to reach all aspects of the relationship.” Here, Nauru’s demand for arbitration states that DDI’s failure to perform pursuant to the Development Agreement affects its liability on the Promissory Note. Thus, DDI knew that Nauru’s liability on the Promissory Note was indeed an issue before the arbitration panel.

Further, by virtue of the two agreements, the Development Agreement had to be performed without material breach by DDI in order for the noteholders to be paid. Nauru’s duty to make payment pursuant to the Promissory Note was a “conditional obligation,” and Nauru had “certain set-off rights” against its obligation to pay which were specified in the Development Agreement. By the very terms of the Promissory Note, any material breach of the Development Agreement by DDI would put payment on this Note at risk. The evidence on record shows that Mr. Drago Daic wanted DDI to be the developer of Bentwood pursuant to the Development Agreement and the Promissory Note were intimately related to one another, and the district court did not err in finding that the arbitration panel had the authority to rule on Nauru’s liability on the Promissory Note since it was intimately “related to” the Development Agreement. Indeed, it goes to the heart of the dispute over DDI’s performance of the Development Agreement.¹⁴¹

Judge Higginbotham further noted that “[a]s effective third-party beneficiaries, the noteholders may be precluded from litigating the issue of

140. *Id.* at 165.

141. *Id.* at 164-66 (citations omitted).

breach of the Development Agreement in any subsequent proceeding and may be bound by the panel's finding of non-liability on Nauru's part for the Promissory Note.¹⁴²

In light of the holding in this case, third-party beneficiary clients (and their lawyers) ought to consider asking for leave to intervene in arbitration proceedings (and litigation) in order to assert their rights whenever there is doubt that the promisor or promisee is insufficiently represented. If a person's rights are going to be adversely affected, he or she should have the opportunity to defend his or her rights.

II. Under a Broad Arbitration Clause Which States That, "[A]ll Controversies and Claims Arising out of or Relating to this Agreement, Shall Be Settled by Arbitration," the Arbitration Panel Shall Have Jurisdiction to Determine Whether the Contract Was Fraudulently Induced, Even When the Contract Provides for the Application of Ohio Law Which Forbids this Kind of Determination by Arbitrators.

In *Ferro Corp. v. Garrison Indus., Inc.*,¹⁴³ two corporations entered into a contract calling for the production of a chemical which the seller agreed to sell to the buyer. The contract provided that "[a]ll controversies and claims arising out of or relating to this agreement shall be settled by arbitration."¹⁴⁴

The contract also provided that the Ohio law would control. The parties disagreed with each other, and arbitration was called for by one of the parties. The other party asserted that it was fraudulently induced to enter into the contract. The party asserting fraud claimed that the arbitrators did not have the power to determine whether fraud induced the party to enter into the contract, because Ohio law governed the contract and in Ohio, arbitrators do not have jurisdiction to decide fraudulent inducement cases.

The Sixth Circuit Court of Appeals held that the adoption of Ohio law simply governed the relationship between the parties, but that the arbitration clause governed any arbitration proceedings. The court noted that Ferro (the complaining party) drafted the broad arbitration clause, and there was no indication in the contract that the parties intended that Ohio law would control the determination of fraudulent inducement.¹⁴⁵

JJ. The United States Supreme Court Has Held That Non-members of a Labor Union Who Are Forced to Pay Union Dues under an "Agency

142. *Id.* at 166.

143. 142 F.3d 926 (6th Cir 1998).

144. *Id.*

145. *Id.*

Shop Agreement” and Who Object to the Non-labor Use of a Portion of Their Dues, Are Not Compelled to Undergo Arbitration to Determine the Amount of the Dues Unless They Consent to Arbitration.

In *Air Line Pilots Assoc. v. Miller*,¹⁴⁶ pilots of Delta Airlines, who were non-members of the Airlines Pilots Association Union, protested about the partial use of their “Agency Shop Agreement” dues for non-labor purposes. The Airline Pilots Union sought arbitration to determine the amount to be set aside and the amount returned to the non-member pilots, but the non-member pilots sought court adjudication. The federal district court upheld the arbitration, but the Court of Appeals for the District of Columbia Circuit reversed. The United States Supreme Court held that submission to arbitration is normally a matter of contractual consent by the affected parties, and the non-members of the ALPA Union did not contractually consent to arbitration and are entitled to hearings in the federal courts. In effect, the court held that even though the non-members of the union had to pay a portion of their wages as union dues, they were not bound by the arbitration clause agreed to by the Union.

Dissenting Justices Breyer and Stevens expressed the view that the non-members should submit to non-binding arbitration. It is submitted that the addition of a non-binding additional step would not add to the efficient determination of the ultimate question. It would simply add additional delay and expense to the process.

It is submitted that the views expressed by Justice Ginsburg enunciate the correct view that arbitration is based primarily upon contractual consent and non-contracting parties should not be forced to submit to arbitration. The dissenting view seems based upon some notion of judicial convenience which ignores the contractual aspect.

One may wonder as to what effect the failure of the hotel to object as to the “restoration issue” had on the majority of the court as to the ultimate decision in this case?

KK. The Franchisee and the Franchisor in Two Franchise Contracts May Be Bound to Arbitrate Their Differences under Franchise Contract Number One (Which Had No Arbitration Clause) When Franchise Contract Number Two Had a Broad Arbitration Clause.

In *Cara’s Notions, Inc. v. Hallmark Cards, Inc.*,¹⁴⁷ Mr. and Mrs. Gibson contracted (Contract 1) for a franchise from Hallmark Cards to operate a Hallmark greeting card store. The contract was silent as to arbitration.

146. 118 S.Ct. 1761 (1998).

147. 140 F.3d 566 (4th Cir. 1998).

Subsequently, the parties entered into a second contract (Contract 2) which provided for a new store in a different location. The second contract provided:

Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, *or any aspects of the relationship between Hallmark and Retailer*, or the termination thereof, shall be settled by binding arbitration under the United States Arbitration Act in accordance with the Commercial Arbitration Rules of the American Arbitration Association, and judgment upon the award may be entered in any court having jurisdiction thereof.¹⁴⁸

The parties had some serious differences under Contract One, and the Gibson's filed suit in the state court, and Hallmark removed the case to the federal district court and requested the court to order arbitration. The district court held:

that matters regarding Store I were governed only by Contract I and that matters regarding Store II were governed only by Contract II, the district court denied the motion to compel arbitration. The court held that "[b]ecause Contract I does not contain an arbitration clause, this matter regarding Store I is not subject to arbitration." The district court held that the arbitration clause in Contract II did not modify the relationship created by Contract I because it believed that the first contract's merger clause required any modification to be "in writing with a specific reference to Store I." It further held that the arbitration clause in Contract II did not apply directly to matters regarding Store I because "the boilerplate contract [II], in its introduction, specifically states that the contract is in reference to Store II," and because the merger clause in Contract II uses the singular term "a Hallmark account" instead of a plural term such as "accounts," thus "specifically limit[ing] its scope to Store II."¹⁴⁹

For some inexplicable reason, the district court did not expressly analyze the language in the broad arbitration clause in Contract Number 2.

The Fourth Circuit Court of Appeals held that the broad arbitration clause in Contract Number 2 did govern disputes under Contract Number 1. The court then noted that even if the arbitration clause had been ambiguous in its scope, there was still the strong federal policy encouraging arbitrability under the Federal Arbitration Act and this would compel the same result.¹⁵⁰

148. *Id.* at 568.

149. *Id.*

150. *Id.*

This case suggests that when parties contemplate signing successive contracts they should employ legal counsel who will scrutinize the relationship between the contracts to ascertain how they interrelate. But here, even an experienced federal district court judge failed to perceive the interrelationship.

LL. According to the Full Panel of One Circuit Court, an Arbitrator Has the Power to Order an Employer to Re-establish Employment Positions of Workers and to Order the Employer to Hire New Employees to Fill These Re-established Positions, Even Though the Old Employees Have Refused to Return to Work.

In *Madison Hotel v. Hotel and Restaurant Employees of Local 25*,¹⁵¹ a hotel company abolished the "bus boy" positions, discharged the "bus boys," and assigned their duties to others. The union brought arbitration proceedings, and the arbitrator ruled that the hotel must re-establish these positions. The district court disagreed with the arbitrator. A panel of the Court of Appeals for the District of Columbia reversed the district court, and then an en banc Court of Appeals held that the arbitrator had the power to order the hotel to re-establish the positions and to order the hotel to hire employees to fill these positions.

It should be noted that a concurring opinion pointed out that the hotel failed to object to the restoration issue, and it thereby waived its right to object to the consideration of this issue by the arbitrator.¹⁵²

MM. A Buyer of Goods May Be Subject to an Arbitration Clause Even When it May Not Have Actual Notice, (As Contrasted with Constructive Notice) of an Arbitration Clause in Shipping Documents.

In *Steel Warehouse Co. v. Abalone Shipping Ltd.*,¹⁵³ a buyer in the United States contracted to buy steel coils from an English seller. The coils were manufactured in Bulgaria and were shipped to the United States under a charter party arrangement. The coils were damaged by seawater in transit, and the buyer filed suit in a federal district court. The seller and affiliated shipping companies sought arbitration because the terms of the charter party, which were incorporated by reference into the bill of lading, stated that, "all disputes from time to time arising out of this contract shall . . . be referred to final arbitration in London."¹⁵⁴ The court held that

151. 144 F.3d 855 (D.C. Cir 1998).

152. *Id.*

153. 141 F.3d 234 (5th Cir. 1998).

154. *Id.* at 238.

the buyer had constructive notice of this arbitration clause because it was found to be commonly used in bills of lading. As the court put it:

Constructive notice can be defined, crudely, as a rule in which "if you should have known something, you'll be held responsible for what you should have known." In this situation, Steel Warehouse was a sophisticated party, and one of its own agents testified that arbitration clauses of the type at issue are standard operating procedure in this line of business. Also, the bill of lading at issue was on a common, internationally recognized form of bill of lading called a "Congen Bill." In other words, if the charter party clause was properly incorporated, given the facts before us, Steel Warehouse should have known what was around the corner, given the totality of the circumstances. Whether one styles this as an issue of constructive notice or incorporation alone, the analysis basically turns on incorporation.

The key point, then, is whether we believe the charter party was properly incorporated. We hold that it was. The relevant part of the bill of lading (which was the same in both of the bills of lading taken before the district court) stated:

Freight Payable as per CHARTER-PARTY dated 21 OCTOBER 1994 ALL TERMS AND CONDITIONS OF WHICH ARE INCORPORATED IN THIS B/L.

A plain language reading of this clause makes it clear that "THIS B/L [bill of lading]" incorporates the terms of conditions of the charter party, dated October 21, 1994, including, presumably, its (industry standard) arbitration clause. While it would have been preferable for this clause in the bill of lading to have been more specific and detailed, it passes muster, given the facts of this case. Also, precedent allows for quite a bit of leeway in the drafting of such clauses, and does not require a punctilious degree of specificity.¹⁵⁵

The court emphasized that the buyer was a "sophisticated party" and the fact that one of its agents had knowledge of this practice to incorporate by reference, and was bound by an arbitration clause by some kind of constructive notice. The danger in this case is that an unwary court might apply this rationale in a case with a less sophisticated party such as an entry level merchant or, heaven forbid, a consumer. As long as the tiger is confined to its cage, there is no danger.

155. *Id.* at 237 (citations omitted).

IV. CONCLUSION

As the title indicates, this article has been an analysis of miscellaneous federal cases dealing with judicial "interference" in the arbitration process. If there is a common thread running through the cases, it is that the federal courts (as well as some state courts) are too anxious to hear appeals from the arbitral awards with the consequent inflation of legal fees and waste of time and labor.

It is suggested that the FAA should be amended to provide that arbitrators issue their awards in a "preliminary draft" with the parties given leave to ask for a single rehearing or re-evaluation of the preliminary award (by the arbitrator).

Further, it is suggested that the FAA should provide that the parties in commercial arbitration may agree, in advance, that the final award shall be deemed final and non-appealable in accordance with the relatively new English Arbitration Act.

The author has no illusions that these changes in the law would constitute a panacea for judicial tinkering with the arbitration process, but it might be two steps out of the present morass.