Arbitration Update in Missouri:

2001-2002

by

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Thanks to a plethora of groundbreaking decisions in 2001 and 2002 from Missouri's appellate courts and the Eighth Circuit Court of Appeals, arbitrators enjoy unprecedented power. Generally, trends in the law are measured in years to decades, but not so in the field of Alternative Dispute Resolution (ADR). In the past two years these courts have deferred to arbitrators virtually all decisions about how to handle the arbitration. Also, the courts continue to support the arbitrator's final orders and awards when challenged in a court of law. However, arbitrator awards are not immune from being vacated, as shown in a recent Missouri appellate decision involving attorney fees.

This paper examines the significant cases and updates on the present state of the law in arbitration.

I. Missouri's Appellate Courts

A. Jurisdiction

1. Typically, after someone files a petition, if there is an arbitration agreement, the defendant moves the court to stay the lawsuit and requests an order compelling arbitration. Before a court can grant a motion to compel arbitration, the court must first decide whether the agreement containing the arbitration provision is valid and legally binding. *Estate of Leila Grace Burford by Pam Bruse v. Edward D. Jones & Co.*, 2002 Mo. App. LEXIS 1258, decided June 11, 2002 by the Western District. Only then does the arbitrator have jurisdiction.

In *Edward D. Jones*, the court determined that co-conservators did not have authority to enter into an account agreement on behalf of the estate without prior court approval and therefore the agreement was void. The language of the arbitration clause was "wholly irrelevant" if the party never entered into the contract as a whole or agreed to be bound by an arbitration.

The court rejected the argument that the validity of the account agreement was an issue to be decided by the arbitration tribunal and not

the court. "Missouri courts have held that under either the Missouri Arbitration Act or the Federal Arbitration Act 'before a court may grant a party's motion to compel arbitration, it must decide whether the agreement containing the arbitration is valid and legally binding.'" *Id.*

2. In *Estate of James Athon and Joe Athon v. Conseco Finance Servicing Corp. and Ronsee*, 2002 Mo. App. LEXIS 1716, decided August 20, 2002, the Western District reversed a trial court's order denying a motion to compel arbitration. The estate had sued Conseco alleging that it wrongfully trespassed onto the estate's property and repossessed a mobile home.

The appellate court found that the claims in dispute, including those in tort, were subject to an arbitration agreement. The agreement provided in part: "All disputes, claims or controversies arising from or relating to this Contract or the parties thereto shall be resolved by binding arbitration by one arbitrator selected by you with my consent."

The court stated that the Federal Arbitration Act (FAA), 9 U.S.C. § 2 (1999), applied to the case because the contract between the parties involved interstate commerce. Further, the claims of respondeat superior, conversion, trespass, interference with expectancy of inheritance and unlawful repossession of personal property involve issues whose resolution "requires reference to or construction of some part of the Contract." For arbitration not to be compelled, the tort claim must be independent of the contract terms and not require reference to the underlying contract.

3. In *Workman v. Orkin Exterminating Co.*, 66 S.W.3d 743 (Mo. App. S.D. 2001), the Southern District reversed a trial court's order denying without explanation a motion to compel arbitration. The appellate court applied the FAA since employees for Orkin had to cross state lines and the material Orkin used came from another state.

Plaintiffs sued for actual and punitive damages, alleging that Orkin failed to treat as outlined in their agreement and that it did not prevent termite problems. Orkin moved for arbitration. The appellate court agreed with Orkin that the FAA mandated enforcement of the arbitration agreement. The court rejected plaintiffs' argument that since the treatment "had not been performed" the arbitration agreement had no effect, stating that the record on appeal did not contain any evidence concerning Orkin's performance.

4. In *Metro Demolition v. H.B.D. Contracting*, 37 S.W.3d 843 (Mo. App. E.D. 2001), the appellate court agreed that a trial court correctly denied a motion to stay litigation pending arbitration with regard to one

particular subcontract. The subcontract incorporated by reference the provisions of a prime contract between the owner and the contractor that included binding arbitration. The problem was that the prime contract was not in existence at the time of the incorporation and thus the incorporation was not valid. The court set out the elements to consider in deciding whether an arbitration agreement warrants an order staying litigation. They are:

(1) whether the parties agreed to arbitrate;
(2) the scope of the agreement;
(3) if federal statutory claims are asserted, whether Congress intended those claims to be arbitrable; and
(4) if the court concludes that some but not all claims are arbitrable, whether to stay the balance of the proceeding pending arbitration.

Id. at 846.

B. Award Vacated (Attorney Fees)

In a case of first impression, the Eastern District vacated an arbitrator's award of attorney fees where the fees related to litigation previously decided by the Missouri courts (rather than attorney fees due to the arbitration itself). The case is *Strain-Japan R-16 Sch. v. Landmark Systems*, 51 S.W.3d 916 (Mo. App. E.D. 2001), decided August 14, 2001.

The case involved a dispute over construction of an addition to a school. The School District withheld $72,000 plus from final payment to the contractor claiming defective work by the general contractor Landmark Systems, Inc.

Landmark filed a demand for arbitration with the American Arbitration Association. The District filed a petition in circuit court requesting a stay of the arbitration and argued that the agreement was unenforceable. The court granted a Temporary Restraining Order, then dissolved the TRO and declared the contract to be enforceable.

Landmark amended its demand for arbitration to include a request for attorney fees incurred in the court action but not the arbitration. The arbitrator awarded to Landmark without explanation the remaining contract price minus costs to repair certain items, interest, and $41,530 in attorney fees.

The appellate court applied the Federal Arbitration Act (FAA) to decide whether the arbitrator correctly awarded the attorney fees. The FAA's

grounds for vacating an award include an arbitrator exceeding his or her powers.

Given this standard, the appellate court concluded that the arbitrator did exceed his powers under 9 U.S.C. § 10(a)(4) by awarding the attorney fees since they related to litigation other than the arbitration before him. "There was no express or written provision in the contract allowing for attorney's fees from a prior litigation to be recovered." *Id.* at 923.

C. Punitive Damages

1. For years, litigators considered arbitration to be a safe haven to avoid punitive damages. That thinking may change given the decision in *Groceman v. Pulte Homes Corp.*, 53 S.W.2d 599 (Mo. App. W.D. 2001), decided August 21, 2001. The Western District upheld an arbitrator's award of punitive damages.

The case involved a contract dispute (with fraud allegations) over the construction of a house, alleged to have several structural defects, including roof deflection, inadequate rafters, and ceiling cracks. On its face, this case hardly seemed to be the kind that would muster any serious concern that punitive damages were a realistic possibility, especially since it was in arbitration. The arbitrator—appointed by the court—awarded $50,000 in actual damages and another $50,000 in punitive damages against the contractor.

The contractor tried to overturn the punitive damage award by arguing to Missouri's appellate court that the award demonstrated a "manifest disregard of the law." The case had proceeded under the Federal Arbitration Act, which unlike Missouri's Uniform Arbitration Act (Chapter 435 R.S.Mo.), allows for an award to be attacked on the ground of "manifest disregard of the law". To succeed, however, the contractor had to prove that the arbitrator correctly understood the law but then chose to ignore it.

Given this high burden, the appellate court left in place the punitive damage award, even though the arbitrator "did not clearly delineate the law applied or the analysis used." Moreover, the court noted that an arbitrator does not even have to explain his or her decision. While the arbitrator in *Pulte Homes* did provide some reasoning, it was not enough to convince the court that it could overturn the award of punitive damages. Without more, the court had no choice but to confirm the award.

The safest way for an arbitrator to protect his or her decision is to say nothing about it—to provide an award without any explanation. Absent

a requirement in the arbitration agreement that the award contain reasons or a specific request from at least one of the parties, the arbitrator is not required to explain his or her thinking. Some parties request in advance that the arbitrator set forth the reasons for the decision in the award. Organizations such as the American Arbitration Association (AAA) provide in their rules that the parties can jointly request a written, reasoned opinion, thereby avoiding the problem presented in this case. See, for example, R-44 of AAA's Commercial Dispute Resolution Procedures, effective September 1, 2000.

Generally, parties do not make the request, as it increases the cost of the arbitration by forcing the arbitrator to spend more time and savvy arbitrators know how to prepare an award that will typically withstand judicial scrutiny anyway. Thus, a well-constructed award serves mostly to offer some guidance about the arbitrator's thought process. It does not often provide lethal ammunition to attack the decision in a court of law.

Probably few arbitrators will consider *Pulte Homes* to be a catalyst to start awarding punitive damages. Its importance is that if punitive damages are appropriate, the arbitrator now has court support for his or her decision and absent a showing that the arbitrator "manifestly disregarded the law," the courts will uphold the decision. This case, while reaching a drastic result, should not dissuade parties from using arbitration, but rather reaffirm the importance of carefully selecting the arbitrator.

2. In *Hoskins v. Business Men's Assurance*, 2002 Mo. Lexis 79, decided July 23, 2002, the Supreme Court in Missouri upheld the constitutionality of Sec. 537.675 R.S.Mo (2000), dealing with the state's lien of 50 percent on any final judgment for punitive damages. While the case did not involve arbitration, it is noteworthy because the statute in question includes this provision: "Cases resolved by arbitration, mediation or compromise settlement prior to a punitive damage final judgment are exempt from the provisions of this section." This, coupled with the decision in *Pulte Homes*, may provide a significant reason for some claimants to consider arbitration.

D. Discovery

Until recently, one of the more unknown and untested areas of arbitrator power involved depositions and whether they can and should be ordered, especially when at least one party objects. In *CPK/Kupper Parker Communication, Inc. v. Hart*, 51 S.W.3d 881 (Mo.App. E.D. 2001), the court made clear that an arbitrator's decision about discovery—including whether and how many depositions will occur—rests with the arbitrator, period. Citing *United Paperworks International Union, AFL-CIO v. Misco,*

Inc., 484 U.S. 29 (1987), the Court held that "courts thus do not sit to hear claims of factual or legal error by an arbitrator as an appellate court does in reviewing decisions of lower courts." *Id.* at 38. The Court can determine the validity of an agreement to arbitrate, but that is about all.

At issue was whether the arbitrator should have granted a party's request for twenty depositions, even though the arbitration agreement appeared to limit the number to three. The court declined the opportunity to monitor arbitration, administered under AAA's rules, and held instead that such power rested with the neutrals, including when a party desires discovery that an arbitrator has denied. Accordingly, the court held:

> If Missouri allowed every alleged misinterpretation of an arbitration agreement by an arbitrator to be litigated and appealed arbitrations would be a mere prelude to litigation and would, in the end, prove more time-consuming and expensive than litigation. The order of the circuit court is quashed because it had no jurisdiction to reverse an arbitrator's denial of a request to take depositions.

Id. at 886. The court also provided this helpful summary of a typical arbitration before a tribunal, in this case the American Arbitration Association (AAA):

> The procedures under the Rules of the American Arbitration Association are informal by design. An ordinary letter summarizing the claim and stating the relief sought typically serves as a demand for arbitration. No responsive pleading is required. The arbitrator, often selected by the parties themselves, is expected to have expertise in the subject matter of the controversy. In order to speed the process and to reduce expenses certain rights have been sacrificed. One of these is the right to depose every witness endorsed by one's opponent. Absent a compelling reason, arbitrators ordinarily direct limited document disclosure and deny requests for interrogatories and depositions. The hearing is marked by informality. Rules of evidence do not apply unless the arbitrators choose to enforce them. And a stenographic record of the hearing is kept only if one of the parties makes arrangement for a court reporter.

Id. at 883.

E. Waiver of Arbitration

1. Even though there is a binding arbitration agreement, the parties, through their actions, often proceed in other directions, as if the arbitration agreement did not exist. This is what happened in *McIntosh v. Tenet Health Systems*, 48 S.W.3d 85 (Mo. App. E.D. 2001), decided June 12, 2001.

The parties clearly had an arbitration agreement that provided for dispute resolution through AAA. In the underlying litigation, an employee sued Tenet for alleged wrongful termination and breach of contract, and also requested that the trial court compel arbitration, or in the alternative, promptly hear the case. The employee then filed a demand for arbitration with AAA, and while a hearing was set, the employee's lawsuit proceeded toward trial.

Tenet moved to stay the lawsuit pending arbitration. The employee responded by withdrawing the demand for arbitration. He argued that various actions by the employer following discharge constituted a waiver of its rights to arbitrate, including an alleged failure to provide a meaningful grievance process.

The trial court determined that Tenet, the employer, waived its right to arbitrate under the Federal Arbitration Act. Upon appeal, the appellate court reversed, finding there was no waiver, that the parties had mutually agreed to submit their dispute to arbitration with AAA, and that this "constitutes an enforceable contract." *Id.* at 89.

The appellate court noted that waiver of a right to arbitrate occurs when 1) the party had knowledge of the existing right to arbitrate, 2) acted inconsistently with that right, and 3) prejudiced the party opposing arbitration. There is a strong presumption, however, against such a waiver and any "doubts as to whether a party has waived its right to arbitrate must be resolved in favor of arbitration." *Id.* The court concluded that mere delays in seeking to compel arbitration do not constitute a waiver.

2. Recently, the Western District decided, in a case of first impression, that there is a waiver of the right to arbitrate, however, when the plaintiff files in a court of law a petition for injunctive relief seeking replevin and engages in sufficient trial-oriented activity. The case is *Getz v. Recycling, Inc.*, 71 S.W.3d 224 (Mo. App. W.D. 2002), decided March 26.

Plaintiff, a recycling company, had leased pursuant to a written contract a piece of equipment to business owners who owned a rock crushing

business. The business owners complained that the equipment was useless for its intended use and thus they only paid rent for one month. Getz sued in equity for replevin and an injunction, and sought declaratory relief and damages for breach of contract. Getz then sought a temporary restraining order (TRO) after the business owners refused to return or surrender the piece of equipment. The business owners countersued.

The court set a hearing on the TRO and entered a show-cause order on why the court should not order an injunction and replevin. The parties resolved this dispute by agreeing to the return of the equipment and the posting of a replevin bond of $45,000 pending resolution of the underlying lawsuit. Counsel also discussed the arbitration agreement and they decided that rather than enforcing its terms, they would stipulate to the return of the equipment and the bond.

A month later, plaintiff filed an application to stay the court proceedings and to move the dispute to arbitration pursuant to the arbitration agreement. Defendants did not timely respond to the motion, so the court treated it as being unopposed and granted the request.

The case was transferred to a new judge who granted defendants' motion to set aside the earlier order. The court set the case for trial and Getz appealed.

The appellate court concluded that the arbitration agreement covered the claim and counterclaim, including defendants' allegations of negligent misrepresentation and misrepresentation. The agreement provided: "In the event of any dispute as to the terms and/or conditions as set forth in the agreement, arbitration is to be conducted under the rules of the American Arbitration Association in Phoenix, Arizona at a time and location to be specified by GETZ RECYCLE, INC. or its authorized representative."

To find waiver, the court noted, requires a finding of prejudice and the burden of showing prejudice is on the party seeking waiver. The problem is whether a party whose arbitration agreement is silent on injunctive relief can seek a TRO in a court and then arbitrate the substance of the claim.

The court found that a four-month delay between filing the lawsuit and the application to stay the proceeding pending arbitration was not substantial, citing as support *McIntosh v. Tenet Health Sys. Hosps., Inc./Lutheran Med. Ctr.*, 48 S.W.3d 85, 89 (Mo. App. 2001). In *McIntosh*, there was no waiver where the period of time before seeking arbitration

was less than a year after filing the lawsuit and the substantial discovery already conducted could be used in the arbitration.

Other events, however, more clearly pointed to waiver, according to the court. First, there was the TRO activity, and then Getz's counsel lead defendants to believe that it would not invoke the arbitration clause. While the court noted that "bad faith" is not an element to a finding of prejudice, this conduct may have influenced the outcome.

The court thus concluded that Getz's actions deprived the defendants of the main goals of arbitration, namely "speedy and low-cost dispute resolution." *Id.* at 231. The court further found that plaintiff "misused the court process." *Id.*

Given the substantial amount of trial activity, there was prejudice and given that the arbitration agreement did not allow for injunctive relief, the appellate court decided there was a waiver of plaintiff's right to arbitrate.

F. Statutory Requirement to Arbitrate

In early 2001, the Supreme Court of Missouri upheld the constitutionality of §226.095 R.S.Mo., a 1999 statute that requires the Missouri State Highway Commission to submit to arbitration before a panel of three arbitrators when requested by a plaintiff who has a negligence action against the Commission. The case is *Murray v. Missouri Highway and Transp.*, 37 S.W.3d 228 (Mo. 2001), decided January 31, 2001.

The Supreme Court considered two personal injury cases, consolidated for its opinion, arising from car accidents (one involving a death). In a reversal of positions from the norm, the plaintiffs wanted arbitration and the Commission wanted a traditional trial. The appeal involved statutory and constitutional attacks against §226.095. Missouri's Supreme Court found the statute to be constitutional, even when the Commission has not agreed to arbitration. The court determined that the Missouri legislature has spoken, and by law, a plaintiff can have arbitration. This case paves the way for the Missouri legislature to enact similar statutes requiring other agencies of government to accept arbitration.

II. Eighth Circuit Cases

A. The Agreement to Arbitrate

1. In two recent cases, the Eighth Circuit has decided, contrary to precedent from other jurisdictions, a court's role in the arbitration process is limited to determining whether a valid agreement to arbitrate exists. Once this is resolved, the arbitrators will decide "all other issues" including matters that typically fall within the court's purview, such as whether the parties' agreement, which excludes recovery of punitive damages, violates public policy and is unenforceable. The cases are *Larry's United Super, Inc. v. Werries*, 253 F.3d 1083 (8th Cir. 2001), decided June 13, 2001, and *Gannon v. Circuit City Stores, Inc.,* 262 F.3d 677 (8th Cir. 2001), decided August 17, 2001.

- "At this juncture, our jurisdiction extends only to determine whether a valid agreement to arbitrate exists, not to determine whether public policy conflicts with the remedies provided in the arbitration clause." *Werries* at 1086.

- "Our role in determining whether a court should compel arbitration is limited. We must determine simply whether the parties have entered a valid agreement to arbitrate and, if so, whether the existing dispute falls under the coverage of the agreement.…Once we conclude that the parties have reached such an agreement, the FAA compels judicial enforcement of the arbitration agreement." *Gannon* at 680.

2. Recently, some litigants have been attacking enforcement of arbitration agreements by arguing that they do not allow an arbitrator to award all relief that could be available in a court of law, and thus the agreement is not enforceable. "Whether the Agreement validly limits the arbitrator's remedies for an AFPA violation does not affect the validity of the agreement to arbitrate. Rather, issues of remedy go to the merits of the dispute and are for the arbitrator to resolve in the first instance." *Arkcon Digital Corp. v. Xerox Corp.*, 289 F.3d 536, 539 (8th Cir. 2002). All doubts about arbitration are resolved in favor of arbitration, even when the agreement may attempt to limit statutory rights to certain claims. *Id.* at 538.

These cases solidify the court's essentially unqualified vote of confidence in arbitrators and their decisions and recognize their authority to adjudicate disputes.

B. Enforcing Arbitrator Awards

The Eighth Circuit recently made clear that arbitrator awards and orders, once confirmed by the District Court, are not subject to trifling or disregard without incurring a substantial consequence, including contempt of court. The case is *International Brotherhood of Electrical Workers, Local Union No. 545 v. Hope Electrical Corp.*, 293 F.3d 409 (8th Cir. 2002), decided June 7.

A corporation had failed to comply with two arbitration awards. The union asked the District Court to enforce the awards, which it did, and when the corporation did not comply with the court's orders, the union sought an order of contempt. Considerable procedural maneuvering and additional motion activity followed.

In the end the Eighth Circuit upheld the district's contempt order using an abuse of discretion standard for review. "As a general matter, when a litigant refuses to respect the authority of the court, it is not an abuse of discretion for the court to hold the litigant in contempt and impose a sanction to coerce compliance." *Id.* at 418.

C. Arbitrator Ethics

One of the few ways under Missouri law that an arbitrator's award must be vacated by a court is: "There was evident partiality by an arbitrator appointed as a neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party." § 435.405.1(2) R.S.Mo (2000).

Does an arbitrator's lapse in ethics subject the award to being overturned? That was the very question presented recently to the Eighth Circuit in *Delta Mine Holding Co. v. AFC Coal Properties, Inc.*, 280 F.3d 815 (8th Cir. 2001). The answer is no.

The case involved two arbitrations, each one using a panel of three arbitrators. Claimant and respondent each selected an arbitrator to be its "party arbitrator" for both cases. The two party-designated arbitrators then chose a neutral third arbitrator for each of the two cases.

One of the party arbitrators did not disclose an ongoing relationship with the party including helping it prepare the case for arbitration. The trial court found this conduct to be a violation of AAA's Canons of Ethics and thus vacated the award. (While the parties were using AAA's Rules, the arbitration was not being administered by AAA and the record does not indicate that the arbitrators were AAA-approved and trained arbitrators.)

The Eighth Circuit reversed and upheld the award of the panel of arbitrators on the basis that Missouri's statute only allows a few defined ways to overturn an arbitrator's award; ethical breaches by a party arbitrator, without something more, is not enough. In fact, "where the parties have expressly agreed to select partial party arbitrators, the award should be confirmed unless the objecting party proves that the party arbitrator's partiality prejudicially affected the award." *Id.* at 822.

AFC also argued that the arbitrators improperly consolidated two arbitrations, disallowed cross-examination of witness, refused to hear new evidence, ignored key lease provisions, and issued awards "that are irrational on their face." The court found these contentions to be without merit. *Id.* at 823.

D. Class Action Lawsuit

Courts have started to consider if and how class action lawsuits can be moved to arbitration. In *Dominium Austin Partners v. Emerson,* 248 F.3d 720 (8th Cir. 2001), the question was whether the trial court erred in denying a request of plaintiffs to arbitrate their disputes as a class. The underlying dispute involved limited partners and other partnership entities that had invested in low income housing.

The Eighth Circuit agreed with the trial court that the claims would be sent to arbitration as individual claims and not as a class action. Since the arbitration agreements were silent on class actions, the court concluded that the district court was without power to consolidate the arbitration proceedings.

The court also decided to send to the arbitrator for his or her consideration arguments that one of the parties was fraudulently induced to adopt the entire package of amendments to the agreement and arguments that the arbitration agreements had been waived because of a tardy submission of the demand for arbitration.

E. Employment Termination

1. The Eighth Circuit also decided that an arbitration agreement is important enough that it remains viable and enforceable after an employee no longer works for the employer and their agreement has terminated. The case is *Lyster v. Ryan's Family Steak Houses,* 239 F.3d 943 (8th Cir. 2001).

In this case, the agreement provided that all potential claims that an employee may have against his or her employer, which otherwise could

have been pursued in state or federal court, had to be arbitrated. The court broadly construed this arbitration agreement to allow arbitration even when the employee did not follow the requirements for claim submission with the Equal Employment Opportunity Commission (EEOC) or the Missouri Commission on Human Rights (MCHR). The failure to follow these requirements may have provided strong legal defenses in a court of law, but they carried no weight in deciding whether the dispute was subject to arbitration. Consequently, any further arguments along these lines would have to be presented to and decided by the arbitrator.

2. Sometimes there are simultaneous lawsuits and arbitrations involving the same parties. *Taylor v. Southwestern Bell Telephone Co.*, 251 F.3d 735 (8th Cir. 2001), involved a court lawsuit over an employee's termination allegedly due to discrimination. Her union had filed a grievance procedure on her behalf and later a demand for arbitration. The Eighth Circuit noted that an arbitrator's inquiry could extend beyond that of a court or jury in a discrimination action, to include issues such as whether the employee's punishment was disproportionate. Depending on the circumstances and the scope of the arbitration agreement, both actions could be underway at the same time.

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