The American Arbitration Association

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Recent Developments in ADR: 2002
Missouri and the Eighth Circuit

a Two-Hour Discussion

by

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at

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The Agenda

20 Minutes:	1. The Agreement to Arbitrate
20 Minutes:	2. Jurisdiction (courts and the arbitration tribunal)
10 Minutes:	3. Waiver of Arbitration
10 Minutes:	Break
20 Minutes:	4. Punitive Damages
10 Minutes:	5. Attorney Fees
10 Minutes:	6. Enforcing Arbitration Awards
10 Minutes:	7. Class Action Lawsuits and Arbitration

Summary of Presentation

This program examines recent cases from Missouri's appellate courts and the Eighth Circuit involving alternative dispute resolution, principally arbitration. The cases, with a few significant exceptions, are from the year 2002 wherein there has been an explosion of legal activity, especially notable since ADR by definition does not involve the traditional courts.

These appellate courts continue to generate numerous decisions at a rapid pace on how and when arbitration will proceed and what powers the arbitrator has to decide the issues pending before him or her. This program will review many of our more significant recent cases and explore the depth and reach of ADR as a parallel to traditional litigation, focusing when appropriate on the maturation of ADR as a legitimate means to resolve serious disputes.

Biography of James R. Keller

Mr. Keller has been a neutral on the Commercial and Construction panels of the American Arbitration Association since 1999 wherein he has served as an arbitrator in more than 35 cases ranging in dollar volume of dispute from $10,000.00 to more than $15,000,000.00. As a member of AAA's large complex, case panel, he has been the chair of four arbitration's in the last year that exceeded $1,000,000.00. He also continues his primary endeavor for the past 23 years of being a trial lawyer in business and construction disputes, having tried more than 70 jury and bench trials, with 40 of them lasting at least one week, several lasting almost a month, one taking five months (a case in state court in Benton, Illinois) and the longest consuming nine months (a jury trial in federal court in Buffalo, New York). Mr. Keller also represents clients in arbitration as well, including several hearings before the AAA in the past couple of years.

Mr. Keller is the chair of AAA's Construction Advisory Committee, the St. Louis Region and the Co-Chair of the Construction Committee of BAMSL. He has written more than 25 articles in the past three years on ADR, construction and consumer fraud. He is the legal writer for the St. Louis Construction News & Review and on the list of certified mediators in federal court and approved mediators in state court. He also has been the trainer for updating other AAA neutrals on the law in 2002 and he represents AAA in various matters. He is a frequent speaker at seminars for the Missouri Bar and other groups.

The Agreement to Arbitrate

Missouri Appellate Court: Nowhere has arbitration been under more attack recently than by parties who assert that they did not execute an agreement to arbitrate and thus they cannot be forced against their will into this forum for dispute resolution when they prefer traditional litigation. Construction projects, in particular, seem to involve this issue since there are so many parties necessary to begin and complete the job and thus there are many layers of agreements. This leads to the practice of referring to other contracts, both to save time in repeating obligations and to make certain that multiple parties have the same obligations.

When a contract refers to another contract, and the referenced contract contains an arbitration provision, it is quite possible that the parties have agreed to binding arbitration even though it was not specifically discussed in the body of the main contract between the two parties.

In *Dunn Industrial Group, Inc. v. City of Sugar Creek and Lafarge Corp.*, 2002 WL 31548615 (Mo. App. W.D. 2002), decided November 19, the Western District concluded that a mere reference to another contract that contained a binding agreement to arbitrate was not enough, however, especially since the party resisting arbitration had been consistently resolute in its opposition throughout the process of litigation and arbitration. Instead, there must be a specific incorporation by reference to the contract in question.

The Eighth Circuit: Recently, some litigants have been attacking 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).

This decision reaffirms that the courts have been resolving doubts about arbitration in favor of arbitration, even when the agreement may attempt to limit statutory rights to certain claims. *Id.* at 538. The federal courts continue to voice confidence in arbitrator decisions and to offer solid recognition for the authority of arbitrators to adjudicate disputes.

In 2001, the Eighth Circuit had decided, contrary to precedent from other jurisdictions, in two different cases that 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.

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.

Jurisdiction

Missouri Appellate Court: Typically, after someone files a petition, if there is a written agreement to arbitration, 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 Burford by Pam Bruse v. Edward D.*

Jones & Co., 83 S.W.3d. 589 (Mo. App. W.D. 2002), decided June 11. 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.*

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 had 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 all involved issues whose resolution "requires reference to or construction of some part of the Contract." For arbitration not to apply, the tort claim had to be independent of the contract terms and not require reference to the underlying contract.

In *Finley Joint Protective Board Unit 200, Brotherhood of railway Carmen Division, Transportation Communications International Union v. Norfolk Southern Railway Company*, 312 F.3d 943 (8th Cir. 2002), filed December 13, the Eighth Circuit reaffirmed that judicial review of an arbitration award is very limited, and review of the decision of a public arbitration board under the Railway Labor Act "is among the narrowest known to

the law." *Id.* at 946. The dispute was over the exclusion of a polygraph test when the collective bargaining agreement required that the arbitrator "receive all evidence."

The court stated that "Arbitrators have broad procedural discretion." In fact, arbitrators may even look to outside sources, including prior unrelated awards, "without straying beyond their jurisdiction to interpret and apply the collective bargaining agreement." *Id.* at 947. Accordingly, the "manner in which the Board resolves evidentiary disputers 'does not fall within any of the narrow jurisdictional grounds for review under 45 U.S.C. § 153 First (q).'"

In *Howsam v. Dean Witter Reynolds, Inc.*, 123 S. Ct. 588 (2002), decided December 10, the U.S. Supreme Court held that the timeliness of an arbitration was subject to decision by arbitration rather than court, thereby reversing the Tenth Circuit. The case focused on a rule of the National Association of Securities Dealers (NASD), which provided that no dispute "shall be eligible for submission to arbitration … where six (6) years have elapsed from the occurrence or event giving rise to the …dispute."

The court stated that the question whether the parties have submitgted a particular dispute to arbitration, the "question of arbitrability," is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise. This, the court labels, is the "gateway question."

The time-limit rule, the Court concluded, is not a question of arbitrability, but rather it is a prerequisite such as notice, laches, estoppel and other conditions precedent to an obligation to arbitrate, and as such, it is a matter for the arbitrator to decide. "Moreover, the NASD arbitrators, comparatively more expert about their meaning of their own rule, are comparatively better able to interpret and to apply it." *Id.* at 592.

In other words, the Supreme Court has deferred to the expertise of arbitrators, over its own lower-court judges, to resolve the dispute. Consequently, "parties to an arbitration contract would normally expect a forum-based decisionmaker to decide forum-specific procedural gteway matters." *Id.* at 593.

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.

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.

Eighth Circuit: 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.

Waiver of Arbitration

Missouri Appellate Court: Recently, the Western District decided, in a case of first impression, that there was a waiver of the right to arbitrate when the plaintiff filed in a court of law a petition for injunctive relief

seeking replevin and then engaged in significant trial-oriented activity. The case is *Getz v. Recycling, Inc.*, 71 S.W.3d 224 (Mo. App. W.D. 2002), decided March 26. Since waiver cases are fact intensive, the following facts are necessary to understand the court's decision.

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 also 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 court transferred the case to a new judge who granted defendants' motion to set aside the earlier order. This judge scheduled 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 had 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. E.D. 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 led 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.

Punitive Damages

For years, Missouri litigators considered arbitration to be an unlikely forum for the award of punitive damages, at least until the decision in *Groceman v. Pulte Homes Corp.*, 53 S.W.2d 599 (Mo. App. W.D. 2001), decided in August of 2001. The Western District upheld an arbitrator's award of punitive damages, despite facts that that many would argue did not seem to support such a result.

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.

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

Now there is the decision in *Hoskins v. Business Men's Assurance*, 79 S.W.3d 901 (Mo. 2002) decided July 23. The Supreme Court of 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 convince many, who previously shied away from arbitration because of a perception that punitive damages would not be awarded by an arbitrator or affirmed by a court, to reconsider the merits of arbitration.

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.

Enforcing Arbitrator Awards

The Eighth Circuit: Parties who disregard arbitrator awards may want to reconsider their thinking. The Eighth Circuit has 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 court'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.

In *Smart v. Sunshine Potato Flakes*, 307 F.3d 684 (8th Cir. 2002), filed October 7, the Eighth Circuit considered a complicated set of procedural facts involving actions pending in state and federal court. Initially, the plaintiff had filed a diversity action in federal district court, but it was stayed pending arbitration. After the arbitrator entered an award in favor of defendant Sunshine for $688,530.00 (presumably on a counterclaim), plaintiff Smart filed an action in state court in North Dakota to vacate the award pursuant to North Dakota's version of the Uniform Arbitration Act.

Sunshine then filed an improper motion to remove that action to federal district court since Sunshine failed to allege diversity jurisdiction. Sunshine then moved the federal district court to lift the stay from the original action and confirm the arbitration award. After more motions and skirmishes by the litigants, the Eighth Circuit ruled finally that the federal district court properly granted Sunshine's motion to confirm the

arbitration award. Ultimately, Sunshine successfully chose the third option.

Further, the court concluded that the doctrines of preclusion, estoppel, and election of remedies do not bar a party from "sequentially pursuing alternative venues that may be available." *Id.* at 686. "Rather, the statutory time limits on filing lawsuits, seeking judicial review of arbitration awards, and exercising one's right of removal protect the courts and litigants from an excessively protracted search for alternative venues." *Id.*

Finally, the court reaffirmed its own power when others suggest that a federal court should defer to another action pending in state court. "[W]hen the issue is whether a federal court should defer to a pending suit in state court, as in this case, the order in which jurisdiction was obtained, while still a relevant factor in applying the abstention doctrine, is far less apt to be determinative because of the federal court's 'virtually unflagging obligation' to exercise its jurisdiction." *Id.* at 687.

In *Brotherhood of Maintenance of Way Employees and Wabash Federation v. Terminal Railroad Association of St. Louis*, 307 F.3d 737 (8th Cir. 2002), filed October 15, the Eighth Circuit reversed a district court's decision to grant summary judgment in favor of the railroad and reinstated the arbitration award for the union. The central issue was whether the arbitration panel exceeded its jurisdiction, as set out in the parties' agreement, by allowing the union to submit written arguments when the arbitration agreement had provided that the parties would present the file to the panel "with no alterations of any kind."

The Eighth Circuit noted that "our review of the arbitration award itself is among the narrowest known to the law." *Id.* at 739. The court stated that an award should be set aside or vacated if he arbitrator ignores the plain language of the agreement or exceeds his jurisdiction. The court then decided that the arbitration agreement was ambiguous on this point and thus the arbitrator's decision is "procedural." *Id.* at 740. "An arbitrator's procedural determinations should be set aside by a court when the arbitrator is guilty of misconduct or bad faith." *Id.*

Class Action Lawsuits and Arbitration

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.

In the recent case of *Bond v. Twin Cities Carpenters Pension Fund*, 307 F.3d 704 (8th Cir. 2002), filed October 8, the Eighth Circuit decided that a pension plan that required that arbitrator fees be split equally between the parties was not in accord with ERISA's statutory and regulatory framework.

The plan required binding arbitration and the payment of a split-fee initially of the arbitrator's fee to be adjusted, if at all, upon the final determination by the arbitrator. It is this up-front fee that turned the Eighth Circuit to reverse the district court, decide that this "arrangement" was not "reasonable" within the meaning of federal statutory law, and therefore discourages the pursuit of "many legitimate claims by those who cannot afford such costs."