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U.S. Supreme Court Again Clarifies the Power of Arbitrators

As it has several times over the past six years, the U.S. Supreme Court further clarified the law on arbitration in its Dec. 10 decision in *Howsam v. Dean Witter Reynolds, Inc.*¹ Reaffirming the policy favoring the enforceability of arbitration clauses, the Court held that arbitrators must decide gateway procedural issues, such as whether a claim is time barred or has been waived.

The Court is expected to hear argument this month in *PacifiCare Health Systems, Inc. v. Book*,² a case that will provide even further guidance in this area by resolving a split among the circuits as to whether a court or arbitrator must determine the arbitrability of a claim brought under a statute (RICO in this case) that allows treble damages when the agreement contains a limitation on remedies clause.

'Howsam'

In *Howsam*, the issue was whether a court or an arbitrator should decide whether a claim was time barred pursuant to a provision in the National Association of Securities Dealers (NASD) Code of Arbitration Procedure that provided that no dispute "shall be eligible for submission to arbitration ... where six years have

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elapsed from the occurrence or event giving rise to the ... dispute."³

Pursuant to the Client Service Agreement she had executed with Dean Witter, Ms. Howsam commenced an

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arbitration proceeding before the NASD to resolve her claim that the company had misrepresented the virtues of certain partnerships in which she had invested. Dean Witter then filed a lawsuit in federal court asking that the dispute be declared ineligible for arbitration because it was more than six years old.

The District Court dismissed the action, finding that an arbitrator, not the court, should interpret the NASD rule. The Tenth Circuit reversed, finding that the issue was one of "arbitrability," and thus is a question for a court to decide.

The Supreme Court reversed, resolving a split among the circuits in favor of the holdings of the First and Fifth circuits, and rejecting those of the Tenth and Seventh circuits.

The High Court began by reaffirming that "questions of arbitrability" — that is, questions related to whether the parties have submitted a particular dispute to arbitration — are for the court to decide unless the parties have clearly provided otherwise. The Court then clarified that not all gateway questions are necessarily "questions of arbitrability." Rather, a court must assess whether the gateway matter is one that the contracting parties would likely have expected a court to determine.

According to the Court, parties would ordinarily expect a court to resolve questions of substantive arbitrability, such as whether the parties are bound by an arbitration clause or whether an arbitration clause in a contract applies to a particular dispute.

Conversely, procedural issues — such as waiver, delay and like defenses — are presumptively for the arbitrator to decide in the first instance. The Court held that such issues are the type that parties would expect an arbitrator to decide. Because the NASD rule fell within the class of gateway procedural disputes, it did not present a "question of arbitrability" and therefore the arbitrator, rather than the court, was to assess its application.

Justice Clarence Thomas concurred in the judgment only, arguing that the Court's precedents instructed that

arbitration agreements must be enforced in accordance with their terms. The agreement at issue provided that it should be construed and enforced in accordance with the laws of New York state, and the New York Court of Appeals, interpreting two provisions nearly identical to the one at issue in this case, held an arbitrator must decide the issue.

Thus, Justice Thomas would hold that the arbitrator must resolve the issue because that is what the law of New York requires.

The Court's decision reaffirms the increasingly important role arbitrators play in resolving disputes. Although many courts were already submitting procedural issues to the arbitrator, this case makes clear that all courts must do so.

Furthermore, because resolution of many procedural disputes determine whether the underlying dispute may proceed at all in arbitration (such as the case in *Howsam*), the decision could be cause for concern because arbitrators, who are typically compensated based on the duration of the arbitration proceeding, have an incentive to resolve threshold procedural matters in a way that will allow them to reach the merits of the underlying controversy.

More Guidance

The Court will provide further guidance this year in *PacifiCare Health Systems*, which is scheduled to be heard on Feb. 24. This case involves whether an arbitration agreement that includes a limitation of remedies provision is enforceable where a claim is brought under a statute that allows for treble damages.

The Eleventh Circuit held that the court could not compel plaintiffs to arbitrate their RICO claims because the arbitration agreement prohibited the arbitrator from awarding punitive damages.

In deciding this case, the Court will reconcile a direct conflict between the Eleventh Circuit's decision and the

Eighth Circuit's in *Larry's United Super, Inc. v. Werries*, 253 F.3d 1083 (8th Cir. 2001), which held that a plaintiff must arbitrate RICO claims even where the arbitration clause barred recovery of punitive damages.

The case also will resolve a more general split among the circuits as to whether a court or arbitrator must decide whether a limitation on remedies clause contained in an arbitration agreement is valid. The Eleventh Circuit, joined by the Fifth⁴ and Ninth⁵ circuits, held that it is for the court to decide, before ordering arbitration, whether a limitation on remedies clause is valid. If it is found that it is not, the court refuses to compel arbitration. The First,⁶ Third,⁷ Seventh⁸ and Eighth⁹ circuits, conversely, held that the arbitrator must decide whether limitation on remedies clauses are valid.

Conclusion

As in *Howsam*, the Supreme Court's decision in *PacifiCare* will offer further insight into the extent of an arbitrator's authority relative to the court.

In light of the High Court's increasingly favorable view of arbitration, it will not be surprising if the Court concludes that the arbitrator is empowered to interpret the limitation on remedies clause. In either event, *PacifiCare* will offer an important opinion because it will further clarify where the line between judicial and arbitrable issues lies.

Although the use of arbitration is expanding — as are its risks and benefits — attorneys are not powerless in the process.

At its core, an arbitration agreement is a contract and, therefore, parties have control over what issues the arbitrator will resolve. For example, in *Howsam*, the Court made clear that the distinction between "questions of arbitrability" and other gateway issues was simply the presumption that would apply in the absence of a contrary agreement by the parties.¹⁰ Therefore, one way to protect

clients from having to arbitrate procedural issues they may not want to arbitrate is to clearly provide for judicial resolution of these issues.

Another option to protect against the risk of arbitration, while still retaining many of the benefits, is to provide for heightened judicial review of an arbitrator's award. Currently the courts are split on whether such a clause is enforceable.¹¹ Therefore, this too is an issue awaiting further clarity from the Supreme Court. However, attorneys who are familiar with these and other arbitration cases will be in a position to best protect the interests of their clients when arbitrable issues arise.



- (1) 2002 U.S. LEXIS 9235 (Dec. 10, 2002).
- (2) 285 F.3d 971 (11th Cir. 2002), cert. granted, 123 S. Ct. 409 (2002).
- (3) 2002 U.S. LEXIS 9235, at *5.
- (4) *Investment Partners v. Glamour Shots Lic., Inc.*, 298 F.3d 314, 2002 WL 149872 (5th Cir. July 15, 2002).
- (5) *Graham Oil Co. v. ARCO Prods. Co.*, 43 F.3d 1244 (9th Cir. 1995).
- (6) *MCI Telecomm. Corp. v. Matrix Commun. Corp.*, 135 F.3d 27 (1st Cir. 1998).
- (7) *Great Western Mortgage Corp. v. Peacock*, 110 F.3d 222 (3d Cir. 1997).
- (8) *Metro East Center for Conditioning & Health v. Qwest Commun. Int'l, Inc.*, 294 F.3d 924, 2002 WL 1378752 (7th Cir. June 27, 2002).
- (9) *Arkcom Digital Corp. v. Xerox Corp.*, 289 F.3d 536 (8th Cir. 2002).
- (10) *Howsam*, 2002 U.S. LEXIS 9235, at *8 ("The question whether the parties have submitted a particular dispute to arbitration, i.e., the 'question of arbitrability,' is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise.").
- (11) See e.g., *Gateway Technologies, Inc. v. MCI Telecommunications Corp.*, 64 F.3d 993 (5th Cir. 1995) (upholding agreement that provided for expanded judicial review); but see *Bowen v. AMOCO Pipeline Co.*, 254 F.3d 925 (10th Cir. 2001) (expanded judicial review is not available, but the parties can contract for an appellate arbitration panel).

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