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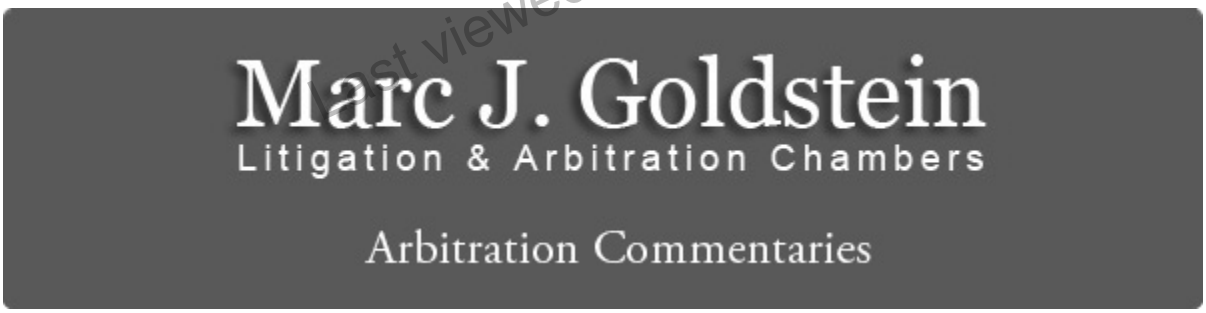

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03.29An FAA Cause of Action to Enjoin Arbitration: Is It Necessary?

The question whether the US Federal Arbitration Act ("FAA") permits a cause of action that seeks only the relief of a stay or injunction against arbitration proceedings has arisen in several recent cases mentioned in *Arbitration Commentaries*, including the Chevron v. Ecuador saga, in which the Second Circuit decided not to decide this undecided question, finding that neither Ecuador nor the plaintiffs in the Ecuador environmental litigation against Chevron had shown

grounds for such a stay of Chevron's investment arbitration against the Republic of Ecuador. The question was raised again in a case decided last week, involving a more mundane commercial dispute over Subway sandwich franchises in Ireland. The New York federal district court in this case held that the FAA and New York Convention do permit a cause of action for a stay of arbitration. (Farrell v. Subway International, B.V., 2011 U.S. Dist. LEXIS 29833 (S.D.N.Y. Mar. 23, 2011)).

Farrell owned Subway franchises in Dublin, Ireland. The franchisor was a Netherlands affiliate of Subway. The franchise agreement called for arbitration under the UNCITRAL Rules in New York "*administered by an arbitration agency, such as the International Centre for Dispute Resolution, an affiliate of the American Arbitration Assocation.*" Subway commenced arbitration by filing a demand for arbitration with the American Dispute Resolution Center, Inc. ("ADRC"). ADRC is located in New Britain, Connecticut, in close proximity to the New Milford, Connecticut headquarters of Subway's U.S. parent company Doctor's Associates, Inc. Although the ADRC holds itself out as willing to administer arbitrations under any rules the parties wish to adopt (www.adrcenter.net), Farrell evidently interpreted Subway's resort to ADRC as an attempted end-run around the arbitrator appointment process according to Article 6 of the UNCITRAL Rules. Farrell brought an action in the New York Supreme Court to enjoin the ADRC arbitration. Subway removed the case to federal court under Chapter 2 of the FAA, as a case arising under the New York Convention.

The federal judge agreed with Farrell. The court interpreted the arbitration clause as requiring appointment of arbitrators in accordance with the UNCITRAL Rules, considered Subway's choice of ADRC to be an attempt to vary from the UNCITRAL Rules' procedures, and further interpreted the "*administered by*" clause as prohibiting a unilateral choice of administering institution. The Court then decided that the FAA permits a court to enjoin arbitration, enjoined the ADRC arbitration "*pursuant to the FAA and the [New York] Convention,*" and, while

noting that the parties were in agreement that their dispute should be resolved by arbitration, provided no affirmative pro-arbitration relief, no such relief having been sought by either party.

The threshold question before the Court was whether Chapter 2 of the FAA confers power on federal courts to stay arbitrations in New York Convention cases. There is no controlling decision from the U.S. Supreme Court or the US Second Circuit Court of Appeals. In support of the position that FAA Section 206 empowers a court to stay arbitration, the court in *Farrell* cited a 1999 decision of another federal district judge in New York. That decision held that, based on the authority expressly granted in Section 206 to compel arbitration, that "*[i]t would follow … that the court should have a concomitant power to enjoin arbitration where arbitration is inappropriate.*" The "concomitant power" seemed logical, to that court, because "*a failure to do so would frustrate the goals of arbitration, since there would be delay and increased expense as the parties ligitated in both fora*."

Is this analysis correct? As the following discussion demonstrates, the pragmatic concerns motivating this conclusion are overstated at best.

Suppose it were clearly decided by the Supreme Court or Second Circuit that the FAA, or least Chapter Two, does not authorize a stay of arbitration. Would the position of the party aggrieved by a wrongful arbitration be made untenable? I submit the answer is no. If the position of the aggrieved party is that there is no agreement to arbitrate, or the agreement is invalid, or that the issues on which arbitration has been filed are beyond the scope of the clause, the aggrieved party may commence litigation on those issues in a competent court. Normally the adverse party will respond with a motion to compel arbitration, and the arbitrability issue will be resolved in the traditional way. If the adverse party elects to litigate the merits, it will waive the right to arbitrate. Normally such a waiver, when brought to the attention of the arbitral tribunal (if one has even been constituted), should result in a termination of the proceedings. If the tribunal does not stay its own hand, and the adverse party

still attempts to go forward in the arbitration, then the Court may issue an anti-arbitration injunction to protect its own jurisdiction. In that scenario the injunction power comes not from the FAA, but instead from the undisputed inherent power of the Court to protect by injunction its legitimately-acquired jurisdiction. Equally, if the adverse party inexcusably defaults in the court case, having been duly served with process, judgment will be entered on the merits and waiver of the right to arbitrate would be one of the issues implicitly determined by that judgment. In that scenario as well, if the party against whom judgment on the merits by default has been entered still pursues arbitration, the Court may grant an anti-arbitration injunction against that party to protect its judgment from collateral attack, and this is another form of injunction based on the Court's inherent powers, with no need to find authority in the FAA.

Those courts holding that the FAA does not itself authorize a cause of action to stay or enjoin arbitration take note of the limited and precise affirmative powers that the FAA does expressly confer on the courts, *i.e.* to enforce an arbitration agreement or award, and they refer to the principle of statutory construction "*expressio unius est exclusio alterius*" (the express mention of one thing implies the exclusion of others not mentioned). Those courts which have either held that the FAA does permit an action to enjoin or stay arbitration, or which have assumed without deciding that such a cause of action exists, have stated either that the power to compel arbitration necessarily implies a power to enjoin or stay arbitration, or that such power is at least not inconsistent with the express powers granted by the FAA. Many of the older cases cited in recent decisions for the proposition that such power does exists under the FAA in fact did not so hold, but were instead decisions affirming district court stay orders based on the inherent powers of the Court. A recent example of the inherent powers approach to stays of arbitration can be seen in Jock v. Sterling Jewelers, Inc., 2010 U.S. Dist. LEXIS 132759 (S.D.N.Y. Dec. 10, 2010), in which Judge Rakoff after reviewing many of the leading authorities wrote:

> The Court concludes that, as a necessary incident to its power to compel

> arbitration proceedings under § 4 of the FAA, it may preserve the integrity of those proceedings by enjoining later-filed arbitrations that arise out of the same controversy. Any other conclusion would impede rational application of § 4 of the FAA, as well as fundamentally limit the power of a court to enforce its own judgments. Cf. Landis v. N. Am. Co., 299 U.S. 248, 254 …(1936) (noting that 'the power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket.')"

In regard to international arbitrations taking place in the United States, this inherent/incidental powers approach to stays of arbitration may indeed be a more "pro-arbitration" position than the position that the FAA authorizes a cause of action for a stay of arbitration. Adoption of this position would mean that a party seeking intervention of a US court, to establish non-arbitrability in a pending international arbitration at a US seat, would have to proceed by starting an action to litigate the merits of the putatively non-arbitrable claims. The non-U.S. parties to such arbitrations often will have no interest in litigating the merits in a US court. The consequence of having no access to a US federal court at the seat merely to stay or enjoin the arbitration would mean that more arbitrability issues will be presented to the arbitral tribunal, or will be presented to a foreign court where the non-US party would prefer to litigate the merits if its non-arbitrability position is correct. Some of those foreign jurisdictions may have higher barriers than does the US to the commencement of litigation on the merits of claims already raised in a pending arbitration, and some of those jurisdictions may have more forceful rules requiring arbitrability issues to be resolved by the arbitral tribunal in the first instance. (Section 32 of the UK Arbitration Act 1996, for example, provides that the Court will not consider an issue of arbitral jurisdiction absent the agreement of all the parties or permission of the arbitral tribunal.) Where the objecting party's position is that its adversary had commenced arbitration at variance with the agreement, the unavailability of an injunction remedy in federal court should motivate the objector to commence what it regards as a proper arbitration.

Let us consider how the Farrell v. Subway dispute might have played out if the law in the

Second Circuit were as I suggest it should be. Farrell, if well advised, and understanding the law, would not have sought relief in federal or state court to enjoin arbitration. Instead, Farrell would have commenced an arbitration under the UNCITRAL Rules, sought agreement from Subway on an administering institution and procedure for selecting arbitrators, and if Subway had refused to participate Farrell would have applied to the Permanent Court of Arbitration in the Hague ("PCOA"), pursuant to Article 6 of the UNCITRAL Rules, for assistance in appointing arbitrators. So far, no role for the courts. As a practical matter, the institution unilaterally selected by Subway to administer and appoint arbitrators might well have declined to proceed once notified that the PCOA's assistance had been sought. If so, there would still have been no necessary role for the courts, as there would not have been two arbitrations going forward. Subway might then have conceded the legitimacy of Farrell's UNCITRAL arbitration. If not, it would have had to bring its own FAA Section 4 petition to compel arbitration in accordance with its version of what the agreement allowed. Chances are that its request for temporary relief to enjoin the UNCITRAL arbitration would have been denied, and the UNCITRAL arbitration would have proceeded. Subway at that point would have been facing sacrifice of its ability to appoint a co-arbitrator, by further refusing to participate in the appointment process in the UNCITRAL case. It would have been significantly motivated to concede the legitimacy of Farrell's UNCITRAL case. A pro-arbitration solution, in accordance with the agreement of the parties and without judicial intervention, would have been more likely in a legal environment not provding a cause of action for a stay of arbitration.

Of course, things might not play out so well. Parties might not be well advised. Or they may be obstinate in pursuing aggressive but self-defeating litigation strategies. Statutory interpretation cannot be a cure-all. But if the foregoing analysis is correct, the chances for resolution of the arbitrability disputes without the need for courts to get involved would be increased if the US federal courts declare themselves unavailable for commencing a case whose sole purpose is to

enjoin a pending arbitration. It requires only an interpretation of the FAA according to the plain meaning of its relevant provisions for this objective to be accomplished.

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