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FAA Applicability to Med-Arb Agreements

Whether a dispute resolution procedure is covered by the Federal Arbitration Act[1] (FAA) has many ramifications, particularly with respect to triggering the statutory framework that permits specific performance of the agreement and suspends litigation of the same dispute.[2]

Any procedure qualifying as "arbitration" under the FAA would trigger, under 9 U.S.C. §3, the mandatory stay of litigation involving any arbitral dispute and, in accordance with 9 U.S.C. §4, would provide the party seeking arbitration the right to file a motion to compel.

But should a court determine that a particular dispute resolution procedure does not qualify as "arbitration" under the FAA, it is at best unclear whether and to what extent courts can require participation in that process, facilitate its implementation or enforce its results.

The recent case of *Advanced Bodycare v. Thione*[3] invited the U.S. Court of Appeals for the Eleventh Circuit to explore which types of ADR (alternative dispute resolution) are considered "arbitration" for purpose of the FAA. The question itself is not a novel one, as several appellate courts have had to struggle with this issue at one time or another in light of the statute's failure to define its key term: "arbitration."

More novel is the Eleventh Circuit's approach in applying a particularly narrow test to determine which ADR procedures qualify as "arbitration," thus making them applicable to the provisions of the FAA staying litigation in favor of arbitration and permitting a court to compel a reluctant party to arbitrate where it is contractually bound to do so.

According to the Eleventh Circuit, an agreement to mediate, as well as an agreement to either mediate or arbitrate, falls outside of the FAA's scope, making the FAA's remedies unavailing to parties wishing to use its provisions to stay litigation or to compel a single agreement which requires the parties to either mediate or arbitrate. The logical extension of *Thione* portends troubling developments for ADR, particularly the growing use of two-step ADR mechanisms which combine mediation and arbitration in sequence, a procedure often referred to as Med-Arb.[4]

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'Arbitration' Under the FAA

Not only does the Federal Arbitration Act fail to define "arbitration," but the legislative history of the statute falls short of providing any direct indicators of the term's meaning.[5] As a result, courts have struggled to define the contours and parameters of arbitration in the fast-evolving field. Without a clear signal from Congress, at times it has been difficult for courts to determine the scope and application of arbitration law and which types of conciliatory agreements and procedures are enforceable under the FAA.

A variety of legal tests for determining what constitutes "arbitration" under the FAA have been put forward by state and federal courts. Some of these tests are narrow, defining "arbitration" according to the contours of what judges and scholars have historically referred to as "classic arbitration." The First Circuit's opinion in *Fit Tech v. Bally Total Fitness*,[6] defined "classic arbitration" to comprise at least four "common incidents": (i) an independent adjudicator, (ii) who applies substantive legal standards, (iii) provides an opportunity for the parties to be heard; and (iv) renders a final, binding decision, or award after the hearing. The Fifth and Tenth circuits have also subscribed to this "classic" arbitration model.[7]

In contrast, other appellate courts have articulated broader tests for "arbitration," encompassing dispute resolution procedures which do not conform to the "classic" model.[8] District courts have been even more open-minded with their interpretation of the FAA, finding the statute's provisions applicable not only to mediation agreements, but agreements where virtually any ADR process is used to settle controversies.[9] The conflicting body of judicial decisions surrounding arbitration law illustrates how courts have failed to agree on a universal definition for the term "arbitration."

Eleventh Circuit: 'Thione'

Until two months ago, the Eleventh Circuit had not put forth a test for determining which types of dispute resolution procedures qualify as "arbitration" under the FAA. The court's decision in *Thione* did just that, and drew a bright line as to which ADR procedures do, and do not, qualify.

In *Thione*, the parties had agreed to a licensing agreement whereby the plaintiff was granted exclusive rights to market and distribute the defendant's nutritional supplements and a related "testing kit." The licensing agreement contained a dispute resolution clause which stated that if a dispute were to arise under the agreement, and such dispute was not resolved privately within 60 days, it would be submitted to either "non-binding arbitration or mediation with a mutually agreed upon, independent arbitrator or mediator." Over the course of the parties' commercial relationship, defendant allegedly sent plaintiff defective testing kits, and failed to adequately cure.

In derogation of the dispute resolution clause in the licensing agreement, plaintiff brought a breach of contract case in Florida state court without first resorting to mediation or nonbinding arbitration. After removal, the defendant sought to stay the suit pending arbitration. The District Court denied a stay on the grounds that the parties' agreements failed to require the parties to arbitrate the dispute through a final decision.[10] The District Court reasoned that since the agreement created "an option for the aggrieved party to call for either nonbinding arbitration or mediation, the parties had made resort to arbitration the prerogative—not the obligation—of the aggrieved party."[11]

On appeal, the Eleventh Circuit framed the issue as whether a contract under which disputes were to be submitted to either "nonbinding arbitration or mediation" was an agreement "to settle by arbitration a controversy" in accordance

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with 9 U.S.C. §2, thereby making the dispute "referable to arbitration" under 9 U.S.C. §3 and thus making entry of a stay of litigation mandatory. The court observed that where a dispute resolution procedure failed to meet the qualifications of "FAA arbitration," §3's stay remedy would be unavailable.

Four 'Common Incidents'

The Eleventh Circuit was persuaded by the First Circuit's reasoning in *Fit Tech*, which suggested that the true test for deciding whether a particular dispute resolution method constituted FAA arbitration was to look for the four "common incidents" of "classic arbitration."[12] Stating that neither the presence nor absence of any one of these "common incidents" would always be determinative, the court held that "there is one [common incident] that controls [the *Thione*] case," and that is that the FAA "clearly presumes that arbitration will result in an 'award' declaring the rights and duties of the parties."[13] Finding that "much of arbitration law is predicated on the existence of an award," the Eleventh Circuit used this single common incident of classic arbitration as the basis for its holding that where a dispute resolution procedure "does not produce some type of award that can be meaningfully confirmed, modified, or vacated by a court upon proper motion, it is not arbitration within the scope of the FAA."[14]

Because mediation "does not resolve a dispute, [but] merely helps the parties to do so," the Eleventh Circuit explicitly stated that mediation "is not within the FAA's scope," thus holding that FAA remedies, including mandatory stays under §3, or motions to compel under §4, are not appropriately invoked with respect to mediation.[15] What is more, the court stated that when a single contract provides the parties an option to engage in either mediation "or" arbitration, such agreement nevertheless fails to qualify as "an agreement to settle by arbitration a controversy" and therefore is not enforceable under the FAA.[16]

Tellingly, the existence of the possibility that the parties might elect to mediate, which is not capable of an award, was enough to defeat FAA enforceability of the contract in *Thione* even where it provided that the parties could also elect to arbitrate. By crafting such a narrow definition of what constitutes FAA arbitration, the *Thione* court joins those circuits which have narrowly construed FAA arbitration. It uses a strict, easily applied definitional boundary for arbitration—the possibility that an award will issue—and warns that courts should exercise restraint and not apply the FAA indiscriminately to ADR procedures.

But while the Eleventh Circuit's ruling is clear that the FAA should not be applied to an agreement which provides the parties the election to either mediate or arbitrate their dispute, the court is silent with respect to whether, and if so, how, the FAA should be applied where parties agree to both mediate and, if necessary, submit their dispute to binding arbitration. If the only type of arbitration enforceable under the FAA is "classic" arbitration, as the Eleventh Circuit posits, what role, if any, do mechanisms such as mandatory stays and motions to compel play during the first stage of two-step ADR process such as Med-Arb? In the context of Med-Arb agreements, where arbitration is intended to be the final, binding means of dispute resolution, do FAA remedies remain available during the preliminary (mediation) stage, or only the arbitration stage?

Mediation After 'Thione'

Let us consider what happens when a party to a Med-Arb agreement refuses to mediate and instead files suit. In some jurisdictions, when a dispute resolution agreement calls for mediation followed by arbitration, motions to stay litigation pending mediation and if necessary, arbitration, have been liberally granted under the authority of the FAA.[17] Other jurisdictions have taken a more cautious approach, reasoning that since mediation was a "condition precedent" to arbitration, the arbitration provision of the Med-Arb agreement was not triggered, and thus the remedies under the FAA could not properly be invoked, until one of the parties first requested mediation.[18]

The logical extension of 'Thione' portends trouble for ADR, particularly the growing use of two-step ADR mechanisms which combine mediation and arbitration in sequence, a procedure often referred to as 'Med-Arb.'

In either scenario, courts have been inclined to issue a stay under §3 of the FAA in support of a Med-Arb agreements. Similarly, in the context of motions to compel the enforcement of a Med-Arb, including at the mediation stage, many courts have done so reasoning that the mediation is part and parcel of the arbitral process. But in light of the Eleventh Circuit's *Thione* decision, the availability of these FAA processes to support the mediation portion of a Med-Arb agreement are called into question. The Eleventh Circuit did not address whether FAA remedies can be applied to the mediation process when that process is a predicate to "classic" arbitration, as in Med-Arb agreements.

Much like "classic" arbitration agreements, Med-Arb agreements rely on arbitration as the final stage of dispute resolution and are normally used to avoid resort to court. In this respect, we believe it is efficient to allow parties to a Med-Arb agreement to streamline the resolution process by resorting to the FAA remedies under §3 and §4, rendering a stay mandatory and compelling mediation at the onset. Since Med-Arb agreements foresee binding arbitration as a final step in the dispute resolution process, we believe such agreements are designed "to settle by arbitration a controversy" under §2 of the FAA, and that any dispute triggering the Med-Arb provision in the agreement itself should be "referable to arbitration" under §3 of the FAA, even before the arbitration stage (e.g., during the mediation stage of the dispute resolution mechanism).

While mediation alone fails to adjudicate a case, Med-Arb guarantees finality, which comes in the form of a negotiated settlement or arbitral award that can be meaningfully confirmed, modified or vacated by a court. In this light, the FAA affords a proper foundation for enforcing mediation provisions in Med-Arb agreements, by empowering courts to issue a stay of litigation under §3, or an order compelling the parties to mediate, under §4. While various avenues exist to compel mediation outside of the FAA, it is far better for courts to embrace the growing trend in support of Med-Arb by, among other things, finding that these agreements, in their entirety, are enforceable under the FAA.

1. 9 U.S.C §1.
2. Thomas J. Stipanowich, "The Arbitration Penumbra: Arbitration Law and the Rapidly Changing Landscape of Dispute Resolution," 8 Nev. L.J. 427, 431 (Fall 2007).
3. Case No. 07-12309, 2008 U.S. App. LEXIS 8584 (11th Cir. April 21, 2008).
4. For the purpose of this commentary, "Med-Arb" refers simply to any process in which mediation takes place as a condition precedent to binding arbitration, and arbitration is a surrogate for litigation.
5. See generally 1 Ian R. Macneil, Richard E. Spiedel & Thomas J. Stipanowich, "Federal Arbitration Law: Agreements, Awards and Remedies Under the Federal Arbitration Act" §2.3.1.1 (1994).
6. 374 F.3d 1, 7 (1st Cir. 2004).
7. See *General Motors Corp. v. Pamela Equities Corp.*, 146 F.3d 242, 246 (5th Cir. 1998); and *Salt Lake Tribune Pub. Co. v. Management Planning Inc.*, 390 F.3d 684, 689 (10th Cir. 2004).
8. The Fourth, Eighth, and Ninth circuits have gone beyond the "classic" model to enforce dispute resolution procedures that lack a binding award. See *United States v. Bankers Insurance Co.*, 245 F.3d 315, 322 (4th Cir. 2001); *Dow Corning Corp. v. Safety National Casualty Corp.*, 335 F.3d 742, 747 (8th Cir. 2003); *Wolsey v. Foodmaker Inc.*, 144 F.3d 1205, 1209 (9th Cir. 1998).
9. See *Cecala v. Moore*, 982 F.Supp. 609, 613 (N.D. Ill. 1997); *Ellis v. Am. Envtl. Waste Management*, 1998 WL 903495 *2 (E.D.N.Y. 1998); see also Stipanowich, "The Arbitration Penumbra," 8 Nev. L.J. 427 n. 110.
10. See *Advanced Bodycare Solutions LLC v. Thione Int'l Inc.*, 514 F.Supp.2d 1326 (S.D. Fla. 2007).
11. Id. at 1332.
12. 2008 U.S. App. LEXIS 8584, at *7-8.
13. Id. at *8.
14. Id. at *9.
15. Id. at *10.
16. Id. at *11.
17. See, e.g., *Design Benefit Plans Inc. v. Enright*, 940 F.Supp. 200 (N.D. Ill. 1996) (granting party's motion to compel mediation/arbitration and stay proceedings pursuant to §§3-4 of the FAA, respectively); see also *Woodlands Christian Acad. v. Logan*, 1998 Tex. App. LEXIS 3185, at 8-9 (Tex. App. 1998) (citing arbitration precedents in enforcement of multistep procedure involving mediation, followed by binding arbitration of disputes under employment agreement).
18. See, e.g., *HIM Portland LLC v. Devito Builders Inc.*, 317 F.3d 41, 44 (1st Cir. 2003); see also *Kemiron Atl. Inc. v. Aguakem Int'l Inc.*, 290 F.3d 1287, 1291 (11th Cir. 2002).