Second Circuit Clarifies Important Procedural Question under Federal Arbitration Act

In a decision that deepens a long-standing circuit split, the U.S. Court of Appeals for the Second Circuit held last week that a stay of proceedings—rather than a dismissal of the action—must be entered when all claims have been referred to arbitration and a stay has been requested.[1]

I. Background[2]

Michael Katz, a wireless telephone subscriber with Cellco Partnership d/b/a Verizon Wireless (the "Company"), filed suit against the Company on behalf of a putative class of its New York-area customers. His complaint alleged breach of contract and consumer fraud claims under New York state law on the basis of a monthly administrative charge assessed by the Company that, Katz contended, amounted to a concealed rate increase in violation of applicable consumer protection laws.

At focus in this case was a standard arbitration clause found in the Company's wireless customer agreement, which required all disputes arising from the agreement or from the Company's provision of wireless services in general to be resolved in binding arbitration. Invoking this provision, the Company filed a motion to compel arbitration of all of Katz's claims and to stay the proceedings pending their resolution out of court. The U.S. District Court for the Southern District of New York granted the motion to compel arbitration, but, rather than entering a stay, dismissed the action with prejudice. In doing so, however, it recognized that whether district courts retain the discretion to dismiss an action after all claims have been referred to arbitration, or whether they are instead obligated by the Federal Arbitration Act to stay proceedings, "remains an open question in this Circuit."[3]

As the outright dismissal constituted a final order, this appeal followed prior to the conclusion of the arbitration proceedings. On appeal, the Company maintained that the District Court was required to grant its motion to stay the litigation and that dismissal was therefore an improper disposition.

II. Compelling Arbitration: "To Stay or Not to Stay"

This is an issue on which the Courts of Appeals are squarely divided. The Third, Seventh, Tenth and Eleventh Circuits have held or suggested that the proper course of action when a party seeks to enforce an arbitration clause in a proceeding in which all of the claims presented are arbitrable is to stay the proceedings,[4]

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[1] *Katz v. Cellco P'ship*, No. 14-138(L), 2015 WL 4528658 (2d Cir. July 28, 2015), available at http://www.ca2.uscourts.gov/decisions/isysquery/9a2b0599-ffd1-4785-a044-1c83183e7580/2/doc/14-138_opn.pdf (the "Opinion").

[2] Unless otherwise indicated, the factual background and procedural posture has been summarized from the facts set forth in the Opinion.

[3] *Katz*, 2015 WL 4528658, at *2.

[4] *See Cont'l Cas. Co. v. Am. Nat'l Ins.*, 417 F.3d 727 (7th Cir. 2005); *Lloyd v. HOVENSA, LLC*, 369 F.3d 263 (3d Cir. 2004); *Adair Bus Sales, Inc. v. Blue Bird Corp.*, 25 F.3d 953 (10th Cir. 1994); *Bender v. A.G. Edwards & Sons, Inc.*, 971 F.2d 698 (11th Cir. 1992) (per curium).

while the First, Fifth and Ninth Circuits have held that the district courts enjoy the discretion to dismiss.[5] The issue is unresolved in the Fourth Circuit.[6] The U.S. Supreme Court has yet to address this conflict.

Relying upon the plain language of the Federal Arbitration Act, its structure and the policy underlying its enactment, the Second Circuit sided with the Third, Seventh, Tenth and Eleventh Circuits, holding that a stay of proceedings is "necessary" when all claims have been sent to arbitration and a stay requested.

Turning first to the statutory text, the Court found no evidence that Congress intended to afford a district court discretion in this context. To the contrary, Section 3 of the Federal Arbitration Act is clear in its direction that "[i]f any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending . . . *shall* on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . ."[7]

A mandatory stay, the Court continued, also coheres with the appellate scheme rooted in the Federal Arbitration Act. The statute "explicitly denies the right to an immediate appeal from an interlocutory order that compels arbitration or stay proceedings."[8] Permitting district courts to dismiss an arbitrable matter, the Court observed, "converts an otherwise-unappealable interlocutory stay order into an appealable final dismissal order" in contravention of the Federal Arbitration Act's clear guidance.[9]

Such appellate rights are equally incompatible with the Federal Arbitration Act's aim "to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible."[10] Whereas a stay furthers this "pro-arbitration policy" by allowing the parties to proceed to arbitration "unencumbered by the uncertainty and expense of additional litigation," a dismissal and subsequent appeal invite a degree of judicial interference with the arbitral process that the Federal Arbitration Act precludes.[11]

III. Significance of the Decision

The *Katz* decision bars the entry of dismissal following an order compelling arbitration where certain limited conditions are met. In the process, it removes the opportunity for a plaintiff in the Second Circuit to immediately challenge the referral of its claims to arbitration in an effort to avoid the arbitration requirements of an agreement governing the relationship of the parties. Because the district courts have no discretion and must issue an interlocutory stay in these circumstances, a plaintiff must wait to challenge an order to compel arbitration until that process reaches its completion.

It should be noted that the Court in *Katz* only addressed the disposition of actions in which *all* claims have been referred to arbitration. Although the Court's reasoning and policy considerations seem likely to inform

[5] *See Bercovitch v. Baldwin Sch., Inc.*, 133 F.3d 141 (1st Cir. 1998); *Alford v. Dean Witter Reynolds, Inc.*, 975 F.2d 1161 (5th Cir. 1992); *Sparling v. Hoffman Constr. Co.*, 864 F.2d 635 (9th Cir. 1988).

[6] *See Katz*, 2015 WL 4528658, at *2 (citing *Aggarao v. MOL Ship Mgmt. Co.*, 675 F.3d 355 (4th Cir. 2012)).

[7] 9 U.S.C. § 3 (emphasis added).

[8] *Katz*, 2015 WL 4528658, at *3.

[9] *Id.*

[10] *Id.* at *4 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983)).

[11] *Id.* at *3-*4.

the analysis, this decision does not speak to a proceeding in which fewer than all of the issues presented are referable to arbitration.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com; or Tyler A. O'Reilly at +44.20.7920.9819 or toreilly@cahill.com.