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Appeals of Orders Compelling Arbitration in Embedded Proceedings Must Wait - Altman Nursing, Inc. v. Clay Capital Corp.

Carla Kemp

Appeals of Orders Compelling Arbitration in Embedded Proceedings Must Wait

Altman Nursing, Inc. v. Clay Capital Corp.[1]

I. INTRODUCTION

The enactment of §16 of the Federal Arbitration Act (FAA) afforded courts with specific guidelines to follow in determining whether an order dealing with the arbitrability of a dispute is appealable. One issue, however, was not settled by the language of this statute. *Altman Nursing, Inc. v. Clay Capital Corp.* addresses this unresolved issue of whether an order compelling arbitration in the context of an embedded claim can be classified as final and immediately appealable.

II. FACTS AND HOLDING

Altman Nursing, Inc. (Altman) and Clay Capital Corp. (Clay) included an arbitration clause in their stock purchase agreement.[2] When the parties could not agree on Altman's contract obligations, Altman filed various claims in the United States District Court for the Northern District of Texas, but did not seek to compel arbitration.[3] Clay did, however, seek to compel arbitration in a motion accompanying various counterclaims.[4] The court granted Clay's motion to compel arbitration.[5] Altman appealed, and Clay moved to dismiss the appeal.[6]

Clay's motion to dismiss the appeal asserted that the motion to compel arbitration should be classified as an "embedded" proceeding, one in which some relief is sought apart from the order mandating or prohibiting arbitration.[7] An embedded proceeding typically involves the merits of the dispute and is distinguished from an independent proceeding, one in which the dispute's arbitrability is the sole issue before the court.[8] Clay maintained that under the FAA, which allows appeal of an order compelling arbitration only if it is final, an embedded proceeding, unlike an independent one, is not subject to interlocutory appeal.[9]

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1. 84 F.3d 769 (5th Cir. 1996).
2. *Id.* at 770.
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*
8. *Id.* at 770-71.
9. *Id.* at 770. Relevant parts of the Federal Arbitration Act (9 U.S.C. §§ 1-16) read as follows:
   (a) An appeal may be taken from---
   ....
   (3) a final decision with respect to an arbitration that is subject to this title.

Although Altman conceded that this case involved an embedded proceeding, it argued that the arbitration order was final because it sent all claims to arbitration, thereby ending the litigation proceedings.[10]

The United States Court of Appeals for the Fifth Circuit dismissed the appeal, holding that an order mandating arbitration in an embedded proceeding is always interlocutory and, therefore, not appealable under the FAA.[11]

III. LEGAL BACKGROUND

Before the passage of § 16 of the FAA in 1988, the jurisdiction of an appellate court over a district court's order compelling arbitration was decided under 28 U.S.C. §1291[12] and § 1292.[13] Section 1291 provided that the "courts of appeals . . . shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . ." 28 U.S.C. § 1291 (1988). As a result, the issue under § 1291 was whether the motion compelling arbitration could be classified as final. Courts found that when a motion to compel was brought in an independent proceeding, it was final and appealable. Courts, however, differed in their opinions when the motion was

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(b) Except as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order--
(1) granting a stay of any action under section 3 of this title;
(2) directing arbitration to proceed under section 4 of this title;
(3) compelling arbitration under section 206 of this title; or
(4) refusing to enjoin an arbitration that is subject to this title.

9 U.S.C. § 16.

10. *Id.* at 771.

11. *Id.* at 771-72.

12. 28 U.S.C. § 1291 states that the "courts of appeals . . . shall have jurisdiction of appeals from all final decisions of the district courts of the United States . . . ." 28 U.S.C. § 1291 (1988).

13. 28 U.S.C. § 1292(1) allows the courts of appeals to have jurisdiction of appeals from interlocutory orders only in a few cases:

(a) [T]he courts of appeals shall have jurisdiction of appeals from:
(1) Interlocutory orders . . . granting, continuing, modifying, refusing or dissolving injunctions, or refusing to dissolve or modify injunctions . . . ,
(2) Interlocutory orders appointing receivers, or refusing orders to wind up receiverships or to take steps to accomplish the purposes thereof . . . ,
(3) Interlocutory decrees of such district courts or the judges thereof determining the rights and liabilities of the parties to admiralty cases in which appeals from final decrees are allowed.
(b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order . . . .

28 U.S.C. § 1292 (1988).

embedded, meaning part of other litigation.[14] When the motion was embedded, some courts classified the order compelling arbitration as final, while others classified it as interlocutory and, therefore, not appealable.[15] This disagreement led to uncertainty and frustration of the FAA's goals.[16]

Some courts looked to 28 U.S.C. Sec. 1292 to determine if the appellate court had jurisdiction over the district court's order compelling arbitration. Section 1292, which allows for interlocutory appeals of decisions involving injunctions, also led to a split in the court system. There were decisions which allowed appeals from orders granting a motion to stay judicial proceedings pending arbitration, from orders granting an injunction against arbitration, and from orders granting or denying a motion to compel arbitration.[17] Other courts, however, held that an order compelling arbitration was not appealable as an injunction.[18]

The enactment of 9 U.S.C. §16 has done much to unify the law of appellate jurisdiction in this area. Section 16 generally denies immediate appeal of pro-arbitration orders and allows appeal of refusals to compel arbitration. There is still, however, at least one issue upon which courts disagree: Can an order compelling arbitration and made during on-going proceedings be classified as final and, therefore, appealable under §16(a)(3), which allows for appeal of "a final decision with respect to an arbitration that is subject to this title?"[19]

Clearly, the majority of the circuits have adopted a rule which distinguishes between independent proceedings and embedded proceedings. A proceeding is independent and final if the arbitrability of the dispute is the sole issue before the court.[20] Such proceedings occur when a party seeks an order compelling or prohibiting arbitration, or when a party seeks a declaration of whether the dispute is arbitrable, and no party seeks any other relief.[21] By comparison, an embedded proceeding is one in which a party has sought some relief other than the order requiring or prohibiting arbitration.[22] In the majority of circuits, an order compelling arbitration in an independent proceeding is considered final and appealable, while an order compelling arbitration in an embedded proceeding is considered interlocutory and nonappealable.[23]

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14. Edith H. Jones, *Appeals of Arbitration Orders--Coming Out of the Serbian Bog*, 31 S. TEX L. REV. 361, 373 (1990).

15. For examples of the various approaches taken by courts faced with this issue, see *id.* at 374.

16. *Id.* at 363.

17. *Id.* at 365.

18. *Id.* at 370. Among the cases arriving at this holding were In re Hops Antitrust Litigation, 832 F.2d 470, 473 (8th Cir. 1987); Matterhorn, Inc. v. NCR Corp., 763 F.2d 866, 870 (7th Cir. 1985); Hartford Fin. Sys., Inc. v. Florida Software Servs., Inc., 712 F.2d 724, 729 (1st Cir. 1983); Lummus Co. v. Commonwealth Oil Ref. Co., 297 F.2d 80, 86 (2d Cir. 1961), *cert. denied*, 368 U.S. 986 (1962).

19. 9 U.S.C. §16(a)(3).

20. Humphrey v. Prudential Sec., Inc., 4 F.3d 313, 317 (4th Cir. 1993).

21. Filanto, S.P.A. v. Chilewich Int'l Corp., 984 F.2d 58, 60 (2d Cir. 1993).

22. *Id.*

23. Once the arbitration has occurred, the party opposing arbitrability will have an opportunity to raise that issue in a motion to modify or vacate the award. *Id.* at 60-61.

The Sixth Circuit rejected the independent versus embedded approach in *Arnold v. Arnold Corp.*[24] and relied instead on the legislative history of §16 of the FAA. The court emphasized a quote from the Committee on the Judiciary which states that the policy favoring arbitration is not determinative of whether appeal is allowed under §16.[25] Rather, says the Committee, all final judgments are appealable in the interest of the policy allowing appeals once there is nothing left for the district court to do.[26] The *Arnold* court interpreted the Committee's comment as rejecting the use of the distinction between independent and embedded orders to determine whether appeal is available.[27]

The result of this Sixth Circuit holding is a split of authority on the issue of whether an order compelling arbitration in an embedded proceeding can ever be final and, therefore, appealable under 9 U.S.C. §16(a)(3).

IV. INSTANT DECISION

In analyzing its case, the court in *Altman* first noted that the majority rule classified an order compelling arbitration as final if it was independent, but as interlocutory if it was embedded.[28] The court then considered Altman's position. Altman, relying on the *Arnold v. Arnold Corp.* case,[29] argued that the order to arbitrate, though it was embedded, was also final because it completely ended the litigation.[30]

The Fifth Circuit quickly rejected this line of reasoning along with the *Arnold* holding and adopted a black-letter rule providing that an arbitration order involving an embedded claim is always interlocutory and that an order involving an independent claim is always final.[31]

The court's arrival at this rule was based considerably on precedent. The court cited an earlier Fifth Circuit case, *McDermott International, Inc. v. Underwriters at Lloyds*, [32] as well as cases from several other circuits.[33] Although the Fifth Circuit in *McDermott* did not hold that there could never be an interlocutory appeal from an

24. 920 F.2d 1269 (6th Cir. 1990).

25. *Id.* at 1274-75.

26. *Id.* at 1275. The Committee included as examples of final judgments "a final judgment in an action to compel arbitration, a final judgment that refuses to enjoin arbitration, or a final judgment dismissing an action in deference to arbitration." *Id.* at 1274-75.

27. *Id.* at 1276.

28. *Altman*, 84 F.3d at 770.

29. 920 F.2d 1269 (6th Cir. 1990).

30. *Altman*, 84 F.3d at 771.

31. *Id.*

32. 981 F.2d 744 (5th Cir. 1993), *cert. denied*, 508 U.S. 951 (1993).

33. *Altman*, 84 F.3d at 771; *see* Gammaro v. Thorp Consumer Discount Co., 15 F.3d 93, 95 (8th Cir. 1994); Filanto, S.P.A. v. Chilerrich Int'l Corp., 984 F.2d 58, 60 (2d Cir. 1993); Prudential Insurance Co. of America v. Lai, 42 F.3d 1299, 1302 (9th Cir. 1994); Adair Bus Sales v. Blue Bird Corp., 25 F.3d 953, 955 (10th Cir. 1994); Humphrey v. Prudential Sec. Inc., 4 F.3d 313, 317 (4th Cir. 1993); Perera v. Siegel Trading Co., 951 F.2d 780, 785 (7th Cir. 1992).

embedded proceeding, the *Altman* court felt that this black-letter rule was strongly supported by the *McDermott* holding.[34]

After noting that only the Sixth Circuit in the *Arnold* case has allowed an interlocutory appeal from an embedded proceeding, the court proceeded to reject the Sixth Circuit's approach which was based on the legislative history of the Arbitration Act.[35] The *Altman* court, instead, agreed with the Seventh Circuit's decision in *Perera v. Siegel Trading Co.*[36] In *Perera*, the Seventh Circuit reasoned that if Congress had intended to change the traditional judicial interpretation of the term "final," it would have done so explicitly in Section 16 of the FAA.[37]

Based on the Fifth Circuit's prior holdings and the holdings of the "overwhelming majority of other circuits," the *Altman* court set down the clear rule that orders involving embedded proceedings are always interlocutory and never appealable, while orders involving independent proceedings are always final and always appealable.[38]

V. COMMENT

Though the *Altman* case follows precedent and the majority rule, it is the first case in the Fifth Circuit to use such definite language in order to classify a proceeding involving an embedded claim as *always* interlocutory and a proceeding involving an independent claim as *always* final.[39]

Accordingly, there are two major policies that clash in this case. The first is the policy of allowing immediate appeal of decisions that seem final in the sense that they put an end to litigation. The other is a policy encouraging arbitration and other means of alternative dispute resolution, which in the long run generally saves the parties time and money.

On one side of the debate are the views set forth by the Sixth Circuit in the *Arnold v. Arnold Corp.* case. In *Arnold*, the Sixth Circuit held that even an embedded order can be considered final if it effectively puts an end to the litigation.[40] While this view appears to be antagonistic to the pro-arbitration purpose of §16 of the FAA, the *Arnold* court points out that the policy favoring arbitration must stand alongside the policy allowing appeal when the district court has made a final determination.[41] The Sixth Circuit's reasoning has strengths. The policy of allowing appeal from a decision which seems final gives parties assurance that they

34. *Id.*
35. *Id.*
36. 951 F.2d 780 (7th Cir. 1992).
37. *Id* at 784-85. The phrase "final decision" has been given meaning by judicial interpretation in cases deciding whether a lower court decision is appealable under 28 U.S.C. §1291. *Id.*
38. *Altman*, 84 F.3d at 771.
39. *Id.*
40. *Arnold*, 920 F.2d at 1274-75.
41. *Id.*

can rely on the court system to correct an erroneous order which forces them to arbitrate.

The court in *Altman*, however, rejected the holding in *Arnold* and promoted the pro-arbitration policy behind §16. By making orders compelling arbitration of embedded claims unappealable, the Fifth Circuit (and most other circuits which have reached similar holdings) appears to have taken another step toward promoting alternative dispute resolution. It is, in a sense, allowing a trial judge to force the parties to arbitrate and to postpone any appeal until the arbitration is over.

In some instances, at least, this may successfully dispose of the case as far as the courts are concerned. For example, if the party who initially opposed the arbitration is satisfied with its result, it is likely that there will never be an appeal. Even if the party is not satisfied with the result of arbitration and the arbitration is overturned on appeal, the work that both parties invested in the arbitration process will be helpful at trial.[42]

For some, denying appeal of arbitration orders involving embedded claims does not go far enough. Some pro-arbitration advocates feel that even when orders compelling arbitration are independent and final, they should not be appealable until after the arbitration has occurred.[43] Part of the reasoning behind this view is that increased opportunities for judicial involvement in the process may disparage pro-arbitration goals, tie the parties up in litigation, and directly conflict with the purpose of §16 of the FAA.[44] Proponents argue that even though denying appeal of independent orders to arbitrate would not necessarily undermine the policy of allowing the appeal of final judgments,[45] the fear of that happening may have kept it out of §16 in the first place. At any rate, because such a construction of §16 does not seem possible and because it would require a legislative amendment, the Fifth Circuit in *Altman* appears to have gone as far as it can go to minimize appeals of orders compelling arbitration.

Beyond a pro-arbitration policy, the *Altman* black-letter rule should serve a policy of efficiency in the court system when it comes to such cases by increasing predictability and by reducing claims which are unlikely to succeed. It is doubtful that any party would argue before the Fifth Circuit Court of Appeals that an order on an embedded claim can also be final after the Fifth Circuit's decision in *Altman* which harshly rejected the reasoning in *Arnold*. On a broader scale, however, efficiency could suffer. If a court wrongly orders arbitration in an embedded proceeding, the losing party will have to go through with the arbitration, appeal afterward, and *then* see the decision reversed. Although the effort put into the

42. Jones, *supra* note 14, at 375.

43. *See* David D. Siegel, Practice Commentary; (West), Paragraph 5, 354 (1996); 9 U.S.C.A. §16 (1988).

44. Siegel, *supra* note 43, at paragraph 5, 352-57 (1996).

45. *Id.* Siegel states that "the deferral of an appeal from a 'final' district court decision in favor of arbitration would advance [the final judgment policy] by getting the case expeditiously before the arbitrators on the merits and letting the arbitrability point go up only afterwards." He also points out that a "final" decision to compel arbitration does not end the dispute in the sense that a final decision on the merits does. It simply determines the forum in which the dispute will be heard. *Id.* at 354.

arbitration probably will not be entirely wasted, time will certainly be lost - both the time invested in the arbitration process and the delay in taking the case up on appeal.

In summary, though it may have been the inevitable result of the precedent leading up to it, the Fifth Circuit's decision in *Altman* closes the door on any possibility of immediate appeal in that circuit when a trial court compels arbitration in a case involving an embedded claim. At first glance, the Fifth Circuit's decision appears to promote arbitration among disputing parties and promote efficiency in the courts. The achievement of these goals, however, depends on the reaction of future contracting parties. This decision and those like it may actually cause parties to hesitate before including any kind of arbitration clause in their contract for fear that courts will have too much power to construe the clause to force arbitration in all cases. The results remain to be seen.

VI. CONCLUSION

The *Altman* decision is simply a culmination of the precedent leading up to it combined with a black-letter rule. It clears up any uncertainty that may have previously allowed parties to challenge a court's order compelling arbitration in an embedded proceeding. Based on this decision, such a challenge in the Fifth Circuit can never occur until after the arbitration takes place. It is possible that other circuits which have generally followed the same reasoning as the *Altman* court will adopt the same black-letter rule that arbitration orders in embedded proceedings are always interlocutory and never immediately appealable. Unless the Sixth Circuit drastically changes its stance and overrules *Arnold*, there will continue to be a split of authority on this issue.

CARLA KEMP