The Federal Arbitration Act and the Power of the District Court

This Note will explore an often litigated issue: whether a district court has the power to issue a preliminary injunction in order to preserve the status quo of the parties prior to arbitration of the case which it has previously determined is arbitrable. This question "has divided the state and federal courts."[1] Furthermore, there is a division in thinking within the circuits, and yet the Supreme Court has not ruled on the issue. At the core of this issue is whether the Federal Arbitration Act[2] (FAA) requires a federal court to "immediately divest itself of any power to act to maintain the status quo once it decides that the case before it is arbitrable."[3] An alternative interpretation is that the language of the FAA allows a federal court to grant an injunction.

Section I of this Note will analyze the reasoning of one of the most recent federal cases to examine this issue, *Speedee Oil Change Systems, Inc. v. State Street Capital.*[4] Section II will discuss the other circuit court opinions which are in accord with *Speedee.* Section III will examine the Eighth and Tenth Circuit Courts' reasoning for denying the power. Section IV will explain why district courts do have this power. Section V will examine the test the courts should use to determine the propriety of granting or denying the injunction. Finally, Section VI will describe the mootness problem facing the Supreme Court.

I. THE FIFTH CIRCUIT

In *Speedee,* the United States District Court for the Eastern District of Louisiana held that the ability to grant a preliminary injunction pending arbitration is inherent in a district court's power. The plaintiff, Speedee Oil Change Systems, Inc. (Speedee) was a franchisor of car care service.[5] The parties entered into a franchise agreement providing for State Street Capital, Inc. (State Street) to be the regional franchisee in South Florida. "The Franchise [Agreement] required State Street to collect franchise fees, royalties, advertising fund payments and other payments applicable to the individual agreements signed with the local retail dealers."[6] State Street

1. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum, 469 U.S. 1127, 1129 (1985) (White, J., dissenting), *reh'g denied,* 470 U.S. 1024 (1985).

2. 9 U.S.C. §§ 1-14 (1988).

3. RGI, Inc. v. Tucker & Assocs., Inc., 858 F.2d 227, 228-29 (5th Cir. 1988), *reh'g denied,* 865 F.2d 1266 (5th Cir. 1989).

4. 727 F. Supp. 289 (E.D. La. 1989).

5. *Id.* at 290.

6. *Id.*

was required to give some of the franchise fees and royalties as well as all of the advertising fund payments to Speedee. In return, State Street was to receive the exclusive license to use the name, logo, service marks and confidential operating manuals that Speedee developed for the operation of its franchises.[7] Speedee brought suit claiming State Street had breached the contract, and sought injunctive relief to stop State Street from continuing its operations as a regional franchisee.[8] State Street argued that it was wrongfully discharged, and it asked the district court to stay the case and compel arbitration under the contract's arbitration clause.[9] The arbitration clause read:

> [Speedee Oil Change Systems] and the Region agree to submit any claim, dispute, suit, action or proceeding between them or arising out of or relating to this Agreement or any of the transactions contemplated by it and involving [Speedee Oil Change Systems] to binding arbitration pursuant to the rules for commercial arbitration of the American Arbitration Association, such arbitration to be held at the Office of the American Arbitration Association located closest to the office of [Speedee Oil Change Systems].[10]

The district court granted the defendant's motion to stay the proceedings pending arbitration. It was then that the court faced an issue of first impression in the Fifth Circuit: whether a district court has the power to grant preliminary injunctive relief even though it stays the case pending arbitration. The court answered this in the affirmative and ordered a hearing to determine whether a preliminary injunction was proper.

The court first had to decide whether the dispute was arbitrable. It acknowledged the federal public policy, which has been recognized by its circuit court of appeals to favor arbitration. Thus, the court did not agree with the plaintiff's interpretation of the contract in question because such an interpretation ignored "the strong federal policy in favor of arbitration," as illustrated in *Place St. Charles v. J.A. Jones Construction Co.*[11]

This federal policy of favoring arbitration was also discussed in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*[12] In that case, the Supreme Court stated that Congress' clear intent in the FAA was "to move the parties to an arbitrable dispute out of court and into

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7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. 823 F.2d 120, 123 (5th Cir. 1987).
12. 460 U.S. 1 (1983).

arbitration as quickly and easily as possible."[13] *Moses* involved both a federal and a state action where each focused upon an identical issue of arbitrability. The petitioner hospital wanted to stay the federal action pending resolution of the state action. The district court granted the stay, but the Supreme Court thought this was wrong, because the refusal to proceed was contrary to Congress' intent as evidenced by the FAA to move the parties into arbitration.[14] The Supreme Court stated in *Moses* that federal law through the FAA governs the arbitrability of a dispute whether that issue is in a state or federal court.[15]

Section 2 of the FAA[16] "is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary. The effect of the section is to create a body of federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the Act."[17] This statement suggests that the effect of the FAA is to dictate the arbitrability of all disputes.

The Supreme Court has recently cited *Prima Paint Corp. v. Flood & Conklin Manufacturing Corp.*[18] as an example of the type of cases in which the courts of appeals have consistently applied the federal policy favoring arbitration. In *Prima Paint*, the parties had signed a contract which contained an arbitration agreement, but the plaintiff ignored this agreement and brought an action for rescission based on alleged fraud in the inducement. The issue in this case was whether fraud in the inducement was itself an arbitrable controversy. The Supreme Court held that the language and policies of the FAA required the conclusion that the issue of fraud was arbitrable.[19] The Supreme Court stated in *Moses* that it agrees with the court of appeals that the federal policy favoring arbitration should be controlling in questions of arbitrability:

> The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of

13. *Id.* at 22.

14. *Id.*

15. *Id.* at 24.

16. 9 U.S.C. § 2 (1988) ("A written provision in any maritime transaction or a contract evidencing a transaction involving commerce . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.").

17. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24 (1983).

18. 388 U.S. 395 (1967).

19. *Id.* at 402-04.

waiver, delay, or a like defense to arbitrability.[20]

Thus, the federal policy favoring arbitration has been firmly entrenched and accordingly has led to significant consequences.

The court in *Speedee* discussed some of these consequences. Citing *Mar-Len of Louisiana v. Parsons-Gilbane*,[21] the court stated that an arbitration clause in an agreement forms the basis for determining arbitrability.[22] The *Mar-Len* court itself declared that "[t]he question of arbitrability is determined on the basis of the existence of an arbitration clause that on its face appears broad enough to encompass the parties' claims."[23] The *Speedee* court summarized another consequence stating that "[w]henever the scope of an arbitration clause is reasonably doubtful or debatable, the presumption of arbitrability mandates a decision which favors arbitration."[24] In other words, whenever an arbitration clause seems to govern the parties' disagreement, the court will enforce it, and in situations where coverage of arbitration clauses is ambiguous, the court will follow the federal policy which favors arbitration.

The court in *Speedee* found that the arbitration clause between Speedee and State Street was not ambiguous. Therefore, the court granted the defendant's motion to stay the court proceedings in order for arbitration to occur. However, the court still had to decide whether it had the power to order preliminary injunctive relief after staying the case pending arbitration. Although this was a question of first impression in the Fifth Circuit, other circuits had previously ruled on the question. The *Speedee* court joined the First, Second, Third, Fourth and Seventh Circuits in ruling that district courts do have the power to issue preliminary injunctions after staying a case pending arbitration. However, the Eighth and Tenth Circuits have disagreed and have ruled that courts do not have such power.

II. THE OTHER CIRCUIT COURTS' RESOLUTIONS

The First Circuit addressed this issue in *Teradyne, Inc. v. Mostek*

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20. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983).

21. 773 F.2d 633 (5th Cir. 1985).

22. Speedee Oil Change Sys., Inc. v. State Street Capital, Inc., 727 F. Supp. 289, 291 (E.D. La. 1989).

23. Mar-Len of La., Inc. v. Parsons-Gilbane, 773 F.2d 633, 635 (5th Cir. 1985) (citing Commerce Park at DFW Freeport v. Mardian Constr. Co., 729 F.2d 334, 338 (5th Cir. 1984)).

24. Speedee Oil Change Sys., Inc. v. State Street Capital, Inc., 727 F. Supp. 289, 291 (E.D. La. 1989) (citing Mar-Len of La., Inc. v. Parsons-Gilbane, 773 F.2d 633, 635 (5th Cir. 1985)).

Corp.[25] In *Teradyne*, the defendant, Mostek Corporation, appealed from a district court interlocutory order which was issued in favor of Teradyne. That order required Mostek to place four million dollars of its assets in an interest bearing account for the purpose of satisfying any judgment, or arbitration award, in favor of Teradyne. This burden was thrust on Mostek because it had previously ceased operations and sold its assets.[26]

Initially, Mostek had refused to pay order cancellation charges. It then opposed Teradyne's demand for arbitration pursuant to a contract provision. When Mostek eventually sold all of its assets to Thomson Semiconductors, Teradyne sought the preliminary injunction to force Mostek to set aside funds in order to satisfy any potential judgment resulting from the arbitration proceedings.[27] After deciding that the district court's interlocutory order was appealable, the First Circuit Court addressed the effect of the FAA on the district court's power to grant preliminary injunctive relief. Just as the district court in *Speedee* decided, this circuit court ruled that "a court can, and should, grant a preliminary injunction in an arbitrable dispute whenever an injunction is necessary to preserve the status quo pending arbitration."[28]

The First Circuit followed the decisions from the Second,[29] Fourth[30] and Seventh Circuits.[31] These courts had felt that the language of the FAA did not specifically address the issue. Even though the case was arbitrable, a district court still had an obligation to determine the propriety of an injunction in the case. Accordingly, since the language of the FAA does not prohibit a court from issuing an injunction, a court should use its equitable power to preserve the status quo.[32]

In the Second Circuit, this issue was addressed in *Roso-Lino Beverage Distributors, Inc. v. Coca-Cola Bottling Co. of N.Y., Inc.*[33] In *Roso-Lino*, the district court denied Roso-Lino a preliminary injunction. This case involved a termination by the defendant of the plaintiff's eleven year Coca-Cola distributorship. Roso-Lino brought suit claiming the termination was wrongful and that Coca-Cola had engaged in price discrimination, thereby violating the Robinson-Patman Act, 15 U.S.C. §

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25. 797 F.2d 43 (1st Cir. 1986).

26. *Id.* at 44.

27. *Id.* at 45.

28. *Id.* at 47.

29. Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co. of N.Y., Inc., 749 F.2d 124 (2d Cir. 1984).

30. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048 (4th Cir. 1985).

31. Sauer-Getriebe KG v. White Hydraulics, Inc., 715 F.2d 348 (7th Cir. 1983), *cert. denied*, 464 U.S. 1070 (1984).

32. Teradyne, Inc. v. Mostek Corp., 797 F.2d 43 (1st Cir. 1986).

33. 749 F.2d 124 (2d Cir. 1984).

13.[34] The district court judge decided the dispute was arbitrable under the distributorship agreement. Yet, the judge refused to grant the plaintiff a preliminary injunction believing that his decision to stay the proceedings until arbitration was completed had "stripped the court of power to grant injunctive relief."[35] The circuit court relied on its decision in *Erving v. Virginia Squires Basketball Club*,[36] and reversed the denial of the preliminary injunction. It held that "[t]he fact that a dispute is to be arbitrated . . . does not absolve the court of its obligation to consider the merits of a requested preliminary injunction; the proper course is to determine whether the dispute is 'a proper case' for an injunction."[37] In other words, the court held that even if a court stays the litigation in order for a dispute to be arbitrated, the court must still decide whether that case is one which meets the requirements necessary for granting a preliminary injunction.

In *Erving*, a basketball player filed suit for rescission of his contract with a professional club. The Club then sought injunctive relief to prevent the plaintiff from playing for another club during the arbitration process. The district court granted the injunction to preserve the status quo.[38] Although this case might have been distinguished because Erving's contract expressly authorized a preliminary injunction in the event of a breach, the Second Circuit specifically noted that "[t]he provision relative to 'obtaining an injunction or other equitable relief' is merely declaratory of existing legal rights."[39] This statement suggests that the court would have granted the injunction even if the contract had not expressly allowed this type of relief because the Club had a legal right to an injunction.

The Third Circuit also addressed this issue in a similar situation. *Ortho Pharmaceutical Corp. v. Amgen, Inc.*,[40] involved a contract dispute between a biotechnology company, Amgen, and a subsidiary of Johnson & Johnson, Ortho. The Plaintiff, Ortho, was granted a preliminary injunction that prevented Amgen from receiving approval from the FDA to produce EPO (a human protein normally produced in the kidney) by itself. Previously, the two parties had agreed upon a joint license to produce EPO.[41] After analyzing the language of the FAA, the circuit court decided that the district court was not precluded from issuing an

34. *Id.* at 125.

35. *Id.*

36. 468 F.2d 1064 (2d Cir. 1972).

37. Roso-Lino Beverage Distribs., Inc. v. Coca-Cola Bottling Co. of N.Y., Inc., 749 F.2d 124, 125 (2d Cir. 1984) (citing Erving v. Virginia Squires Basketball Club, 468 F.2d 1064, 1067 (2d Cir. 1972)).

38. Erving v. Virginia Squires Basketball Club, 468 F.2d 1064, 1066 (2d Cir. 1972).

39. *Id.* at 1067.

40. 882 F.2d 806 (3d Cir. 1989).

41. *Id.* at 808-09.

injunction.[42]

The Fourth Circuit reached the same conclusion in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley*.[43] Merrill Lynch had brought suit against its former account executive seeking injunctive relief that would prevent him from using Merrill Lynch's records and from soliciting its clients.[44] The district court granted the injunction and ordered expedited arbitration. The circuit court examined the Act's language and determined that the district court was not precluded from issuing an injunction. The court declared that if the FAA was intended to have a different meaning, Congress would have written it as such.[45] Without language clearly indicating an intent to remove this power from the judiciary, the court refused to interpret it as doing so. Additionally, the court reasoned that Congress' goal was furthered by preserving the status quo, thus providing an opportunity for arbitration to be effective.[46]

A case arising in the Fifth Circuit involved a contract between the prime contractor on a government project and the subcontractor.[47] Tucker, the prime contractor, discovered that the subcontractor, RGI, was not complying with federal regulations and terminated the contract. RGI filed an action in the district court seeking an order to enforce arbitration and an injunction reinstating the contract pending arbitration.[48] The Fifth Circuit reviewed the language of the FAA and determined that it contained nothing regarding the district court's power to act and concluded that Congress' intent would be frustrated if the district court was precluded from issuing the injunction. The court then held that the district court could issue the injunction to further the arbitration process.[49]

The Seventh Circuit also decided this issue. In *Sauer-Getriebe KG v. White Hydraulics, Inc.*,[50] the plaintiff alleged that the defendant had repudiated a contract which had given the plaintiff manufacturing and marketing rights to motors manufactured by the defendant. The alleged repudiation occurred when the defendant announced it was negotiating for the sale of its assets.[51] The plaintiff, wishing to exercise its contractual right to arbitrate, asked for a preliminary injunction to prevent the defendant from transferring any of its manufacturing rights pending

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42. *Id.* at 812.
43. 756 F.2d 1048 (4th Cir. 1985).
44. *Id.* at 1048-49.
45. *Id.* at 1052.
46. *Id.* at 1054.
47. RGI, Inc. v. Tucker & Assocs., Inc., 858 F.2d 227 (5th Cir. 1988).
48. *Id.* at 228.
49. *Id.* at 229-30.
50. 715 F.2d 348 (7th Cir. 1983), *cert. denied*, 464 U.S. 1070 (1984).
51. *Id.* at 349.

arbitration.[52] The district court refused to grant the injunction holding that the contract was not repudiated. The Seventh Circuit Court of Appeals reversed. The circuit court held that the plaintiff had not waived its right to arbitrate by filing the suit. Thus, the plaintiff was entitled to an injunction, which would make its right to arbitration meaningful (in the face of defendant's transfers before arbitration was settled). The circuit court held that "the right to arbitrate and to seek injunctive relief were not incompatible and that the plaintiff was not obliged to abandon one in order to pursue the other."[53] Therefore, even though the plaintiff had filed suit, the right to arbitrate was still valid. Additionally, the plaintiff was entitled to an injunction to maintain the status quo pending arbitration in order that the right to arbitrate would not be rendered meaningless.

These circuit courts have used the same reasoning and policy considerations to determine that district courts do have the power under the FAA to issue a preliminary injunction to preserve the status quo after staying the litigation during arbitration. The Tenth and Eighth Circuits, however, have reached a different conclusion.

III. THE EIGHTH AND TENTH CIRCUIT COURTS' DECISIONS

The Eighth[54] and Tenth[55] Circuits have concluded that the district court does not have the power to grant an injunction to preserve the status quo pending arbitration.

Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey[56] involved an employment contract dispute where the employer sought an injunction to prevent its five former employees from using records and soliciting clients. The court found that the agreement was arbitrable under the FAA because the employment contract contained an arbitration agreement.[57] However, the court of appeals reversed the district court's grant of an injunction finding an abuse of discretion. "In light of our determination that the controversy is arbitrable, however, we find that the issuance of injunctive relief abrogates the intent of the Federal Arbitration Act and

52. *Id.*

53. Teradyne, Inc. v. Mostek Corp., 797 F.2d 43, 48 (1st Cir. 1986) (citing Sauer-Getriebe KG v. White Hydraulics, Inc., 715 F.2d 348, 350 (7th Cir. 1983), *cert. denied*, 464 U.S. 1070 (1984)).

54. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286 (8th Cir. 1984).

55. *Id.* (citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Scott, No. 83-1480 (10th Cir. May 12, 1983) (summary order staying the injunction pending arbitration)). In *Scott*, the 10th Circuit vacated, by order and without formal written opinion, a preliminary injunction that the district court had granted pending arbitration.

56. 726 F.2d 1286 (8th Cir. 1984).

57. *Id.* at 1287-88.

consequently was an abuse of discretion."[58]

The court believed that the language of the FAA[59] directs a court to stay the judicial action. The court relied on *Moses*,[60] in which the Supreme Court stated that the congressional intent of the FAA was to move the dispute into arbitration as quickly as possible. Therefore, the court decided that even a limited hearing for an injunction was inappropriate because the court would then be involved in the merits of the dispute, which was the proper role of the arbitrator.[61] The *Hovey* court cited *Prima Paint*[62] and *Buffalo Forge*.[63] In those cases, the Supreme Court had refused to become involved in the merits of the case because arbitration was pending. Those two cases provided sufficient authority for the *Hovey* court to conclude that "where the Federal Arbitration Act is applicable and no other qualifying contractual language has been alleged, the district court errs in granting injunctive relief."[64] Other district courts are in agreement with this reasoning, although no other court of appeals has issued such an opinion.[65]

However, the *Hovey* opinion is not as sound as it may appear at first glance. In footnote 10,[66] the court leaves open the possibility that where the parties to the contract have contemplated arbitration beforehand, and thus have provided for it in the contract, an injunction may be issued. Footnote 10 discusses *Erving*,[67] in which the court found the dispute was arbitrable and also granted an injunction to maintain the status quo. The *Hovey* court distinguished *Erving* by pointing out that the contract in *Erving* expressly provided for injunctive relief and consequently the issues to be determined on the propriety of injunctive relief were not the same as issues on the merits.[68] Footnote 10 leaves open the possibility of granting

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58. *Id.* at 1291.

59. 9 U.S.C. § 3 (1988).

60. 460 U.S. 1 (1983).

61. 726 F.2d 1286, 1291-92 (8th Cir. 1984).

62. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) (issue of fraud in the inducement of contract was for the arbitrator).

63. Buffalo Forge Co. v. United Steelworkers of Am., AFL-CIO, 428 U.S. 397 (1976) (Court refused to enjoin strike pending arbitration of validity of strike).

64. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286, 1292 (8th Cir. 1984).

65. *Accord* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Shubert, 577 F. Supp. 406 (M.D. Fla. 1983); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. DeCaro, 577 F. Supp. 616 (W.D. Mo. 1983); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson, 574 F. Supp. 1472 (E.D. Mo. 1983); Smith v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 575 F. Supp. 904 (N.D. Tex. 1983).

66. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286, 1291 n.10 (8th Cir. 1984).

67. 468 F.2d 1064 (2d Cir. 1972).

68. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286, 1291 n.10 (8th Cir. 1984).

an injunction. It seems that in a situation similar to *Erving*, where the contract expressly provides for injunctive relief, the *Hovey* court would rule that granting an injunction is appropriate.

A second item making the *Hovey* decision less persuasive is that two months after that decision, another Eighth Circuit panel affirmed the granting of a preliminary injunction where there was an arbitrable dispute in *Ferry-Morse Seed Co. v. Food Corn, Inc.*[69] In *Ferry-Morse*, the defendant, Food Corn, had developed a seed corn which the plaintiff wanted to market. The dispute involved an exclusive licensing agreement, which was exchanged for royalties based on a percentage of the retail price. The disagreement was over the meaning of "retail price."[70] The plaintiff brought an action to compel arbitration and in addition asked for a preliminary injunction requiring the defendant to give the corn to the plaintiff.[71] The Court of Appeals for the Eighth Circuit affirmed the district court's grant of the preliminary injunction, finding that the plaintiff had met the irreparable harm burden. The court of appeals also found that the district court properly ruled that the plaintiff had a probability of success on the merits, and therefore, the district court had not abused its discretion in granting the injunction.[72]

Footnote 10 in *Hovey*, and the decision in *Ferry-Morse* make the argument that the district court does not have the power to grant the injunction less compelling.

IV. DISTRICT COURTS DO HAVE THE POWER

District courts do have the power to grant an injunction pending arbitration. An examination of this issue must begin by looking at the FAA. Section 3 of Title 9 states:

> If 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, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, 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, providing the applicant for the stay is not in default in proceeding with such arbitration.[73]

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69. 729 F.2d 589 (8th Cir. 1984).
70. *Id.* at 590.
71. *Id.*
72. *Id.* at 592.
73. 9 U.S.C. § 3 (1988).

The language of the FAA does not indicate clearly whether the courts have been given the power to grant an injunction pending arbitration or not.

However, the two sides apparently are in agreement in one area: where the contract expressly provides for injunctive relief, all the courts will probably grant it. The Fifth Circuit has stated that injunctive relief is available where a case is stayed pending arbitration as long as the contract suggests that the parties contemplated such relief.[74] The Eighth Circuit left open the possibility of an injunction where the parties had contemplated its use beforehand in *Hovey*.[75] But, if the parties do not contemplate such a remedy, then the question remains whether the court has the power to grant the remedy or not.

In *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson*,[76] the court used the language of section 3 of the FAA in concluding that it was prohibited from granting an injunction. That language provides that if the court decides the dispute is arbitrable, "the court . . . shall . . . stay the trial of the action until such arbitration has been had . . . ."[77] The court found that "shall" was a mandatory term, once arbitration is determined and "a stay under Section 3 is issued, the court cannot concern itself with the merits of the dispute until arbitration has been had."[78] The court felt that once it referred the case to arbitration, it could no longer address the merits. Issuing an injunction would require a hearing, which the court felt necessarily explored the merits of the case, and thus would cause burdensome delays.

The *Thomson* argument, however, is not very persuasive. If Congress had intended to include all actions within the judicial power, then it certainly could have written the statute to do so explicitly.[79] The Court of Appeals for the Fourth Circuit concluded in *Bradley*, "[w]e do not believe that Congress would have enacted a statute intended to have the sweeping effect of stripping the federal judiciary of its equitable

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74. RGI, Inc. v. Tucker & Assocs., 858 F.2d 227 (5th Cir. 1988), *reh'g denied*, 865 F.2d 1266 (5th Cir. 1989).

75. 726 F.2d 1286, 1291 n.10 (8th Cir. 1984).

76. 574 F. Supp. 1472 (E.D. Mo. 1983).

77. 9 U.S.C. § 3 (1988).

78. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Thomson, 574 F. Supp. 1472, 1478 (E.D. Mo. 1983).

79. For example, 28 U.S.C. § 2283 (1948) provides: "A court of the United States may not grant an injunction to stay proceedings in a State court except as expressly authorized by Act of Congress, or where necessary in aid of its jurisdiction, or to effectuate its judgments." *See also* 11 U.S.C. § 362(a)(1) (1978) (filing of bankruptcy petition operates as a stay of any "judicial, administrative, or other proceeding against the debtor.") Anthony S. Fiotto, Note, *The United States Arbitration Act and Preliminary Injunctions: A New Interpretation of an Old Statute*, 66 B.U. L. REV. 1041, 1049 (1986) (citing Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048, 1052 (1985)).

powers in all arbitrable commercial disputes without undertaking a comprehensive discussion and evaluation of the statute's effect."[80] The *Bradley* court concluded that "trial" as written in 9 U.S.C. § 3 means, "the ultimate resolution of the dispute on the merits,"[81] and does not include pretrial proceedings. The court then held that the FAA's language does not prevent a district court from granting a preliminary injunction.

Additionally, the language of § 3 states that the courts should not decide those issues that are referable to the arbitrator. The language only states that the court must stay the trial of those issues that are being referred to the arbitrator.[82] However, the goals of the FAA would not be achieved if the court could not maintain the status quo. If a court referred a case to arbitration, yet denied injunctive relief, then a party could take such action that would irreparably harm the other party and thereby render arbitration meaningless.

Even if the language of the FAA does not prevent the district court from issuing a preliminary injunction, the court would be prohibited where the policy of the FAA would be impaired. However, the majority of courts feel that the congressional policy is furthered, not hindered, by issuing an injunction. If courts are unable to preserve the status quo by issuing an injunction, then one of the parties may be able to alter his position so as to render the arbitration meaningless. If this is so, then there is no reason for the dispute resolution process to take place at all.[83]

Still, injunctions will not be issued in all instances. Generally, the courts have developed a test that the moving party must meet before an injunction will be granted. For example, in the Third Circuit, there are four factors that a court considers in determining whether a preliminary injunction is appropriate or not:

> (1) whether the movant has demonstrated reasonable probability of eventual success in the litigation;
> (2) whether the movant has demonstrated that it will be irreparably injured *pendente lite* if relief is not granted to prevent a change in the status quo;
> (3) the possibility of harm to other interested persons from the grant or denial of the injunction, and

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80. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048, 1052 (4th Cir. 1985).

81. *Id.*

82. Philip E. Karmel, *Injunctions Pending Arbitration and the Federal Arbitration Act: A Perspective from Contract Law*, 54 U. CHI. L. REV. 1373, 1386-87 (1987).

83. Ortho Pharmaceutical Corp. v. Amgen, Inc., 887 F.2d 460 (3d Cir. 1989); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048, 1054 (4th Cir. 1985).

(4) the public interest. (emphasis omitted)[84]

If these factors are met, then the party is entitled to an injunction. By establishing these four criteria, a party shows that it is essential to grant the injunction to prevent irreparable harm and preserve the status quo.

Parties who argue against the issuance of an injunction also argue that the preliminary injunction will prejudice the arbitrator's subsequent decision.[85] This argument fails, however, because the movant has demonstrated only a reasonable probability of eventual success in the litigation, and not in the arbitration. Furthermore, although a court conducts a hearing to determine the appropriateness of an injunction, the outcome of the litigation is never decided at that hearing. Therefore, except in the event of an abuse by the district court, or an abuse by the arbitrators, the granting of a preliminary injunction by the district court to preserve the status quo pending arbitration seems to further the federal policy behind the FAA: that policy is to "move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible."[86] This was the reasoning used by the district court in *Speedee.*

The goals of the FAA are reflected in its legislative history. This history demonstrates an intent to reverse the common law courts' refusal to enforce arbitration agreements.

> The House Report accompanying the bill summarizes 'the need for the law' as follows:
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> > [it] arises from an anachronism of our American law. Some centuries ago . . . English courts . . . refused to enforce . . . agreements . . . to arbitrate. . . . [Contemporary] courts have felt that the precedent was too strongly fixed to be overturned without legislative enactment, although they have frequently criticized the rule and recognized its illogical nature and the injustice which results from it.
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> According to this Report, 'the purpose of . . . [the Act] is to make valid and enforceable agreements for arbitration. . . . '[87]

In addition to the legislative intent stating the purpose of the FAA,

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84. Ortho Pharmaceutical Corp. v. Amgen, Inc., 887 F.2d 460 (3d Cir. 1989) (citing Constructors Assoc. of Western Pa. v. Kreps, 573 F.2d 811, 814-15 (3d Cir. 1978)); *see also* A.L.K. Corp. v. Columbia Pictures Indus., Inc., 440 F.2d 761, 763 (3d Cir. 1971).

85. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048, 1054 (4th Cir. 1985).

86. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 22 (1983).

87. *Karmel, supra* note 82, at 1391 (citing *To Validate Certain Agreements for Arbitration*, H.R. REP. NO. 96, 68th Cong., 1st Sess. 1-2 (1924)).

the Supreme Court has also explained Congress' intent in *Dean Witter Reynolds, Inc. v. Byrd.*[88] In *Byrd*, an investor sued his broker believing that financial transactions had violated the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78o(c), 78t, and various state law provisions. Byrd alleged that an agent of Dean Witter acted improperly by trading without prior consent, having an excessive number of transactions, and by misrepresenting the status of the account.[89] Although the parties had signed an agreement to arbitrate, the broker tried to compel arbitration of only the state law claims. Dean Witter assumed that the federal claims were not arbitrable and could be resolved only in a federal forum. Therefore, he did not seek to compel arbitration of those claims. The district court denied the motion to compel arbitration, and the Court of Appeals for the Ninth Circuit affirmed by holding that the FAA required enforcement of the arbitration agreement even though it may result in separate proceedings in different forums.[90]

> [Although] Congress was [not] blind to the potential benefit of the legislation for expedited resolution of disputes[,] . . . passage of the Act was motivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered, and we must not overlook this principal objective when construing the statute, or allow the fortuitous impact of the Act on efficient dispute resolution to overshadow the underlying motivation.[91]

The Court found that the primary motivation for Congress to pass the FAA was to enforce agreements between parties to arbitrate disputes. The Court went further and held that when there is a conflict between enforcing an arbitration agreement and quick resolution, then a court must enforce the agreement to accommodate the legislature's intent.[92]

Thus, the Supreme Court established that the "principal objective" of the FAA was to enforce arbitration agreements and that the need for expedited dispute resolution is generally an incidental benefit. This statement undermines the argument of many district courts' decisions in denying an injunction.[93] These courts reasoned that the FAA denied district courts the power to grant an injunction pending arbitration because the purpose of the FAA was to expedite the dispute into arbitration.

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88. 470 U.S. 213 (1985).

89. *Id.* at 214.

90. *Id.* at 215-17.

91. *Karmel, supra* note 82, at 1393 (quoting Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 220 (1985)).

92. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 221 (1985).

93. *See, e.g.*, Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286 (8th Cir. 1984).

Thus, a hearing on the appropriateness of an injunction would not meet this purpose. However, since the Supreme Court has ruled that this expedited resolution of the case is not the principal objective, but only a benefit, this argument is no longer convincing.

The Arbitration Act's language is not prohibitive. Therefore, in light of the legislative intent, and the ruling of the Supreme Court in *Byrd*, the district court does have the power to grant an injunction to maintain the status quo pending arbitration.

V. THE PROPER TEST

Today, courts have tests which they use to determine the propriety of an injunction.[94] Most of these tests involve factors such as a determination of the potential success in the litigation and a showing of irreparable harm if the injunction is not granted.[95] The Fourth Circuit Court of Appeals used what it called a "hollow formality test" in *Bradley*.[96] The court followed its holdings in *Lever Brothers Co. v. International Chemical Workers Union, Local 217*,[97] and *Drivers, Chauffeurs, Warehousemen & Helpers Teamsters Local Union No. 71 v. Akers Motor Lines, Inc.*[98] In *Lever Bros.*, the court adopted its standard for issuing preliminary injunctions in labor disputes:

> An injunction to preserve the *status quo* pending arbitration may be issued either against a company or against a union in an appropriate *Boys Markets* case where it is necessary to prevent conduct by the party enjoined from rendering the arbitral process a hollow formality in those instances where, as here, the arbitral award when rendered could not return the parties substantially to the *status quo ante*.[99]

In *Akers Motor Lines*, the court held that if the injunction were not granted and the conduct would result in a "hollow formality" of an arbitration process, then the language of the Norris-LaGuardia Act, which expressly forbids injunctive relief must yield to the federal policy favoring

94. *See supra* note 84 and accompanying text.

95. *Id.*

96. 756 F.2d 1048 (4th Cir. 1985).

97. 554 F.2d 115 (4th Cir. 1976).

98. 582 F.2d 1336 (4th Cir. 1978).

99. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048, 1053 (4th Cir. 1985) (citing Lever Bros. Co. v. International Chem. Workers Union, Local 217, 554 F.2d 115, 123 (4th Cir. 1976)).

arbitration.[100]

The court found that if the conduct were not enjoined, then one party could act so as to render the arbitration proceeding meaningless (or a "hollow formality"). In such a situation, the action taken could prevent the arbitrator's decision from restoring the status quo. Where actions, which may irreparably alter the status quo, are possible, the court found that an injunction should be issued to protect that status quo, finding that only then will the arbitrator's decision be meaningful.

This hollow formality test used by the Fourth Circuit is the most logical test to use. Congress has developed a federal policy which favors arbitration. The Supreme Court has furthered this policy with a decision that when arbitration agreements are ambiguous, they are to be interpreted in light of this federal policy and consequently arbitration should occur.[101] Yet, if the courts allow parties to take actions which may irrevocably alter the status quo, then what use is this process when it takes away the power of the arbitrator's decision? It is vital to the integrity of the arbitration procedure that the arbitrator retain the power to render meaningful decisions. In order to do this, the court must have the equitable power to maintain the status quo by issuing necessary injunctions.

VI. MOOTNESS CONCERNS

The Supreme Court should finally settle this issue and officially recognize this power of the district courts. In 1985, the Court denied certiorari to a case[102] which presented the question of whether section 3 of the FAA bars a court from issuing a temporary injunction pending arbitration of an employee contract dispute. Justice White dissented from the denial of certiorari and wrote an opinion that was joined by Justice Blackmun. Justice White noted that state and federal courts are divided on the issue.[103] Additionally, he wrote that since this issue is so frequently litigated and important to arbitration agreements, the Court should resolve it. However, an obstacle to review may be that the question will be moot before any case reaches the Supreme Court. Justice White stated that these cases fit into the exceptions to the general mootness doctrine for cases that are "capable of repetition, yet evading

100. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bradley, 756 F.2d 1048, 1053 (4th Cir. 1985) (quoting Drivers, Chauffeurs, Warehousemen & Helpers Teamsters Local Union No. 71 v. Akers Motor Lines, Inc., 582 F.2d 1336, 1341 (4th Cir. 1978)).

101. Prima Paint Corp. v. Flood & Conklin Mfg. Corp., 388 U.S. 395 (1967).

102. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum, 469 U.S. 1127 (1985).

103. *Id.* at 1129.

review."[104] Therefore, Justice White concluded that unless the Court applied this exception, it would never resolve the issue.[105] However, since two Justices would have granted review in 1985, perhaps the Court will soon grant certiorari in light of the fact that the issue seems to be continually litigated. The Supreme Court needs to render a decision in order to remove doubts as to lower courts' power regarding arbitration and to ensure the continued preferred status that arbitration agreements now have because federal policy favors them.

VII. CONCLUSION

District courts have struggled over the issue of whether the FAA precludes issuing an injunction to maintain the status quo pending arbitration. The language of the FAA and the legislative history do not prevent the court from doing so. If Congress had intended the FAA to take away a court's power, then it would have made that intention clear in the language. Additionally, the Supreme Court has interpreted the main purpose of the FAA to be enforcement of arbitration agreements[106] with a corollary purpose being to move the parties into the arbitration process as quickly as possible.[107]

With these purposes in mind, it seems inconsistent that federal policy favors arbitration, yet would deny courts the power to maintain the status quo. If one side could alter its status and render arbitration meaningless, then it seems rather insignificant to have a policy favoring such meaningless arbitration. Why would such a policy exist if the arbitration were useless? The district courts must have the power to determine the propriety of issuing an injunction. The most logical test to do so is the Fourth Circuit's hollow formality test. This test allows the courts to prevent meaningless arbitrations and continue the federal policy favoring arbitration. Congress must have intended the courts to be able to maintain the status quo and uphold the integrity of the federal policy.

Megan J. F. Williams

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104. *Id.* at 1131.
105. *Id.*
106. Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985).
107. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983).