In the

Supreme Court of the United States

MOSES H. CONE MEMORIAL HOSPITAL Petitioner v. MERCURY CONSTRUCTION CORPORATION	)	No. 81-1203

Washington, D. C.

November 2, 1982

Pages 1 thru 51

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MOSES H. CONE MEMORIAL HOSPITAL, :

Petitioner :

v. : No. 81-1203

MERCURY CONSTRUCTION CORPORATION :

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Washington, D.C.

Tuesday, November 2, 1982

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:00 p.m.

APPEARANCES:

JACK W. FLOYD, ESQ., Greensboro, North Carolina; on behalf of Petitioner.

A.H. GAEDE, JR., ESQ., Birmingham, Alabama; on behalf of Respondent.

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C O N T E N T S

P R O C E E D I N G S

CHIEF JUSTICE BURGER: Mr. Floyd, you may proceed whenever you're ready.

ORAL ARGUMENT OF JACK W. FLOYD, ESQ.

ON BEHALF OF THE PETITIONER

MR. FLOYD: Mr. Chief Justice, and may it please the Court:

The case currently under consideration presents the question of the exercise of the district court's discretion in staying matters pending on its docket in view of a filed state court action between the same parties involving the same issue in both courts.

QUESTION: You didn't put in the word "federal" before that "issue." Is it a federal issue?

MR. FLOYD: It is a federal district court.

QUESTION: I know, but federal issue pending before the courts.

MR. FLOYD: It is not a federal issue, Your Honor.

QUESTION: I wouldn't think you would think it is.

MR. FLOYD: The issue is arbitration provided by both the federal act and the state act.

QUESTION: But your position would be that the consequence is the same in terms of enforcing

arbitration or not enforcing it.

MR. FLOYD: They are, Your Honor.

QUESTION: If the question is whether under the contract between the parties arbitration is required, in this case is it a matter of state law or federal law?

MR. FLOYD: It is to be decided under the Federal Arbitration Act.

QUESTION: I know, but what -- that's the jurisdictional thing for the federal court.

MR. FLOYD: Your Honor, that is both federal and state law. The Federal Arbitration Act --

QUESTION: You mean -- the Federal Aribration Act converts a contract question normally controlled by state law into a federal question?

MR. FLOYD: It is not a federal question in terms of federal --

QUESTION: Suppose a hospital sued a contractor for breach of contract. What law would govern that?

MR. FLOYD: The state law of North Carolina.

QUESTION: Exactly. And if the hospital sued the contractor in state court to enforce an arbitration clause and the question was whether the contract required arbitration or not, it would be state law,

wouldn't it?

MR. FLOYD: Unless the Federal Arbitration Act applies.

QUESTION: I just said the only thing it said -- my question was if they sued him in state court for an order to arbitrate, that's all, to enforce the contract, it would be a state law question.

QUESTION: Don't answer that too quickly.

(Laughter.)

MR. FLOYD: I think my answer is yes, it would be a state law question, and the Federal Arbitration Act is a part of the law of the state of North Carolina.

QUESTION: Okay, but if you sue under the Federal Arbitration Act, then whether or not the construction of the contract is to be decided by federal law or by state law?

MR. FLOYD: I have trouble answering the question.

QUESTION: You should.

MR. FLOYD: In that the construction --

QUESTION: You should have trouble, and you shouldn't hurry.

QUESTION: Is it your position that the state courts are obliged to enforce the Federal Arbitration Act in this setting?

MR. FLOYD: Absolutely, Your Honor.

QUESTION: So to that extent there is a federal statutory question involved.

MR. FLOYD: There is a federal statutory question involved. The federal statute involved is the Federal Arbitration Act which the North Carolina Supreme Court has held is a part of the law of North Carolina under the supremacy clause and must be enforced as any other part of the law of North Carolina would be enforced.

So the dichotomy between federal and state law is confusing in the circumstances. Higher courts have always held that the Federal -- the supremacy clause requires enforcement. The question under the North Carolina Court of Appeals case was not that at all; it was an interpretation of the commerce clause, which was too narrow and overruled ultimately in the Schafer Partnership case in the North Carolina Supreme Court.

The next question involved, and just as important as that one, in my view, is how and when the federal appeals courts may review the exercise of the district judge's discretion.

QUESTION: That really is preliminary in any analytical sense to the Arbitration Act question, isn't it? Because if this question wasn't properly in the

court of appeals, it's not properly here, either.

MR. FLOYD: It is jurisdictional in the court of appeals, and that court, absent jurisdiction, could not proceed. So analytically I think that is the first question that we should discuss.

The facts giving rise to these questions are that on October 8th, 1980, the hospital filed suit in the North Carolina Superior Court of Guilford County in Greensboro against two defendants. First was Mercury Construction Corporation, an Alabama corporation; and second was J.N. Pease & Associates, a North Carolina corporation.

The complaint filed in the Superior Court in North Carolina alleged that some months earlier, Mercury had delivered to Pease, the architect, a document entitled Claim for Equitable Adjustment of Contract Price; that this asserted a claim for some $2 million against the hospital. The hospital had spent some months investigating that claim, had concluded it had no validity, had concluded that the basis for the claim was alleged delays which were the fault of the hospital during a period of construction of about five years on a renovation and new construction project at the hospital.

The complaint in the district court alleged that there was no fault in the hospital concerning

delays of an ongoing hospital operation, renovation and construction project; that if there were delays beyond that which was contemplated by the parties in the beginning, they were the fault either of Mercury or of the architect. And alleged various instances in which the architect was at fault in failing to adjudicate, in failing to pass on decisions of both parties.

The complaint prayed that if it was found that the hospital was liable in any respect, that it sought judgment over against the architect. Mercury, some three weeks later, filed -- or removed the action under the removal statute to the federal court. And curiously, at the same time filed a Section 4 petition under the Federal Arbitration Act.

QUESTION: Was the question involved in the state court suit that was removed, did that have any federal issue in it?

MR. FLOYD: It had no federal issue in it, Your Honor.

QUESTION: And it was going to be controlled wholly by state law; namely, whether the dispute was arbitrable?

MR. FLOYD: No, sir.

QUESTION: What was it?

MR. FLOYD: The question in the state court

suit was -- one of the questions was whether the dispute was arbitrable; you're right.

QUESTION: All right. On that one, it would be a question of state law. And if it was decided then as a matter of state law that the dispute was not arbitrable, that would be the end of -- then that would just be decided by litigation -- by arbitration.

MR. FLOYD: Yes, Your Honor. Under state law or any other law if the decision is that the dispute is not arbitrable, it proceeds to litigation.

QUESTION: Suppose the removal to the federal court was all that had happened, and suppose the removal was justified. Suppose the removal was upheld. Whether the dispute was arbitrable or not would still be a matter of state law, wouldn't it?

MR. FLOYD: A matter of state law when you define it as I've already defined it for Your Honor.

QUESTION: Exactly. It would still be a question -- whether the dispute was arbitrable would be a question of state law.

MR. FLOYD: State law, including the Federal Arbitration Act. That's correct.

QUESTION: How does the Federal Arbitration Act get into it, just because it's removed to federal court?

MR. FLOYD: If the aribtration question arises in a contract which is subject to the Federal Arbitration Act; to-wit: one in commerce, in this context --

QUESTION: Well, it may be that federal courts can enforce promises to aribitrate under the Arbitration Act, but that doesn't mean that whether they're arbitrable or not is a matter of federal law.

MR. FLOYD: They cannot enforce such contracts absent diversity and amount in controversy requirements of the diversity statute. The federal scheme for enforcement of arbitration, under the federal act, contemplates in its genesis that it will be enforced by state courts simply because there is no jurisdiction given to the federal courts except in diversity cases, if you've got a commerce clause kind of contract as opposed to a maritime kind of contract.

So the scheme in the beginning is that who shall enforce arbitration; it must be both federal and state courts because the federal courts are not given jurisdiction or an independent basis of jurisdiction. Therefore, several of the circuits have held there is no federal question jurisdiction under the Federal Arbitration Act.

If you analyze it as what relief is available,

assuming you are under the Federal Arbitration Act, the relief available is either state or federal, --

QUESTION: Yes.

MR. FLOYD: And it makes no difference which court decides the question.

QUESTION: But you say it could be either state law or federal. But there isn't any federal law of contracts, is there?

MR. FLOYD: No federal law of contracts. There's a federal law of arbitration. The law of contracts -- and this contract, incidentally, specifies the garden variety sort of thing; that is, that the law of North Carolina shall apply to its terms and to its interpretation.

QUESTION: And a federal court sitting in diversity would apply North Carolina law to a contract dispute.

MR. FLOYD: Absolutely.

QUESTION: Including whether or not a particular dispute is arbitrable under the contract.

MR. FLOYD: No, Your Honor. I don't think a federal court or a state court would apply general contract law to that provision.

QUESTION: No. But it would be governed by state law as to whether or not the dispute was

arbitrable. In interpreting the contract; namely, did the parties promise to arbitrate -- that's a question of state law.

MR. FLOYD: Your Honor, that's the same kind of question that Justice Fortis wrestled with in the Prima Paint case. You recall that in that case we had a similar provision, and his holding in Prima Paint is that you do not apply the state law to the question of coverage under the Federal Arbitration Act.

QUESTION: Well, I agree with that.

MR. FLOYD: You do apply the arbitration law to that question. And it matters not in this case whether you apply the Uniform Arbitration Act in effect in North Carolina or whether you apply the federal act. Whether you call it federal law or state law has no substantive result.

QUESTION: Mr. Floyd, supposing in a somewhat different situation the North Carolina law had a statute of frauds for arbitration agreements that required them to be in writing and signed by the party to be charged. And there was no such a requirement, of course, in the Federal Aribtration Act. Now, do you think that if a claim is made to arbitrate in North Carolina under a North Carolina contract that that provision of state law is enforceable notwithstanding the provisions of the

Federal Arbitration Act in the prima case?

MR. FLOYD: I assume Your Honor is asking about a contract otherwise in commerce.

QUESTION: Yes.

MR. FLOYD: And therefore, the provisions of the act are invoked. Any provision of state law not compatible with the federal act is not enforceable under the supremacy clause.

QUESTION: How do you know whether it's compatible with the federal act or not?

MR. FLOYD: Well, if the federal act says go arbitrate and the state law says you don't have to for whatever reason in this case, then my answer is you go arbitrate because the federal law is supreme.

QUESTION: Then, Mr. Floyd, are you saying that in this case, -- under Section 4 of the federal statute, as I read it, there are only two issues; one, was there a contract containing an aribtration clause, and I guess that's not in dispute, is it?

MR. FLOYD: There is no dispute about the contract.

QUESTION: And the second issue is did one of the parties refuse to arbitrate, and I guess that's not in dispute; you did refuse to arbitrate. That's your position in the state court, that you don't have to

arbitrate.

MR. FLOYD: We are not in arbitration, obviously --

QUESTION: So you have refused. And aren't those the only two issues the federal judge has to rule on, and doesn't he, then, under the plain language of the statute have a duty to order arbitration?

MR. FLOYD: The answer is yes, once he has conducted the hearing that the act requires.

QUESTION: Why do you need a hearing if there are no disputed issues?

MR. FLOYD: The disputed issues are the making of the agreement.

QUESTION: I thought you said you admitted that, and I think your pleadings do.

MR. FLOYD: The agreement, Your Honor, --

QUESTION: In this case, neither of those issues is disputed.

MR. FLOYD: The agreement is a book that long.

QUESTION: I understand. But you don't deny it contains an arbitration provision.

MR. FLOYD: I do not deny it contains an arbitration clause --

QUESTION: Therefore, the first condition of the statute is satisfied. And you also don't deny that

you refused to arbitrate.

QUESTION: Well, not if the particular dispute isn't covered by the arbitration clause, which is your position, isn't it?

MR. FLOYD: That's correct. To say I agree to arbitrate does not mean that I agree to arbitrate every conceivable dispute. For instance, the federal cases are clear that if we deal with an antitrust case, regardless of an agreement to arbitrate you don't arbitrate it. A patent case you don't arbitrate it, even though it may be subject to the act.

Further, the Pima Paint case says you look to the agreement to determine what the parties agreed to arbitrate. Our contention here is we never agreed to arbitrate a dispute arising after the construction project of five years. If you look at the contract clause to arbitrate; that is, the agreement to arbitrate clause, you will find that it is not an unconditional agreement to arbitrate; it is cross-referenced. The Fourth Circuit opinion leaves out the cross reference.

It is cross-referenced to Article II, which says arbitration can be had only when -- Article II deals with resolution of disputes during the ongoing of construction. It says that you cannot arbitrate, we do not agree to arbitrate unless during construction. It

is referred to the architect for decision. Then within a reasonable time, --

QUESTION: Isn't those -- aren't those questions that the arbitrator will review?

MR. FLOYD: No, Your Honor. An agreement that says I will arbitrate on Wednesday; if you seek to arbitrate on Thursday, have you agreed to arbitrate? Answer: no. You have entered a conditional agreement to arbitrate, and you don't go to an architect to find out whether the conditions preceding are met. By the time you're doing that, you're already in arbitration.

So my answer to that -- and I'd like to pause for a moment and state that we have never been able to have the district court judge make this kind of inquiry. He has never reached it.

QUESTION: Suppose that the hospital had been engaged in a dispute with another contractor under the very same words of another contract and the state court had ruled that as a matter of state law, this particular kind of a dispute that you're talking about now was not subject to the arbitration clause in the contract. Now, a federal court is deciding the issue. Wouldn't the federal court have to follow the state court as a matter of state law?

If the state court has already said as a

matter of state law, language like this in the contract will not subject to arbitration the kind of a dispute that is involved in this case, wouldn't the federal court have to follow it?

MR. FLOYD: I don't think a federal court --

QUESTION: You should say yes, but --

MR. FLOYD: I don't think a federal court would apply state law. That's where my hangup is. You see, --

QUESTION: You go ahead. You run your own --

QUESTION: Why are you hung up on that? Do you think Prima goes that far?

MR. FLOYD: I think Prima requires that the court, regardless of state or federal, --

QUESTION: Well, that doesn't help your case, does it? Why do you concede so much to Prima?

MR. FLOYD: Because I'm afraid that that's the way the law's developed. I'm afraid that it doesn't matter which court decides.

QUESTION: Well, it develops through cases and decisions of this Court such as the one before it right now.

MR. FLOYD: Yes, Your Honor.

I believe that if a state court has decided on the arbitrability question that it is not arbitrable,

that that will be a final determination for all purposes. And a party can obtain review of that through the state court appeals process.

I don't think we have a situation where we ought to have multiple federal courts and multiple state courts racing to judgment on the same question. That just does not comport with common sense. I think once a party has had determined his right -- and in this instance, there is no question but what Mercury has a right to have the question of arbitration decided by a court of competent jurisdiction. Mercury has no right to select its court. It was the defendant in this case.

Mercury has filed a duplicative litigation in this case in federal court. The parties have always been able to go to the court in which this action was instituted and obtain a speedy adjudication of that very right.

The question presented, therefore, is not whether Mercury has been deprived of its right of prompt decision. What Mercury is complaining about is it's been deprived of the right to choose the forum, and that's the only difference. It has no right to choose the forum. Wise administration of justice compels the conclusion that you don't keep racing to judgment whenever you have multiple litigations.

So the question is which court should wait on the other. In the circumstances here, it makes sense that the federal court should wait on the state. All the traditional considerations are present.

If I may now address the question of appealability. The central point here is that the stay order is not a final order. The cases in this Court are so recent that I don't think they require extensive discussion.

In this case, the judge was free, and I think designedly so -- he did not dismiss the case -- he was free, if Mercury comes back in and says I can't get a decision -- in other words, my prompt hearing is being denied me in the state court -- the judge could clearly have lifted his stay order and proceeded to the merits. But we didn't have time to determine that the way this case went. There's no doubt but that he was free to do so.

If Mercury was being denied its right to a prompt hearing before a court of competent jurisdiction, he probably would have lifted his stay order. There can be no doubt, therefore, that this is not a final order.

In the court of appeals, the court applied its practical finality analysis. I submit to this honorable Court that the "death knell" in Coopers & Lybrand is not

materially distinguishable from the practical finality rule applied here. The point is that Congress did not intend the courts of appeals to fashion on a case-by-case basis their own jurisdiction. When Congress enacted Section 1291 that appeal shall lie only from final decisions, that does not include stay orders.

The court of appeals should not analyze its jurisdiction on a case-by-case basis; that is a mini-trial all over again, just as the death knell economic inquiry was a mini-trial all over again.

QUESTION: If we were to agree with you on the appealability issue, then would the respondent still be entitled to seek mandamus in the court of appeals which they originally sought as an alternate to the appeal?

MR. FLOYD: Your Honor, I think the alternate was the appeal to mandamus. They sought mandamus, or in the alternative, gave notice of appeal.

QUESTION: Well, they got appeal.

MR. FLOYD: They got appeal.

QUESTION: And if we say they shouldn't have gotten the appeal, would they be free to go back to the court of appeals and seek mandamus?

MR. FLOYD: I think the court of appeals denied mandamus in this case. The court of appeals' heading is In Re Mercury, which is the mandamus case, in

Mercury against Cone. I think the implication of the court of appeals' opinion is that we have denied mandamus.

QUESTION: But of course, one of the reasons you deny mandamus is if you think an appeal is available. Mandamus isn't a substitute for an appeal.

MR. FLOYD: That is the court's --

QUESTION: If the court of appeals now saw that no appeal was available, might it not be at least more inclined than it was to grant mandamus?

MR. FLOYD: It might be, Your Honor. It might be. I submit that there's no ground for mandamus either, however. And as this Court said in Allied Chemical back in 1980, mandamus in discretionary orders -- what, never? Well, hardly ever. This is not a case where the court of appeals should, by mandamus, interfere with the trial court's running of its docket. So while yes, conceivably the proper result would be to send it back and let the court of appeals reconsider, in view of its ambiguous ruling on mandamus, I submit that should not and need not be done in this case. The opinion of the court of appeals rejects mandamus when it finds the matter appealable. To reconsider in light of this Court's rulings on mandamus in discretionary order cases, would be a waste of the parties' and the court's

time.

I submit that the proper result in this Court is to reverse the court of appeals and direct the case be remanded subject to the stay order; that is, affirm Judge Ward's stay order.

QUESTION: I have another question if I may, Mr. Floyd. May I go back to the question that I was asking you before about the issues raised by your opponent's petition in the federal court for an order directing aribtration. Your response to that petition alleged that Mercury was in default in proceeding with arbitration and in complying with the express conditions of the agreement to arbitrate. I'm reading from your response.

You do not respond, as I read your response, by saying that the dispute in question is not covered by the arbitration clause. Rather, you say they were in default in meeting some of the conditions to arbitration. And would not that kind of issue be appropriately submitted to the arbitrator?

MR. FLOYD: I think not, Your Honor.

QUESTION: You see the distinction I'm trying to draw?

MR. FLOYD: I do. If my allegation is read to be solely Mercury did not move fast enough to cause

aribtration to take place, then I am alleging one of the time delay kinds of defenses to arbitration.

QUESTION: Correct.

MR. FLOYD: That the federal courts have largely overruled. That is, that sort of dispute is for the arbitrator.

QUESTION: Correct.

MR. FLOYD: That is not what is intended by the language that you read. When I say Mercury has failed to comply with the conditions, the condition I'm talking about is the contingent nature of the agreement to arbitrate. And the point is you can't decide that without getting into a question of what was the intent of the parties. If you say I'll arbitrate but not if, or not unless a condition is complied with, that is not the agreement to arbitrate that must in all instances be submitted to arbitrate.

QUESTION: It was a condition precedent other than timeliness that they failed to comply with. One is you say they're in default, I gather you say because they didn't act with sufficient promptness. Is there some other condition that --

MR. FLOYD: Because they did not submit the dispute to the arbitrator during the course of construction.

QUESTION: Well, that's back to timeliness.

MR. FLOYD: No, sir. Submit the dispute to the architect, I'm sorry, I misspoke. There are two material provisions which are conditions precedent to Cones' agreement to arbitrate. One is Article 2 of our contract deals with how you conduct yourself during construction. And that's very important to the owner.

QUESTION: I understand. And you're saying that one of the conditions is before they can request arbitration they must submit the dispute to the architect.

MR. FLOYD: During the process of construction.

QUESTION: And there's a factual dispute as to whether or not they did that.

MR. FLOYD: Yes, sir.

QUESTION: And you're saying that's --

MR. FLOYD: Well, there's no factual dispute. They did not.

QUESTION: You're saying that's an issue that the judge must decide, not the arbitrator.

MR. FLOYD: That's correct, Your Honor. That's correct. It's a condition precedent issue. That is, I agree to arbitrate but only if.

QUESTION: Is the contract in the papers before us?

MR. FLOYD: The entire contract is not. As I say, it's a large book.

QUESTION: Is the portion of the contract that describes this condition you've just discussed --

MR. FLOYD: It is, Your Honor.

QUESTION: Can you tell me where?

MR. FLOYD: It's in the Joint Appendix, JA28 begins the provisions of the contract. And I might emphasize that that is not, by any means, all of the provisions of the contract.

QUESTION: Thank you.

MR. FLOYD: I feel like I shouldn't sit down without mentioning this Court's decision in Colorado River and in the Will case. This case, on the question of the propriety of the stay, is stronger than either of those cases. That is, in this case, the circumstances compelled stay much more clearly than in either of those cases. In Will you had a question of exclusive jurisdiction of the court. Simply not present here. Nevertheless, the stay was upheld.

In Colorado River you had federal interest more deeply involved than we have here, and this Court sanctioned and affirmed a dismissal, not a stay.

QUESTION: Well, your opponent says that the same issue of federal law was involved in both the state

suit and the federal suit. But if the issue is arbitrability, it seems to me that I don't read Prima Paint as saying that the question of arbitrability is a matter of federal law, of statutory law. It's a question of whatever law governs the contract.

And if arbitrability is really the major issue which you seem to think it is, -- is that right?

MR. FLOYD: It's the only issue in the Section 4 of the petition.

QUESTION: Well, if the arbitrability is the central issue, and if that's a matter of state law, then this case might even have been subject to a motion to stay under Pullman. That is, if this case is subject to state law, and we ought to find out how the state courts construe this kind of a local contract.

MR. FLOYD: I would certainly agree with that. I do not read Justice Fortis's opinion the same way the Court does, but hopefully, you read it better than I do. That is certainly the result I want.

QUESTION: I know, but the -- well, we don't need to argue.

CHIEF JUSTICE BURGER: If you want to save any time for rebuttal, you'd better save it.

MR. FLOYD: I do not care for rebuttal. I've said what I have to say. Thank you.

QUESTION: Good for you.

(Laughter.)

CHIEF JUSTICE BURGER: Mr. Gaede.

ORAL ARGUMENT OF A.H. GAEDE, JR., ESQ.

ON BEHALF OF THE RESPONDENT

MR. GAEDE: Mr. Chief Justice, and may it please the Court:

If arbitration is to become the effective speedy alternative to litigation that Congress intended by the Federal Arbitration Act, and that the present crunch of litigation in our court system seems to compel, then we believe that this Court should affirm the decision of the Fourth Circuit Court of Appeals. To reverse and reinstate the district court's decision would undercut the vitality and viability of arbitration as an alternative to court litigation.

Mercury, my client in this case, went into the federal court and filed an action under Section 4 of the Federal Arbitration Act, an action that was a right granted to it by Congress in the Federal Arbitration Act. And that section, Section 4, says that if you establish two things, as Justice Stevens pointed out, one, an agreement to arbitrate, and two, a failure on the other party to arbitrate --

QUESTION: Well, the question is the agreement

to arbitrate. A lot of contracts have arbitration clauses in them, but not every dispute that is brought up between the parties is covered by the arbitration clause. That's routine.

MR. GAEDE: Your Honor, I believe --

QUESTION: But -- just bear with me a minute. Suppose that there is a contract that clearly specifies a certain category of issues that are subject to arbitration, and some other issues that are not subject to arbitration. Now, -- and the people get into an argument about which category of particular disputes falls under. Is that a matter of state law or federal law?

MR. GAEDE: Your Honor, in our view that would be a matter of federal law.

QUESTION: Why would that be?

MR. GAEDE: Because under the Federal Arbitration Act, the courts are charged to -- if they find an agreement to arbitrate --

QUESTION: They can find it, but the question is what law governs that determination. There are a lot of cases arising in federal law. You can have a diversity action seeking specific performance on a contract, and the applicable law is going to be state law.

MR. GAEDE: Your Honor, as the Federal Arbitration Act has developed in the circuit courts, the circuit courts have developed a body of substantitve federal law for the purpose of interpreting the Federal Arbitration Act.

QUESTION: Well, that may be so, but is it a body of federal law interpreting contracts that otherwise would be governed by state law?

MR. GAEDE: It is a body of law for interpreting the enforceability of arbitration agreements. If, for example, Justice White, --

QUESTION: But if it's an agreement.

QUESTION: Maybe that's --

MR. GAEDE: I can agree with you very easily, Your Honor, that if it says disputes involving X are not subject to arbitration, then clearly, there's no agreement to arbitrate. No one would dispute that. And if the arbitration clause says this clause is applicable only to disputes A, B, C and D, then that is --

QUESTION: But if the contract says X disputes are subject to arbitration and Y disputes are not, but then there's an argument about whether it's X or Y, what law governs?

MR. GAEDE: I believe that the -- I believe that properly interpreted, the federal substantive law

should apply, but in most instances that would be, I suspect, the adoption of state law.

QUESTION: I would think they would be governed by --

QUESTION: Isn't that a contract question?

MR. GAEDE: That would be a contract question.

QUESTION: Then where did you get federal substantive law of contracts, which is the answer you just gave.

MR. GAEDE: There are certain situations where federal courts have, in effect, adopted a federal substantive law of contracts.

QUESTION: Well, what cases from this Court support that in this particular situation?

MR. GAEDE: In this particular situation I think the Prima Paint case --

QUESTION: I thought Prima didn't address that question as to what law would govern if you were trying to determine whether or not the dispute between the parties was arbitrable.

QUESTION: That was conceded it was arbitrable in Prima Paint.

MR. GAEDE: I have to -- I will agree, Your Honor, that Prima Paint did not deal directly with that question, but I think the fair inference from Prima

Paint is that that would be the result.

QUESTION: Well, if it was conceded that it was arbitrable, Prima Paint didn't hav to decide that question. Isn't that correct?

MR. GAEDE: That is certainly correct, yes, sir.

To try to return to what I think is the central point on this part of the case, Congress in its wisdom gave to parties to agreements to arbitrate the right to go into federal court and to have a hearing. And if based on that hearing the federal court was obligated -- if it found that there was an agreement to arbitrate and if it found that there was a failure to comply, to compel arbitration.

If this Court has a serious question about whether or not there was an agreement to arbitrate, which we don't think there was -- the Fourth Circuit certainly didn't have any problem with that -- but if that is a question, then the proper remedy would be to remand the case to the state court and direct that the state court hold a hearing on that question -- I mean, to the federal court -- and direct the federal court to hold a hearing on that question. As is our right under Section 4 of the Federal Arbitration Act.

QUESTION: Supposing if we were to follow that

we would have to tell the district court of North Carolina to apply substantive state law in determining whether or not the particular agreement did render it arbitrable. And if that's the case, wouldn't it be much simpler to do just what the district judge said; instead of having the federal court look over to state law and try to find what conclusion the state courts would reach, let the companion state court proceeding produce the result in its normal course?

MR. GAEDE: Your Honor, I think not for several reasons. The first is that generally, the federal courts are far more familiar with the interpretation and enforcement of the Federal Arbitration Act. Second, we have a congressionally granted right to a hearing in the federal courts on that issue. And as a matter of fact, the form of relief, although I don't make a big point out of this, the form of relief is different.

Under Section 4, which only federal district courts can apply, we are entitled to an order compelling arbitration. Under the Section 3, which would be the federal remedy in the state court case, the remedy there is to stay that case, pending arbitration. So we do think there is a difference in the remedies, and that different was recognized in Prima Paint. For example,

the court in Prima Paint specifically referred to Section 4 as applying a federal remedy. And we think that is very important in this case.

QUESTION: The question here is not embraced in the proposition that there's an agreement to arbitrate. Everyone concedes there's an agreement to arbitrate. The question is to arbitrate what, and that issue arises under a contract which is a matter of state law, is it not? The interpretation of the contract is a matter of state law.

MR. GAEDE: Yes, Your Honor, I agree with that.

QUESTION: And isn't the state court better able to do that than to have a federal court do it under a diversity route?

MR. GAEDE: I don't believe so, Your Honor.

QUESTION: And that's what the district court did decide, didn't he?

MR. GAEDE: I think the district court in this case, in a sense, abdicated its responsibility. I think the district court came close to the situation in Thermtron, in this case, quite frankly, because you had a situation where the court was obligated to proceed forward.

Section 4 is written in very mandatory terms, Mr. Chief Justice, and we feel as though the district

court was obligated to go forward.

Let me point out one thing if I might. In the record, it is very clear in the affidavits that were filed by our client to the district court, it is clear that the contractor went to the architect during the course of construction and said we will have claims, and the architect said, we understand you will have claims, and we request that you withhold the filing of those claims until after construction is completed. That is undisputed in the record.

Now, under those circumstances, I think that renders the kind of argument that Mr. Floyd is making meaningless. I don't agree with his argument to start with, but even if that was a valid argument, his condition precedent argument in this case.

QUESTION: Well, only part of it I think, because one branch of his argument is that it's not ripe for arbitration until it's been submitted to the architect and passed on by the architect. And it's only after that that you can submit it for arbitration.

MR. GAEDE: Your Honor, in the record, there's also an affidavit by the architect which says if he had made a decision and had advised the hospital of that decision, that may client was entitled to be paid between $600,000 and $1,200,000 prior to the time that

the hospital went into state court in North Carolina.

As a matter of fact, it's been our view --

QUESTION: Was that affidavit before the federal judge at the time you presented your petition for certiorari?

MR. GAEDE: Yes, it was.

QUESTION: What?

MR. GAEDE: Excuse me, Your Honor, I misspoke. It was not before him at the time we presented our petition. It was before him at the time that he ruled on the petition.

QUESTION: I see. And they did not controvert that affidavit?

MR. GAEDE: They did not.

To proceed, --

QUESTION: Just tell me, where is that in the record? Is that in the printed papers before us?

MR. GAEDE: Yes, sir, it's in the Joint Appendix, at page 40, as I recall, Your Honor. Yes, it's Mr. Ward's affidavit in the Joint Appendix at pages 38 through 40.

I might proceed forward. And I think the factual background of this case is important because I think the factual background of this case gets to the other issue, both issues, which is the issue of

appealability or finality, and to the issue of the judge's right to stay.

In this situation, as I said, Mercury had notified the architect of the claims and had been advised to hold off. We did. We then gave the hospital notice of the claims and over a period of months, there was conversation between the hospital and our client about those claims.

As the record will show, and as the uncontested affidavit of Mr. Bynam in the record will show, a meeting had been set between the parties for further discussion of the claims. And when that meeting was a week off, we called to confirm the meeting, the hospital said well, we'll call you back in a few days and let you know. They called back in two days and said we're filing a lawsuit against you tomorrow in state court, taking the position that you have failed to arbitrate.

Justices, at that time we had no right to file our suit in federal court under Section 4. Until that time. One of the conditions of Section 4 relief is the failure of the other party to comply with an agreement to arbitrate. Until the hospital went into the state court we had no notice that they would fail to comply with the arbitration agreement. That was our first

notice.

Mr. Floyd in his argument said that we waited for three weeks to proceed with our Section 4 petition. He's right, we did wait for three weeks, and the reason we waited for three weeks was that the hospital went to the state court ex parte without notice to us and obtained an injunction from a North Carolina court enjoining our client from seeking to enforce its rights to arbitration.

We had that decision set aside on the basis of this Court's decisions in Atomic General and other cases, Donovan and Atomic General. And then immediately proceeded to file our Section 4 petition.

What happened when the district court stayed the Section 4 petition was that he, in effect, finally determined that my client would not be entitled to the hearing that Congress had guaranteed it under Section 4 of the Act.

QUESTION: Are you saying that the district court, in entering that order, ruled out the possibility that if after three months you could show that there was simply no progress made in the state court and that your opponent was blocking normal process, that the district court might not entertain an application to lift the stay?

MR. GAEDE: Your Honor, I suppose that it is conceivable that the state court could have done nothing whatsoever and that we would have attempted to come back in and have the stay lifted. I also assume that it's possible that the state court could have ruled that the Federal Arbitration Act didn't apply, and that we could have tried to come back in and have the stay lifted.

But I think that those are two fairly extreme circumstances, and certainly as a practical matter -- I think the Fourth Circuit was right that as a practical matter, assuming that the state court is going to move with any kind of dispatch, that what has really happened is that the federal court has denied us the right to have our Section 4 right enforced in the federal court.

I can conceive of examples of where that wouldn't happen, but I think as a practical matter, Justice Rehnquist, that belies the reality of the situation. And I might point out two other things at this point.

One is that the stay order did not say I am staying the Section 4 case pending a determination of the question as to arbitrability. It said I am staying the Section 4 case pending a determination of the entire case pending in a North Carolina court.

The second thing is that at the time the

district court made its ruling, it had before it affidavits that had been filed on the issue of arbitration under Section 4, which is the normal way in my experience that that issue is dealt with. And the issue had been fully briefed. No such affidavits and no such briefing had taken place in the state court.

So at that particular point in time, more activity had occurred in the district court, the federal district court, than had occurred in the state court. And, as a matter of fact, as the Fourth Circuit found, the district court had before it all the information that it needed or was necessary to make an order that our client was entitled to arbitration and that the district court should have compelled arbitration.

QUESTION: Suppose under the state law of contracts matters of timeliness, waiver and latches are matters for a court to decide. A plaintiff sues to compel arbitration and the defendant says well, you've waived it or it's untimely or the demand is untimely or there've been latches or something. And the state court says well, this go to arbitrability as to whether this particular dispute is any longer arbitrable, and it's a matter of state law. Would that be a matter of state law then?

MR. GAEDE: I believe not, Your Honor. I

believe that almost every court that I'm aware of that has ruled on that question has held that that is an issue for --

QUESTION: Despite what the state law -- how it would come out in a suit for damages in a state court.

MR. GAEDE: Yes.

QUESTION: The state law must decide it as a federal matter.

MR. GAEDE: Yes, Your Honor. And I believe that the circuit courts of appeals decisions and almost every final state court that has ultimately reached that question are consistent in that regard.

QUESTION: But is that an issue that's normally decided by the court or by the abitrator?

MR. GAEDE: That's an issue that's almost, without fail, decided by the arbitrators.

QUESTION: The court refers those issues to the arbitrator. The federal rule is that issues such as that shall be decided by the arbitrator.

MR. GAEDE: That is correct, sir.

QUESTION: And that that prevails over any contrary state rule where there's a demand for arbitration.

MR. GAEDE: Yes, Your Honor. As long as the contract in which the arbitration clause is contained is

a contract that affects commerce, as defined within the Federal Arbitration Act.

QUESTION: Yes, I understand that. Obviously, that has to be present or the federal law doesn't apply at all.

MR. GAEDE: That is correct. That's a necessary predicate to proceeding.

If I could, I would like to turn for a minute to the question of appealability under Section 1291. As I said in my answer to Justice Rehnquist's questions, I believe that as a practical matter, and looking at the realities of the situation, the district court's stay order effectively terminated our client's petition under Section 4 of the Federal Arbitration Act to compel arbitration and denied us the right to a hearing on that petition.

In so holding, the Fourth Circuit, in our view, followed the rule of this Court that has been applied for many years, and that is that finality is to be given a practical rather than a technical construction.

The underpinning or the basis for the finality rule, as stated in the decisions of this Court, is that you will not have piecemeal reviews. Piecemeal reviews during the process of a case. Not piecemeal litigation,

not the matter of whether we've got two cases going on, but a piecemeal review in the case that we're talking about.

In this situation, the order that was entered by the district court effectively stopped that case forever. And there is no piecemeal review by my client when we went to the Fourth Circuit. What we went to the Fourth Circuit for was to have a determination on the only issue that existed in the case, and that is: will we be entitled to a hearing before the district court in order to determine whether or not we were entitled to an order compelling arbitration. That's the only issue.

This is not like the many other cases that have come before this Court where you had a collateral issue, like in Livesay. You had an issue that deals with the class. But the underlying action of the plaintiff could still go forward, as this Court found. And in other cases before this Court.

QUESTION: But the theory of the "death knell" rule, to the extant that it has been adopted by courts of appeals before in Coopers & Lybrand v. Livesay, was the same sort of practical analysis as yours, wasn't it; that as a practical matter, the case is over when they refused to certify the class because all the plaintiff has at stake is $30.00.

MR. GAEDE: Your Honor, but that underlying cause of action still exists. In our case, when the district court acted as it did, then the question of whether or not we would be entitled to a hearing in the district court is forever settled. Once the state court goes off and rules on that question, then there's nothing left for us to do.

QUESTION: But if the state court doesn't rule, you did say that you thought the judge might entertain a motion to --

MR. GAEDE: If the state court sat on it for a long time, the district court might. But even in that situation, Justice Rehnquist, I am denied the remedy that Congress in its wisdom said that I should have under Section 4 of the Act.

QUESTION: Well, I suppose the state court could enforce the remedies, couldn't it?

MR. GAEDE: The state court does not -- under the Federal Arbitration Act, Justice O'Connor, only the federal court can issue an order compelling arbitration. Under Section 3 any court in which an action is pending has the right to stay that action pending arbitration.

I don't want to make a -- I think that's an important distinction, and as I said it's a distinction

that was recognized in Prima Paint, it was also a distinction that this Court recognized in the Shenferough case back in the 1930s. So I think it's a distinction with meaning. It's not a meaningless distinction.

I might add that North Carolina, after this case was decided by the district court, did enter a case that said the Federal Arbitration Act would be the law of that state, but there are other states at this time that do not do that. As a matter of fact, my own state of Alabama does not recognize it right now, and the Supreme Court of Minnesota, in a recent case decided this summer, the Thayer case, has held that the Federal Arbitration Act is not to apply even though commerce was admitted in that case.

So, I think we've got a mixed bag of ways in which states might or might not rule on these questions, and we think it is very important if arbitration is to become a meaningful way to deal with disputes, commercial disputes, that it is very important that to the extent possible and to the extent that jurisdiction is granted to them, that the federal courts deal with arbitration questions and develop a body of law that will be uniform and will put some meaning out of what, quite frankly, now, in many situations, is chaos.

QUESTION: I don't mean to bring this up time and again, but suppose there is a real honest question as to whether under the language in a contract a particular dispute is arbitrable or not. Now, let's also suppose that contrary perhaps to what you would say

that that issue was a matter of state law. Just suppose that.

And then there is a pending state court issue on the same state law question, and then there is a diversity action in the federal court seeking to invoke the Federal Arbitration Act, and the judge says, well, I think this coverage question, this arbitrability question, is a matter of state law. There is a case pending in state court, already pending there, and it is at issue. I am going to stay.

Do you think that would be an abuse of discretion or just flatly contrary to the Federal Arbitration Act?

MR. GAEDE: Your Honor, I believe that that would be contrary to the intent and purpose of the Federal Arbitration Act, and I believe that Congress in its wisdom, having granted --

QUESTION: It just wanted the federal courts to just take charge of arbitration cases.

MR. GAEDE: I think to the extent that the underlying jurisdiction was available, the answer to that is yes.

QUESTION: Do you have to have a diversity case to get in federal court under the Arbitration Act?

MR. GAEDE: You don't have to have a diversity

case, but you have to have a basis for jurisdiction other than a federal question of a basis of jurisdiction.

QUESTION: Well, the Federal Arbitration Act is not a jurisdictional statute. Is that right?

MR. GAEDGE: That's correct. That is correct.

QUESTION: All right.

MR. GAEDE: It does not set up its own independent jurisdiction --

QUESTION: So suppose all the parties are -- well, if you think that -- if the coverage question, the arbitrability question is a matter of federal law, why wouldn't any action to enforce a contract, promise to arbitrate under the Federal Arbitration Act, why wouldn't that necessarily be arising under federal law?

MR. GAEDE: Your Honor, we believe that it is an issue that is to be determined by federal substantive law --

QUESTION: Well, if it is --

MR. GAEDE: -- but if it happens to be decided in the state court, the state court is obligated to apply that federal substantive law. And as Mr. Floyd said, that is what the North Carolina Supreme Court has held subsequent to this case, and what most other courts have held.

To return for a moment to the question of appealability, this is not a piecemeal appeal. This is an appeal of the only issue that exists. And the Gillespie case, we think, has application here. I understand that in Livesay, this Court said that we want to make sure that the courts understand that Gillespie is limited, a limited decision, but we think that if Gillespie is ever going to have any application, that this is the kind of case to which it ought to apply, and we have cited in our brief a number of cases where the circuit courts have applied Gillespie in a limited way to take appeal of stay orders.

In addition, we think the Cohen case is applicable to this situation, the collateral order rule in the Cohen case. We were denied the right to a hearing, which in our view was finally denied to us. That is an important question. It is an important federal question. It is an important question to people who in our situation are trying to enforce arbitration agreements.

And finally, that decision was unreviewable on appeal, because once the matter went to the state court and was determined by the state court, there is nothing for an appeal to the circuit court, and as a matter of fact, if the circuit court and if the state court finds

the case -- decides the case on the arbitration question, then there is no right of appeal within the federal system to us to a circuit court.

Obviously, it is possible for the case to wind its way up through the state court system and then take a discretionary appeal to this Court, but that is a very difficult and very torturous route.

I would like to turn for one minute, if I could, to the stay question, because I think that what Mr. Floyd and the hospital are suggesting here turns Colorado River upside down. In Colorado River, this Court held that unless there were unusual circumstances, the federal court could not defer its jurisdiction. What the hospital is really arguing, we think, is that the mere fact of the prior filing of the case in the state court system requires that the case be referred back to the state court system.

If you look at the facts in Colorado River, you had the McCarren Act in the Colorado River, which indicated that these water right cases should be decided in the state courts. As a matter of fact, there was even a question before this Court as to whether or not the federal court still had jurisdiction. That was the first issue this Court decided.

There is no such thing in this case. As a

matter of fact, exactly to the contrary. This Section 4 is a right -- granted a right to my client to have a hearing in federal court.

The second thing is that in Colorado River you had a res, the water rights. There is no res in this situation. There is no similar existing body of property to be dealt with. And in the Colorado River, there was a very -- they emphasized there were a thousand defendants in the state court case, and that they were 300 miles apart, all of these factors. That is not true in this case. Both cases are in the courts in the county where Greensboro, North Carolina, resides.

The only factor in this case that is similar to Colorado River or that Colorado River relied on is the matter of priority of filing, and we do not believe that the simple matter of priority of filing should be determined.

On the issue of priority of filing, I would like to point out again that we as a party trying to seek to enforce our Section 4 rights do not have the right to go into court and enforce those rights until the other party has declined to arbitrate. The only solution that we had in this situation absent what happened is to ignore the fact that we were in

discussions with the hospital about our claims, ignore that, file our arbitration demand, and then see whether or not they would resist it or not.

Thank you, Your Honor.

CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 1:59 p.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of:

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81-1203

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BY Pine Hammond

(REPORTER)