

# Whole Court Rules That Arbitral Claims Must be Adjudicated in Bits and Pieces

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## 1. Introduction

In *KPMG LLP v Cocchi*<sup>1</sup> the United States Supreme Court issued a per curiam opinion to re-emphasize that when a lawsuit asserts multiple causes of action, a US court must evaluate the arbitrability of each claim separately, and compel arbitration of the individual claims subject to arbitration, even if this will lead to piecemeal litigation. A lawsuit may involve a mixture of arbitrable and non-arbitrable claims because, for instance, only certain causes of action fall within the scope of the arbitration agreement, as occurred in *KPMG*, or because some of the instruments in a single transaction, such as a personal guarantee, do not provide for arbitration.

## 2. Background to *KPMG v Cocchi*

The underlying claims in the lawsuit stemmed from the financier Bernie Madoff's Ponzi scheme, the largest financial fraud in US history. The plaintiffs, who lost millions of dollars from limited partnerships that invested with Mr Madoff, filed claims in Florida state court against the limited partnership managers and their outside auditors, KPMG. The investors asserted four state law causes of action against KPMG: (i) negligent misrepresentation; (ii) violation of the Florida Deceptive and Unfair Trade Practices Act (FDUTPA); (iii) professional malpractice; and (iv) aiding and abetting a breach of fiduciary duty. The investors' claims variously contended that KPMG failed to use proper auditing standards with respect to the financial statements of the partnerships.

KPMG moved to compel arbitration of all four claims based on its audit services agreement with the limited partnership managers, which required arbitration of "any dispute or claim involving any person or entity for whose benefit the services in question are or were provided". The Florida state court denied KPMG's motion to compel and an intermediate appellate Florida state court affirmed. The Florida courts held that because the plaintiffs had not expressly assented to the audit services agreement, under Delaware state law (which all parties agreed applied), the arbitration clause could only be enforced if the plaintiffs' claims were "derivative". According to the courts, the claims would be "derivative" of the audit services agreement if they arose from the services KPMG performed for the managers pursuant to that agreement.

The Florida state courts determined that two of the claims (negligent misrepresentation and FDUTPA) were "direct" and therefore not subject to arbitration. Neither the Florida trial court nor the Florida court of appeals addressed the arbitrability of the two remaining claims. KPMG filed an unsuccessful motion for rehearing with the court of appeals, arguing that

"if any claim is derivative, then that claim is subject to binding arbitration, and the remaining claims must be stayed pending arbitration because all of plaintiffs' claims involve the same issues".<sup>2</sup>

<sup>1</sup> 132 S. Ct. 23, 25–26 (2011).

<sup>2</sup> Pet. for Writ of Certiorari, *KPMG* 132 S. Ct. 23, No.10-1521) at 13, available at: <http://sblog.s3.amazonaws.com/wp-content/uploads/2011/11/KPMGPetition.pdf> [Accessed June 4, 2012].

KPMG then successfully appealed to the US Supreme Court under 28 USC s.1257(a), which allows for review of a final judgment rendered by the highest court of a state that draws into question the validity of a US statute,<sup>3</sup> here the Federal Arbitration Act.

### 3. The Decision of the Supreme Court

The US Supreme Court accepted review of this case to underline language from an earlier opinion. In *KPMG*, the court stated that when a dispute presents multiple claims, some arbitrable and some not, a court must send the arbitral claims to arbitration even if doing so will lead to “piecemeal litigation”.<sup>4</sup> Citing the Federal Arbitration Act s.2 and its earlier holding in *Dean Witter*, the Supreme Court in *KPMG* reiterated that

“the Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed”.<sup>5</sup>

With a stiff reminder to the court below that a

“court may not issue a blanket refusal to compel arbitration merely on the grounds that some of the claims could be resolved by the court without arbitration”,<sup>6</sup>

the Supreme Court vacated the judgment of the Florida appellate court and remanded the case to that court with directions to examine whether the two remaining claims require arbitration.

### 4. Remaining Uncertainty

*KPMG* provides unequivocal direction to litigants and lower courts as to the proper analysis for cases involving a mixture of arbitrable and non-arbitrable claims. However, to the extent that litigants like *KPMG* seek to stay the non-arbitral claims pending arbitration of the arbitrable ones, see Pet. for Writ of Certiorari, *KPMG*,<sup>7</sup> the Supreme Court provides no additional guidance. While the *KPMG* decision restates that courts may not consider the “inefficient maintenance of separate proceedings in different forums”,<sup>8</sup> it offers no instruction on the proper procedures to co-ordinate the separate proceedings. It seems inevitable that litigants will call on the High Court to elaborate further on this subject.

<sup>3</sup> *KPMG* could not seek review in Florida’s highest state court, the Florida Supreme Court, because that court has “decided that it lacks jurisdiction by appeal to consider per curiam denials of certiorari by the Florida District Court of Appeal”: *Nash v Fla Indus Comm’n*, 389 U.S. 235, 238 n.1(1967); Fla. Const. art.5, §3(b).

<sup>4</sup> *KPMG* 132 S. Ct. 23, 24 (2011) (citing *Dean Witter Reynolds Inc v Byrd* 470 U.S. 213, 217 (1985) (“[T]he Arbitration Act requires district courts to compel arbitration ... even where the result would be the possibly inefficient maintenance of separate proceedings in different forums.”).

<sup>5</sup> *KPMG* 132 S. Ct. 23, 25–26 (2011) (quoting *Dean Witter* 470 U.S. 213, 218 (1985)).

<sup>6</sup> *KPMG* 132 S. Ct. 23, 24 (2011).

<sup>7</sup> Pet. for Writ of Certiorari, *KPMG* 132 S. Ct. 23, No.10-1521) at 13.

<sup>8</sup> *Dean Witter* 470 U.S. 213, 221–223 (1985).