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STUDENT ARTICLE

Is State Law Looking for Trouble?: The Federal Arbitration Act Flexes its Preemptive Muscle

I. INTRODUCTION

This article begins with an overview of the preemption concept as it affects the American legal system. The source of preemption power is revealed and the most common forms of preemption are introduced. Next, the article discusses preemption and its interaction with the Federal Arbitration Act (FAA). The discussion begins with a chronological view of the cases that have defined the effects the FAA has on arbitration agreements via its preemption power and ends with a summary of the current state of the law.

Following the general FAA preemption discussion, the article explores specific and current issues within the subject matter. The FAA's effect on classwide arbitration is analyzed in situations where class action is and is not addressed in the arbitration agreement. Next, state contract defenses against arbitration agreements are examined. Specifically, the article addresses the current approaches courts are taking regarding defenses such as severability of arbitration clauses, mutuality of obligations, and unconscionability when facing the FAA's preemption power. Thirdly, the article addresses the effect of FAA preemption in the contentious area of franchise agreement arbitration clauses. This section of the article explores the legal foundation for preemption in the franchise context and discusses preemption of such agreements in regard to the agreements' validity, the use of forum selection clauses in such agreements, and providing for attorney's fees in such agreements. Finally, the interplay between the FAA and state arbitration rules, as found in the Revised Uniform Arbitration Act (RUAA), is examined. Specifically, the article discusses the issues the RUAA's drafters considered in order to avoid FAA preemption problems.

II. PREEMPTION GENERALLY

Federal laws may preempt state laws because the Framers proclaimed the United States Constitution to be the supreme law of the nation.¹ From its elevated position, the Constitution allows Congress to create statutes, within its Constitutional authority, that nullify state law contrary to those statutes.² Congress does

1. U.S. CONST. art VI, cl.2. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." *Id.*

2. U.S. CONST. art I, § 8, cl.18. An exception emerges when the federal government attempts to preempt the power of a state that is expressly designated to the states by the U.S. Constitution. *See*

not possess the substantive power to preempt state laws, thus the power must emanate from enumerated constitutional powers and the Supremacy Clause, which legitimizes congressional authority to enact preempting laws.³

The Tenth Amendment reserves powers not given to the federal government for the people and individual states.⁴ The Amendment is considered by some as a truism in that it merely pronounces that “all is retained which has not been surrendered.”⁵ However, the message delivered by its text contributes to the policy behind the judiciary’s maxim that “the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.”⁶ Moreover, the Amendment precludes the federal government from requiring states to govern in accordance with federal instructions.⁷ “Congress may not simply ‘commandeer the legislative processes of the States by directly compelling them to enact and enforce a federal regulatory program’.”⁸ Although instructed governance is prohibited, state courts must comply with federal preemption.

When a state law is preempted, state judiciaries must enforce the superior federal law as if they were a federal court.⁹ The Supreme Court has stated:

Federal law is enforceable in state courts not because Congress has determined that federal courts would otherwise be burdened or that state courts might provide a more convenient forum - although both might well be true - but because the Constitution and laws passed pursuant to it are as much laws in the States as laws passed by the state legislature.¹⁰

Perpich v. Dep’t of Defense, 496 U.S. 334, 351 (1990) (explaining that if a state were in need of its State Guard due to a local emergency, the federal government’s order that removed the troops for federal purposes could be vetoed by the state governor).

3. Viet D. Dinh, *Reassessing the Law of Preemption*, 88 GEO. L.J. 2085, 2091 (2000). “[T]he Supremacy Clause itself d[id] not authorize Congress to preempt state laws . . . [it] prescribed a constitutional choice of law rule . . . giv[ing] federal law precedence over conflicting state law.” *Id.* at 2088.

4. U.S. CONST. amend. X. The relationship between the Supremacy Clause and the Tenth Amendment can be characterized as follows:

Preemption of state laws . . . speaks to the effect of these state legislative and executive actions from the script written in the Supremacy Clause. The difference is akin to not having a will of one’s own, as opposed to having the free exercise of one’s will but subject to correction within specified parameters. The former is protected by the Tenth Amendment, and the latter is prescribed by the Supremacy Clause.

Dinh, *supra* note 3, at 2095.

5. Fry v. United States, 421 U.S. 542, 547 (1975) (quoting *United States v. Darby*, 312 U.S. 100, 124 (1941)).

6. Dinh, *supra* note 3, at 2097 (quoting *Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996)). Although federal preemption power of state laws is evident, coexistence can occur between federal and state law on the same subject. *Hillsborough County, Fla. v. Automated Med. Labs., Inc.*, 471 U.S. 707, 713-14 (1985). “[I]n the application of this principle of supremacy of an act of Congress in a case where the State law is but the exercise of a reserved power, the repugnance or conflict should be direct and positive, so that the two acts could not be reconciled or consistently stand together.” *Lincoln Fed. Labor Union No. 19129 v. Northwestern Iron & Metal Co.*, 31 N.W.2d 477, 487 (Neb. 1948).

7. *New Jersey v. United States*, 91 F.3d 463, 466 (3d Cir. 1996).

8. *Id.* (citing *New York v. United States*, 505 U.S. 144, 161 (1992) (citations omitted)).

9. *Howlett v. Rose*, 496 U.S. 356, 367 (1990).

10. *Id.*

It is established that the United States Supreme Court has set forth tests for determining whether federal law should preempt state law. “When considering pre-emption, we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.”¹¹

There are three well-accepted methods by which federal law preempts.¹² The most straight forward method is labeled express or explicit preemption, which occurs when Congress exhibits a “clear and manifest . . . purpose to displace concurrent state law—a requirement that is amply met by an express preemption clause given traditional primacy of statutory text in interpretation.”¹³ Another method, identified as field preemption, transpires when the federal regulation is:

[S]o pervasive as to make reasonable the inference that Congress left no room for the States to supplement it, if the Act of Congress . . . touch[es] a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject, or if the goals sought to be obtained and the obligations imposed reveal a purpose to preclude state authority.¹⁴

Conflict preemption is the final commonly accepted method of federal preemption.¹⁵ Here, preemption occurs when “compliance with both federal and state regulations is a physical impossibility or when a state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”¹⁶

11. *Wisconsin Pub. Intervenor v. Mortier*, 501 U.S. 597, 605 (1991).

12. *Id.* at 604-05.

13. Dinh, *supra* note 3, at 2101. The court’s duty here is not examining constitutional law, specifically the Supremacy Clause, but is statutory interpretation. *Id.* at 2100.

14. *Mortier*, 501 U.S. at 605 (citations omitted). The Supreme Court, when considering whether the statute occupies the field, “look[s] to the federal statute itself, read in the light of its constitutional setting and its legislative history.” *DeCanas v. Bica*, 424 U.S. 351, 360 n.8 (1976).

15. *Mortier*, 501 U.S. at 605.

16. *Id.* (citations omitted). In an effort to determine whether sufficient inconsistency exists, the court stated:

Congressional enactments that do not exclude all state legislation in [sic] same field nevertheless override state laws with which they conflict. The criterion for determining whether state and federal laws are [sic] so inconsistent that the state law must give way is firmly established in our decisions. Our task is to determine whether under the circumstances of this particular case, (the State’s) law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. This inquiry requires us to consider the relationship between state and federal laws as they are interpreted and applied, not merely as they are written.

Jones v. Rath Packing Co., 430 U.S. 519, 525-26 (1977) (citations omitted). The three primary classifications are further subdivided into five categories by Professor Dinh of Georgetown University Law Center. Dinh, *supra* note 3, at 2100. The professor similarly describes express, conflict and field preemption while adding obstacle and dormant commerce clause categories. *Id.* at 2100-13. The first additional category, obstacle preemption, also known as frustration of purpose, preempts a “state law . . . if it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” *Id.* at 2098-99. Obstacle preemption limits conflict preemption application to situations where impossibility exists due to the dual existence of laws. *Id.* at 2104. The final category is dormant commerce clause preemption. *Id.* at 2109. “[S]tate laws that discriminate against or otherwise burden interstate commerce can be displaced after judicial scrutiny even in the absence of any relevant congressional action.” *Id.* Thus, the courts must interpret Congressional silence. *Id.* at 2109-10. The endeavor of interpreting Congressional language has proven sufficiently difficult. “[T]o determine

A test for determining whether a federal statute preempts a state statute is as follows:

An attorney or court should ask . . . whether Congress, in enacting the federal statute, intended to exercise its constitutionally delegated authority to set aside the laws of a state; if so, the supremacy clause requires the court to follow federal, not state, law. If explicit preemption language does not appear in the federal statute or does not directly answer the question whether Congress intended to exercise its authority to set aside state law, then a court that is determining whether the federal law preempts the state law must consider whether the federal statute's structure and purpose, or nonspecific statutory language, reveal clear, but implicit, pre-emptive intent.¹⁷

Preemption becomes more controversial when applied to specific subjects such as arbitration, which are already surrounded by controversial issues other than preemption.

III. FAA PREEMPTION

Congress created the FAA in 1925 to overrule common law that nullified arbitration agreements.¹⁸ In *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*,¹⁹ Flood & Conklin (Flood) entered into a consulting agreement with Prima Paint (Prima) in which Flood would provide advice and consultation with regard to Prima's trade sales accounts.²⁰ The agreement contained a broad arbitration clause in which parties agreed that any dispute that may arise from the agreement would be settled by arbitration under the rules of the American Arbitration Association.²¹ Prima later notified attorneys for Flood that their client had committed fraud; Prima alleged that Flood misrepresented its solvency during the initial contracting phase, while the company actually intended to file for bankruptcy.²²

what Congress means when it has said nothing at all is impossible." *Id.* at 2110 (quoting Daniel A. Farber, *State Regulation and the Dormant Commerce Clause*, 3 CONST. COMM. 395, 395-96 (1986)). Analysis of the final category has been approached through two avenues. *Id.* at 2109. First, it is federal common law analysis. *Id.* Dinh states that:

The Court identifies a uniquely federal interest in maintaining national unity and uniformity in interstate economic regulation and fashions a common law rule to the extent necessary to further those interests. It then compares competing state laws to the federal common law rule to determine the level of conflict with the federal interests and policy.

Id. at 2110. The second analysis "can be seen as a variation on field and obstacle preemption . . . [when] [t]he field is interstate commerce." *Id.* at 2111. If the state law is "an obstacle to the general purpose" of regulating interstate commerce "or fall[s] within the regulated field," then it is preempted. *Id.*

17. 16 AM. JUR. 2D *Constitutional Law* § 53 (2002) (citing *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996) on remand to, 84 F.3d 1401 (11th Cir. 1996); *Conference of Fed. Sav. and Loan Assoc. v. Stein*, 604 F.2d 1256 (9th Cir. 1979) *aff'd*, 445 U.S. 921 (1980)).

18. Pub. L. No. 401, 43 Stat. 883 (1925).

19. 388 U.S. 395 (1967).

20. *Id.* at 397.

21. *Id.* at 398.

22. *Id.*

Flood served on Prima a “notice of intention to arbitrate” the dispute.²³ Soon thereafter, Prima filed suit in a federal district court, invoking diversity jurisdiction.²⁴ Prima sought rescission of the entire consulting agreement based on fraudulent inducement, and also sought an order to enjoin Flood from proceeding with arbitration.²⁵ In response, Flood filed a motion to stay litigation pending arbitration, which was granted by the District Court.²⁶ The Second Circuit Court of Appeals dismissed Prima’s appeal, holding that the FAA governed the contract in question due to its affect on interstate commerce. The Second Circuit came to this decision despite the U.S. Supreme Court’s prior holding in *Erie R. Co. v. Tompkins*,²⁷ which declared that federal courts hearing cases under diversity jurisdiction must apply state substantive law. Prima eventually obtained certiorari from the Supreme Court.²⁸

The Supreme Court held that, for cases within federal courts, the FAA is a body of substantive law that will govern arbitration agreements that are included in a transaction that involves interstate commerce.²⁹ The Court held that this decision was neither a violation of the *Erie* doctrine nor a violation of the U.S. Constitution, because the FAA is an appropriate exercise of the Congressional power under the Commerce Clause.³⁰ Therefore, the Court decided that it was unable to review arguments regarding fraudulent inducement of the contract generally.³¹ Because there was no claim that the arbitration agreement itself was fraudulently induced, the Court affirmed the Court of Appeals’ dismissal of Prima’s appeal.³² This holding erased doubt as to whether the Act would govern diversity cases in federal courts for contracts falling within the gambit of the statute.³³

Other notable implications came from the opinion in *Prima Paint* include the Supreme Court’s broadening of what constitutes “commerce” under Section 2 of the FAA.³⁴ Additionally, it can be implied that the majority rejected Justice Black’s dissenting opinion, which called for the FAA to apply only to “contracts between merchants for the interstate shipment of goods.”³⁵ Also, though the Court did not explicitly say that arbitration agreements are “severable” from the contracts in which they are included, it stated that federal courts may not review

23. *Id.*

24. *Id.*

25. *Id.* at 398-99.

26. *Id.* at 399.

27. See 304 U.S. 64 (1938).

28. *Prima Paint*, 388 U.S. at 395.

29. *Id.* at 400. (stating that Section 4 of the FAA provides a statutory remedy for a party seeking to compel arbitration pursuant to a valid agreement that involves a transaction involving interstate commerce). 9 U.S.C. § 4 (2000), which states, in pertinent part:

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28 . . . for an order directing that such arbitration proceed in the manner provided for in such agreement.

Id.

30. *Prima Paint*, 388 U.S. at 404-05.

31. *Id.* at 406.

32. *Id.*

33. MACNEIL ET AL., FEDERAL ARBITRATION LAW § 14.2 (1999).

34. *Prima Paint*, 388 U.S. at 411.

35. *Id.* at 401 (citing *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 200-01 (1956) (which applied a fairly narrow definition of “commerce”).

claims regarding the contract as a whole but may only review claims regarding the enforceability of the arbitration agreement.³⁶ This holding broadened the scope of the Act, causing it to be applicable to many types of agreements which were not theretofore covered, and created some confusion in state courts as to which law to apply.³⁷ Also, this decision paved the way for future decisions that held the FAA applicable in state and federal courts, although not expressly stated in the instant holding.³⁸

In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*,³⁹ Mercury Construction Corporation (Mercury) entered into a contract with the Moses H. Cone Memorial Hospital (Moses) to provide construction of additions to the hospital.⁴⁰ According to an arbitration clause in the contract, any disagreements that were decided by the architect or that were not decided within a specific time were required to be submitted for binding arbitration, unless both parties agreed otherwise.⁴¹ A dispute arose due to unresolved claims and failure to make payments, and Moses filed suit in state court, in part seeking a declaratory judgment that there was no right to arbitration.⁴² Mercury, invoking diversity jurisdiction, filed a separate action in Federal District Court requesting an order to compel arbitration pursuant to Section 4 of the FAA.⁴³ The federal court stayed the suit pending resolution of the state court suit because the two claims involved the identical issue of whether the claims should be submitted for arbitration.⁴⁴ Mercury appealed to the Fourth Circuit Court of Appeals through two avenues⁴⁵—a notice of appeal under 28 U.S.C. § 1291,⁴⁶ and a petition for mandamus under 28 U.S.C. § 1651.⁴⁷ The Court of Appeals eventually reversed the District Court decision, holding that a grant of an order staying litigation is an immediately appealable final order and that the District Court abused its discretion in granting the stay, and remanded the case with instructions to compel arbitration.⁴⁸

Agreeing with the Court of Appeals, the Supreme Court held that the order of the District Court was final and immediately appealable because the appellant was

36. *Id.* at 403-04.

37. See *Tennessee River Pulp & Paper Co. v. Eichleay Corp.*, 637 S.W.2d 853 (Tenn. 1982) (holding state courts must recognize and apply the FAA to contracts involving interstate commerce).

38. MACNEIL, *supra* note 33 at § 14.2.1(3).

39. 460 U.S. 1 (1983).

40. *Id.* at 4.

41. *Id.* at 4-5.

42. *Id.* at 6-7.

43. *Id.* Prior to filing suit, Moses obtained an *ex parte* injunction from the state court which prohibited Mercury from taking steps toward arbitration, but the injunction was dissolved as soon as Mercury received notice and objected. *Id.* at 7.

44. *Id.*

45. *Id.* at 8.

46. 28 U.S.C. § 1291 (2000) (stating that “[t]he courts of appeals (other than the United States Court of Appeals for the Federal Circuit) shall have jurisdiction of appeals from all final decisions of the district courts of the United States”).

47. 28 U.S.C. § 1651(a) (2000). Also known as the All Writs Act, it states, “The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.”

48. *Moses H. Cone*, 460 U.S. at 8. The Court of Appeals failed to reach the mandamus issue, which is an extraordinary remedy, because it was able to exercise ordinary appellate jurisdiction over final orders pursuant to 28 U.S.C. § 1291. *Id.* at 9.

effectively barred from judicial resolution of the claims.⁴⁹ The Supreme Court also affirmed the Court of Appeals decision that the stay of litigation by the District Court was an abuse of discretion, as there was more progress in the federal action and no other “exceptional circumstances” were found to abstain from deciding the appeal.⁵⁰ Regarding arbitrability of the claims, the Supreme Court found another reason to rule against the District Court’s stay. Relying on its decision in *Prima Paint*, the Court reiterated that Section 2 of the Act was a declaration by Congress of a strong policy in favor of arbitration, and that this federal law was applicable to the agreement.⁵¹ For the first time, the Court declared “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.”⁵² The Court finally noted that the state court probably would not adequately protect Mercury’s rights, because although “state courts, as much as federal courts, are obliged to grant stays of litigation under § 3,” this would leave Moses at the mercy of Mercury, the party owing payment and the party opposing arbitration, because there would be no order compelling Mercury to comply with the agreement.⁵³

The major impact of the instant case was the Court’s clear declaration of a strong policy in favor of arbitration, and its decidedly pro-arbitration interpretation of the FAA. It also reaffirmed *Prima Paint* by stating that while the FAA does not create any independent federal subject matter jurisdiction, it is still a body of federal substantive law that provides a federal remedy to those wishing to compel other parties to honor arbitration agreements.⁵⁴ However, in this decision, the Court first announced that the federal courts exercise concurrent jurisdiction of the FAA with state courts, and mentioned that in some instances, the FAA will govern state court proceedings.⁵⁵ This opened up the idea that at least some of the provisions of the Act could be applicable in state court proceedings.

In *Southland Corporation v. Keating*,⁵⁶ several franchisees entered into agreements with Southland Corporation in order to obtain 7-Eleven stores.⁵⁷ Southland’s standard franchise agreement required arbitration of any controversy or claim arising from agreement, according to the American Arbitration Association’s rules.⁵⁸ Keating sued in a class action against Southland for fraud, misrepresentation, breach of fiduciary duty, and violation of the California Franchise

49. *Id.* at 10. The Court noted that the District Court rationalized its order to stay litigation because the federal suit involved the same issue as the separate state action. *Id.* Since the issue of arbitrability was the only substantive issue that the federal court could review, once the state court had made a decision, its judgment would be *res judicata* and would effectively bar federal judicial decision. *Id.*

50. *Id.* at 22-23.

51. *Id.* at 24.

52. *Id.* at 24-25.

53. *Id.* at 26-27. The Court stated that it was not clear whether or not state courts could *compel* arbitration pursuant to Section 4, so a mere stay of litigation could possibly result in an eventual claim within federal courts under Section 4 to compel compliance. *Id.* at 26. The Court felt this would frustrate the intent of the FAA, which was to provide quick resolution of claims prescribed by the Act. *Id.* at 27.

54. *Id.* at 26.

55. *Id.* at 25-26.

56. 465 U.S. 1 (1984).

57. *Id.* at 4.

58. *Id.*

Investment Law (FIL).⁵⁹ Southland petitioned the California Superior Court to compel arbitration of the cases; the court granted Southland's motion except for the claims based on the FIL.⁶⁰ Southland appealed this portion of the decision.⁶¹ Eventually the California Supreme Court reversed the Court of Appeals' decision holding that the claims asserted under the FIL were not subject to arbitration and that the FIL was not preempted by the FAA as it was not conflicting law.⁶²

The Supreme Court reversed the California Supreme Court's decision, holding that the statutory claims were subject to arbitration.⁶³ California's requirement that the FIL required a judicial resolution was deemed to be in conflict with the FAA and therefore preempted due to the Supremacy Clause.⁶⁴ The Supreme Court relied on prior decisions in *Prima Paint*⁶⁵ and *Moses H. Cone Memorial Hospital*⁶⁶ in affirming that the FAA creates a body of federal substantive law.⁶⁷ It determined that due to Congressional Commerce Clause powers⁶⁸ under which the Act was created, the FAA is applicable in state as well as federal courts.⁶⁹ Looking to and interpreting legislative history, the court stated that it was Congress' intent to create a substantive rule under the Commerce Clause that would be applicable in state and federal courts, and would preclude state laws that attempted to "undercut" enforcement of arbitration agreements.⁷⁰ The Supreme Court finally declined to address the issue of whether the FAA precludes class action arbitration because this issue was not opposed on federal grounds, leaving the Court without jurisdiction to review.⁷¹

The Supreme Court's decision in *Southland* explicitly declared that the FAA was applicable in state courts, and reaffirmed the notion that the FAA is substantive law that will preempt conflicting state law. The Court also noted that state public policy defenses that attempt to interfere with arbitration procedures would not stand.⁷² However, due to Section 2 of the FAA, state substantive laws regard-

59. *Id.* See California Franchise Investment Law, CAL.CORP.CODE § 31000 *et seq.* (West 1977).

60. *Southland* 465 U.S. at 4. A section within the FIL rendered void any provision in an agreement to bind a franchisee to waive compliance with any provision of the FIL. CAL.CORP.CODE § 31512 (preempted by *Discover Bank v. Superior Court*, 129 Cal. Rptr. 2d 393 (2003)). As interpreted by the California Supreme Court, the statute required judicial consideration of claims brought under this statute, and therefore refused to compel arbitration. *Id.* at 10.

61. *Id.* at 4.

62. *Id.* at 5.

63. *Id.* at 17.

64. *Id.* at 16. The Supremacy Clause is found at U.S. CONST. art. IV, § 2.

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

66. *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

67. *Southland*, 465 U.S. at 11-12.

68. U.S. CONST. art I § 8, cl. 3.

69. *Southland*, 465 U.S. at 12. The Court examined legislative history of the FAA and determined that it was Congress' intent to give the Act a very broad reach, due in large part to Section 2's provision that the Act would apply to transactions "involving commerce." *Id.* at 13. However, Justice O'Connor's dissent explicitly rejects the majority's view; she believes the majority misinterpreted Congressional intent and that the FAA was intended *only* to apply in federal courts. *Id.* at 14, 21-26.

70. *Id.* at 13-16.

71. *Id.* at 9 (applying 28 U.S.C. § 1257(2)). Of course, this issue rose in later litigation, most notably in the recent case of *Green Tree Fin. Corp. v. Bazzle*, 123 S.Ct. 2402 (2003).

72. *Id.* at 16, n.11.

ing general contract defenses are applicable, regardless of the forum of the suit.⁷³ As the scope of the Act was being broadened, the Court provided more justification for its decision from legislative history while specifically addressing areas that are left to state substantive law,⁷⁴ perhaps as a response to strong dissenting opinions which argued that state substantive laws and state public policy arguments were erroneously disregarded.⁷⁵

The FAA gained considerable preemption power after the Supreme Court decided *Southland*. The Court found it was “Congressional intent to place arbitration agreements upon the same footing as other contracts.”⁷⁶ In *Southland*, the Court “explicitly held that the FAA applied in both federal and state courts . . . [and] preempted state statutes that invalidated arbitration agreements.”⁷⁷

In *Volt Information Sciences, Inc. v. Leland Stanford Junior University*, Stanford University entered into a standardized construction contract with Volt Information Sciences.⁷⁸ The contract contained an agreement to arbitrate any disputes arising therefrom.⁷⁹ The contract also contained a “choice-of-law” clause, stating that the parties agreed that the contract would be governed by the law of “the place where the Project is located.”⁸⁰ A dispute arose, and Volt formally demanded arbitration.⁸¹ The University filed suit in California Superior Court, and also sought indemnity from two parties that were not involved in the construction contract.⁸² Volt petitioned the court to compel arbitration pursuant to the agreement, and the University responded by moving for a stay of arbitration.⁸³ In moving for a stay of arbitration, the University relied on the California Arbitration Act, which provided that a court could stay arbitration pending the resolution of related litigation between a party subject to the arbitration agreement in question

73. *Id.* However, these contract law defenses may only be used if they are applicable to contracts generally, therefore state laws that contain provisions only applicable to arbitration agreements would not meet Section 2’s scope. *Id.*

74. *Id.* at 15-16.

75. *Id.*

76. Donald E. Johnson, *Has Allied-Bruce Terminix Cos. v. Dobson Exterminated Alabama’s Anti-Arbitration Rule?*, 47 ALA. L. REV. 577, 587 (1996).

77. James Zimmerman, *Restrictions on Forum-Selection Clauses in Franchise Agreements and the Federal Arbitration Act: Is State Law Preempted?* 51 VAND. L. REV. 759, 764 (1998). “The *Southland* [sic] Court noted that there exist ‘only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract evidencing a transaction involving commerce and such clauses may be revoked upon grounds as exist at law or in equity for the revocation of any contract.’” Johnson, *supra* note 76, at 590 (citations omitted).

78. 489 U.S. 468, 470 (1989).

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.* at 470-71. The parties not involved in the construction agreement were not bound by the arbitration agreement and were free to litigate their similar claims. *Id.* at 471-72.

83. *Id.* at 471.

and those who were not bound.⁸⁴ The Superior Court granted the motion to stay arbitration, and a California appellate court affirmed.⁸⁵

Upon appeal to the U.S. Supreme Court, Volt argued that it had a federally protected right to compel arbitration, and that the choice of law provision could not act as a waiver of this right.⁸⁶ The Supreme Court rejected this argument, explaining that Section 4 of the FAA does not give an absolute right to compel arbitration in all circumstances, but rather confers the “right to obtain an order directing that ‘arbitration proceed in the manner provided for in [the parties’] agreement.’”⁸⁷ By choosing California law, the parties agreed that arbitration would not proceed in the situations described within California’s arbitration statute.⁸⁸

The Supreme Court found that federal law did not preempt the state statute in this case because the parties agreed that California law would govern, and the state law allowing for the stay was not contrary to the goals and policies of the FAA.⁸⁹ Although the contract did fall within the jurisdiction of the Act, and the FAA has no similar provision that permits a court to stay arbitration pending resolution of related litigation, the Court nonetheless did not preempt state law.⁹⁰ The Court held that the choice-of-law clause required California rules of arbitration to be applied despite the seemingly negative effects the law had on speedy arbitrability of claims.⁹¹ The Court also rejected appellant’s argument that preemption was appropriate because the law contravened the strong federal policy in favor of arbitration.⁹² The Court stated that “[t]here is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate.”⁹³ If the Court had made the determination that the law was an obstacle to the intent of the FAA, then federal law could have preempted this decision.⁹⁴

In this decision, the Court offered some protection to state court interpretations regarding choice of law provisions within arbitration clauses, affirming that this avenue is safe from preemption once a threshold determination is made that the state law doesn’t conflict with the FAA. This decision created a limitation on the Court’s decision in *Southland*, as well as a showing that federal policy favoring arbitration would not preempt in every situation. *Southland* also left open the

84. *Id.* at 471 n:3 (citing CAL. CIV. PROC. CODE ANN. § 1281(c) (West 1982), which states:

When a court determines that “[a] party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction . . . and there is a possibility of conflicting rulings on a common issue of law or fact . . . the court . . . may stay arbitration pending the outcome of the court action or special proceeding.”)

85. *Id.* at 471.

86. *Id.* at 474.

87. *Id.* at 474-75 (emphasis in original). See 9 U.S.C. § 4 (2000).

88. *Volt*, 489 U.S. at 475.

89. *Id.* at 476-77.

90. See *id.*

91. *Id.*

92. *Id.* at 475.

93. *Id.* at 476.

94. See *id.* at 477.

distinct possibility of lack of uniformity among the states in determining the enforceability of similar arbitration clauses.⁹⁵

In *Volt*, the Supreme Court recognized that Congress did not intend to occupy the entire field of arbitration; therefore, conflict preemption must apply instead.⁹⁶ This holding added to the inherent confusion created by *Southland*⁹⁷ and hampered already struggling lower courts' ability to decide preemption cases involving the FAA.⁹⁸

In *Allied-Bruce Terminix Cos. v. Dobson*,⁹⁹ the Supreme Court was faced with the question of how broad the scope of the jurisdictional requirement of the FAA would reach.¹⁰⁰ The Dobsons commenced a lawsuit against Allied-Bruce for allegedly failing to remove termites and for declaring that a house they inspected was free from infestation.¹⁰¹ Allied-Bruce moved for a stay of proceedings based on an arbitration clause in the initial service contract with the Dobsons.¹⁰² However, a state statute invalidated any written, pre-dispute arbitration agreements,¹⁰³ and the Alabama Supreme Court upheld the lower court's denial of the stay based on the state law.¹⁰⁴ The FAA was passed pursuant to Congress' power under the Commerce Clause, and the statute contains a jurisdictional provision in Section 2 which states that the statute will only apply to contracts "evidencing a transaction involving commerce."¹⁰⁵ "Involving commerce" is defined in Section 1 as "commerce among the several States or with foreign nations."¹⁰⁶ The transaction in question was primarily local, despite the fact that Allied-Bruce was involved in

95. One treatise states the thought that parties who are subject to arbitration often attempt to avoid honoring their agreement by involving third parties in a similar litigation. PHILIP L. BRUNER & PATRICK J. O' CONNER, JR., BRUNER AND O' CONNOR ON CONSTRUCTION LAW § 20:12 (May 2003).

96. 489 U.S. at 477.

97. Johnson, *supra* note 76 at 588. The author stated, "[T]he argument against FAA application in state courts has been persuasively supported. In fact, the first time that any court even suggested that the FAA applied in state courts occurred nearly thirty-five years after the enactment of the FAA." *Id.* Dissenting in *Southland*, Justice O'Conner stated that arbitration is procedural rather than substantive and cited legislative history of the FAA which stated, "Whether an agreement for arbitration shall be enforced or not is a question of procedure." *Id.* (citing *Southland Corp. v. Keating*, 465 U.S. 1, 25 (1984)). The fact that the FAA is now considered substantive is arguably in violation of the *Erie* doctrine. *Id.* at 585. The FAA was enacted before *Erie*, when Congress could create substantive rules for diversity cases contrary to those of states. *Id.* at 585-86. The Court bypassed *Erie* difficulties by declaring that because Congress referenced the Commerce Clause when creating the FAA, "Congress obviously intended that the FAA apply in both state and federal courts." *Id.* at 587.

98. See Brief for Respondent, 2003 WL 1701513, *Green Tree Fin. Corp. v. Bazzle*, 123 S.Ct. 2402 (2003) (No. 02-634) (citing *Ting v. AT&T Techs. Inc.*, 319 F.3d 1126 (9th Cir. 2003); *Bradley v. Harris Research*, 275 F.3d 884 (9th Cir. 2001); *Armendariz v. Found. Health Psychare Servs.*, 24 Cal. 4th 83 (2000); *KKW Enters. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50 (1st Cir. 1999); *Doctors Assocs. v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998); *Graham v. Scissor Tail, Inc.*, 28 Cal.3d 807 (1981).

99. 513 U.S. 265 (1995).

100. See 9 U.S.C. § 4.

101. *Allied-Bruce*, 513 U.S. at 268-69.

102. *Id.* at 269. Allied-Bruce also pointed to Section 2 of the FAA in requesting the stay. See 9 U.S.C. § 2.

103. See ALA. CODE § 8-1-41(3) (1993).

104. *Allied-Bruce*, 513 U.S. at 269. See ALA. CODE § 8-1-41(3).

105. 9 U.S.C. § 2. See U.S. CONST. art. I, § 8, cl. 3 (giving Congress the exclusive power to regulate commerce among the states).

106. 9 U.S.C. § 1.

some interstate commerce activities, and the lower court held that the involvement in interstate commerce was too slight.¹⁰⁷

On appeal, the parties stipulated that the transaction involved interstate commerce.¹⁰⁸ At the time of entering the agreement, appellants argued, they did not contemplate that the transaction would be anything but local.¹⁰⁹ The Supreme Court reversed the state court's decision, applying the FAA as governing law.¹¹⁰ The Act has a broad reach, the Court concluded, relying on precedent which extended the Act's applicability to the same extent of Congress' Commerce Clause power.¹¹¹ The Court refused to overrule *Southland*, which held generally that the FAA is applicable in state courts when contracts fall within its jurisdiction, and that inconsistent state law will be preempted by the FAA.¹¹²

Relying on prior case law, as well as an examination of the FAA's language, legislative history, and purpose, the Court concluded that the federal statute should reach as broadly as the Commerce Clause.¹¹³ In other words, for the FAA to apply to a contract the transaction need only involve interstate commerce as an end result, also called the "commerce-in-fact" test, regardless of whether or not parties to the contract contemplated at any time that commerce would be affected.¹¹⁴ The Court rejected the "contemplation of the parties" test, holding that it would place arbitration agreements on unequal status with other contracts, and was therefore preempted by the FAA.¹¹⁵ The Court reiterated that states may not decide that a contract is fair enough to enforce all of its terms except for the arbitration clause.¹¹⁶

The Court was primarily concerned with interpreting Section 2's language rather than in reexamining the expansive view of the FAA declared in *Southland*. The instant decision also had the effect of eliminating the option of many states to invalidate arbitration agreements that were against public policy, such as clauses within employment or consumer contracts.¹¹⁷

In *Doctor's Associates, Inc. v. Casarotto*,¹¹⁸ once again the Supreme Court was placed in the position of reviewing a Montana state court decision. A dispute arose between Doctor's Associates, Inc. and Paul Casarotto, a franchisee for the operation of a Subway sandwich shop in Montana.¹¹⁹ The standard form franchise agreement that the parties entered into contained an arbitration clause.¹²⁰ After

107. *Allied-Bruce*, 513 U.S. at 269.

108. *Id.*

109. *Id.* at 269.

110. *Id.* at 282.

111. *Id.* at 274. The court relied on *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (holding that the FAA preempts state laws which invalidate arbitration agreements); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (holding that the Act is "based upon and confined to the incontestable federal foundations of 'control over interstate commerce and over admiralty'").

112. *Allied-Bruce*, 513 U.S. at 271.

113. *Id.* at 273-74.

114. *Id.* at 277.

115. *Id.* at 281.

116. *Id.*

117. Section 2 of the FAA would preempt state laws that attempt to exclude employment and consumer contracts from containing enforceable arbitration agreements. See *Southland*, 465 U.S. at 16.

118. *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).

119. *Id.* at 682.

120. *Id.* at 683.

Casarotto filed suit against Doctor's Associates, Inc., the state court stayed the lawsuit pending arbitration because of the arbitration clause.¹²¹ The Montana Supreme Court reversed, holding that the clause was not enforceable because it failed to meet a state "notice requirement" which mandated that arbitration clauses be typed in underlined capital letters on the first page of contract.¹²² Interpreting *Volt*, the Montana Supreme Court felt that the prior decision qualified the *Southland* holding and limited the preemptive force of Section 2.¹²³ The state court felt the language of Section 2 should not be the focus, but whether the application of the Montana statute would undermine the FAA's goals and policies.¹²⁴ The Montana Court reasoned that the purpose of the FAA was not to impose arbitration on those who did not voluntarily consent.¹²⁵ It felt that Montana state law did not undermine the FAA, and presumed the United States Supreme Court would concur.¹²⁶ The Montana court reaffirmed its original ruling, even in light of the Supreme Court decision in *Allied-Bruce Terminix Cos. v. Dobson*¹²⁷ after which this appeal occurred.¹²⁸

The U.S. Supreme Court stated that the Montana Supreme Court had misinterpreted *Volt*.¹²⁹ The state rule examined in *Volt* did not affect the enforceability of the arbitration agreement itself, but merely delayed the arbitration proceedings while a similar lawsuit progressed.¹³⁰ In the instant case, however, Montana's statute would have invalidated the clause entirely.¹³¹ State contract law defenses may be applied to invalidate arbitration agreements without the general threat of federal preemption.¹³² However, state laws that are applicable *only* to arbitration provisions will be preempted by the FAA if they are found within contracts that fall under the FAA's broad jurisdiction.¹³³ The Supreme Court declared that this was true, regardless of whether a state law that singled out arbitration agreements was consistent with the general goals and policies of the FAA.¹³⁴ To single out

121. *Id.*

122. *Id.* at 684. (citing MONT. CODE ANN. § 27-5-114(4) (1994) (repealed 1997) ("Notice that a contract is subject to arbitration pursuant to this chapter shall be typed in underlined capital letters on the first page of the contract; and unless such notice is displayed thereon, the contract may not be subject to arbitration.")).

123. *Id.* at 685. See Casarotto v. Lombardi, 886 P.2d 931, 938 (1994).

124. Casarotto, 886 P.2d at 938. The Court relied on language from *Volt*, which stated, "The question before us, therefore, is whether application of [state law] to stay arbitration under this contract in interstate commerce, in accordance with the terms of the arbitration agreement itself, would undermine the goals and policies of the FAA." *Volt*, 489 U.S. at 477-78. See also 9 U.S.C. § 2 (stating that an arbitration agreement is "valid irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract," when federal law applies).

125. Casarotto, 886 P.2d at 938-39.

126. *Id.* The statute's apparent purpose was merely to protect parties with less bargaining power from agreeing to arbitrate without proper notice, which is consistent with the view of the FAA that the Montana Supreme Court relied upon.

127. 513 U.S. 265, 283 (1995).

128. See Casarotto v. Lombardi, 901 P.2d 596 (Mont. 1995), *rev'd*, Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681 (1996).

129. *Doctor's Assocs.*, 517 U.S. at 688.

130. *Id.*

131. *Id.*

132. *Id.* at 687. However, interpretation of state contract law defenses and the manner in which they are applied can also pose problems. See *infra* Part V.

133. See *Doctor's Assocs.*, 517 U.S. at 688.

134. *Id.*

arbitration clauses for exclusion would place the clauses in suspect status and on an unequal level to other contracts, which is a view inconsistent with the purpose of the FAA.¹³⁵ The decision in *Doctor's Associates, Inc.*, further limited state courts' ability to preserve their public policy defenses to arbitration.¹³⁶

Currently, the FAA's preemptive power is expansive. It applies to nearly all contracts and can be divided into two basic types of preemption.¹³⁷ First, state laws that "thwart parties' attempts to arbitrate" are preempted by the FAA.¹³⁸ Second, "questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration."¹³⁹ The second and more troubling type has unsettled limitations.¹⁴⁰ Federal policy's favor of arbitration leads to preemption only if the state law disfavors arbitration, yet leaves the states free to "take the lead in fashioning" improvements to the arbitration process.¹⁴¹ The FAA does not displace state contract rules; instead, because it allows the language of contracts to identify the disputes subject to arbitration, it modifies "state contract rules . . . to further the Act's 'liberal federal policy favoring arbitration agreements.'"¹⁴²

The Supreme Court's interpretation of the FAA's preemption power leaves lower courts to struggle with, *inter alia*, whether the FAA applies when there is state law regarding procedures, such as classwide arbitration, and if so, whether the FAA precludes classwide arbitration as a procedure for settling disputes. Much of the argument should hinge on whether such arbitration disfavors or favors arbitration agreements and whether the contract providing for typical arbitration is interpreted to allow classwide arbitration.

IV. CLASSWIDE ARBITRATION

The most current Supreme Court case involving classwide arbitration was recently decided. The Supreme Court granted certiorari to a South Carolina Supreme Court decision that determined an arbitration agreement, silent on the matter, was not improperly interpreted to require classwide arbitration as the method for dispute resolution.¹⁴³ The agreement between Green Tree and Bazzle, while not mentioning class arbitration, did provide that South Carolina law would apply

135. *Id.* at 687.

136. However, public policy arguments may be resurfacing in the manner in which state courts apply general contract law defenses such as lack of mutuality and unconscionability. See *infra* Part V.

137. Note, *An Unnecessary Choice of Law: Volt, Mastrobuono, and Federal Arbitration Act Preemption*, 115 HARV. L. REV. 2250, 2253-56 (2002).

138. *Id.* at 2254.

139. *Id.* (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

140. *Id.*

141. *Id.* at 2254-55.

142. *Id.* at 2255-56 (citing *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 25 (1991)).

143. *Bazzle v. Green Tree Fin. Corp.*, 569 S.E.2d 349, 360-62 (S.C. 2002), *vacated by*, 123 S. Ct. 2402 (2003). The court decided the contract for arbitration was ambiguous, therefore it applied *contra proferentum*, "[a]mbiguous language in a contract . . . should be construed liberally and interpreted strongly in favor of the non-drafting party." *Id.* The court acknowledged the split of authority among federal and state courts on whether classwide arbitration was allowed under the FAA absent express contractual authorization, but noted that federal court decisions barring such proceedings were based largely on Section 4 of the Act, which by its terms does not apply to state courts. *Id.* The court further reasoned, "If we enforced a mandatory adhesive arbitration clause, but prohibited class actions in arbitration where the agreement is silent, the drafting party could effectively prevent class actions against it without having to say it was doing so." *Id.*

to any legal action.¹⁴⁴ The law of South Carolina permits classwide arbitrations like the one ordered by the arbitrator.¹⁴⁵ Also in favor of classwide arbitration, the arbitration agreements that the remaining class members signed, contained and were deficient in the same language regarding classwide arbitration as Bazzle's agreement.¹⁴⁶ Moreover, the typical prerequisites were present to warrant class-action certification in accordance with South Carolina rules of civil procedure.¹⁴⁷

Although Green Tree did not focus on preemption in the lower courts, while in front of the Supreme Court of the United States, it argued that the FAA preempts arbitration agreements silent as to classwide proceedings.¹⁴⁸ The Court decided in a plurality decision to vacate the judgment and remand it for further proceedings.¹⁴⁹ Four members of the plurality fashioned the issue as whether contracts such as those at issue are silently approving classwide arbitration or whether they are silently forbidding classwide arbitration.¹⁵⁰ In so framing the issue, the Court quietly indicated there was no preemption.¹⁵¹ Therefore, the plurality decided the FAA did not preempt the lower court's decision to allow classwide arbitration and it concluded the decision should have been made by the arbitrator as the parties had agreed.¹⁵²

The plurality listed the scenarios where the decision was one for a judge rather than an arbitrator.¹⁵³ and then determined the facts of the instant case were not analogous to those on the list.¹⁵⁴ Opposite to the dissent, *infra*, the plurality compared *Howsam v. Dean Witter Reynolds, Inc.*¹⁵⁵ and *First Options of Chicago, Inc. v. Kaplan*,¹⁵⁶ and found that *Howsam* controlled.¹⁵⁷ The question, according to the plurality, was what kind of arbitration was agreed upon rather than

144. Respondent's Brief at *3, 2003 WL 1701523, *Green Tree Fin. Corp. v. Bazzle*, 123 S.Ct. 2402 (2003) (No. 02-634).

145. *Id.*

146. *Id.*

147. *Id.* at *11. There were approximately 3,600 arbitration agreements like Bazzle's. *Id.* The "factual questions at stake" from the cases of the members of the class and Bazzle were alike. *Id.* No potential for conflicts of interest existed among the members of the class. *Id.*

148. Petitioner's Brief at *3, 2003 WL 721716, *Green Tree* (No. 02-634). "[T]he FAA does not permit class-action mechanisms to be superimposed onto private arbitration agreements absent the parties' consent."

149. See *Green Tree*, 123 S.Ct. 2402.

150. *Id.* at 2404.

151. *Id.* at 2408. The Court stated its purpose in taking the case was to determine if the lower court's holding was consistent with the FAA, but offered no discussion of the matter. *Id.* at 2404.

152. Petitioner's Brief at *14, 2003 WL 721716, *Green Tree* (No. 02-634). Justice Stevens concurred in the judgment and dissented in part, noting that the agreement was silent; therefore, because the challenge is directed at whether to conduct class arbitration and not at who made the decision, there is no need to remand. *Id.* at 2408-09.

153. The court stated:

In certain limited circumstances, courts assume that the parties intended courts, not arbitrators, to decide a particular arbitration-related matter (in the absence of "clea[r] and unmistakabl[e]" evidence to the contrary). These limited instances typically involve matters of a kind that "contracting parties would likely have expected a court" to decide. They include certain gateway matters, such as whether the parties have a valid arbitration agreement at all or whether a concededly binding arbitration clause applies to a certain type of controversy.

Id. at 2407 (citations omitted).

154. *Id.*

155. 537 U.S. 79 (2002).

156. 514 U.S. 938 (1995).

157. *Green Tree*, 123 S.Ct. at 2407.

whether they agreed to arbitrate.¹⁵⁸ In conclusion, the plurality did not reach the practical question begged by their holding—whether agreements containing language that precludes classwide arbitration are hostile to arbitration thereby requiring preemption by the FAA.

The dissenting justices would have reversed the South Carolina Supreme Court.¹⁵⁹ The dissenters viewed the issue not as one of contract interpretation, but rather a question of which authority should make the decision.¹⁶⁰ “The decision of *what* to submit to the arbitrator is a matter of contractual agreement by the parties, and the interpretation of that contract is for the court, not for the arbitrator.”¹⁶¹ This approach, unlike the plurality, determined the FAA preempts when the contract is silent.¹⁶² The dissenters distinguished between procedural questions from the dispute that should be decided by the arbitrator and questions of how the agreement should be arbitrated.¹⁶³ Unlike the plurality, the dissenters concluded that how an agreement should be arbitrated is more analogous to the question of what should be arbitrated, which is a question for the courts.¹⁶⁴

The dissenters found conflict between state and federal law, thus it concluded the FAA must preempt.¹⁶⁵ The conflict was found where the Supreme Court of South Carolina ignored the contract language requiring arbitration without a class, thereby clashing with the FAA which allows the contract to fashion arbitration according to state law.¹⁶⁶ The state court “imposed a regime that was contrary to the express agreement of the parties as to how the arbitrator would be chosen.”¹⁶⁷ The dissenters also distinguished between silent contracts and those that specifically agree to allow classwide arbitration, in that if the contract had so provided,

158. *Id.*

159. *Id.* at 2408-12. Justice Thomas continued to stand firm that the FAA does not apply to state court proceedings; therefore, the judgment could not be preempted. *Id.* at 2411.

160. *Id.* at 2408-12.

161. *Id.* at 2409. The court followed this statement reasoning from *First Options*:

Given the principle that a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration, one can understand why courts might hesitate to interpret silence or ambiguity on the “who should decide arbitrability” point as giving the arbitrators that power, for doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator would decide.

First Options, 514 U.S. at 945.

162. *Green Tree*, 123 S.Ct. at 2409.

163. *Id.* at 2410. The dissenters compared *Howsam* and *First Options*. *Id.* at 2409. It concluded that this case should be controlled by *First Options*. *Id.*

164. *Id.*

165. *Id.* at 2410. The court provided supporting law as follows:

“[T]he interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review.” But “state law may nonetheless be pre-empted to the extent that it actually conflicts with federal law – that is, to the extent that it ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’” The parties do not dispute that this contract falls within the coverage of the FAA. The “central purpose” of the FAA is “to ensure that private agreements to arbitrate are enforced according to their terms.” In other words, Congress sought simply to “place such agreements upon the same footing as other contracts.” This aim “requires that we rigorously enforce agreements to arbitrate,” in order to “give effect to the contractual rights and expectations of the parties.” “[A]s with any other contract, the parties’ intentions control.” Under the FAA, “parties are generally free to structure their arbitration agreements as they see fit.”

Id. (citations and quotations omitted).

166. *Id.*

167. *Id.* at 2411.

classwide arbitration would have been appropriate.¹⁶⁸ The dissenters likewise left the practical question unanswered. Entities implementing mandatory arbitration clauses that wish to avoid classwide arbitration must now merely reword their agreements to preclude classwide arbitration. The dissenters gave no indication that such an agreement would be defeated by state contract defenses such as unconscionability. Given the issues avoided by the court, the practical significance of the instant case is minimal.

California state courts reaffirmed their answer to the question of whether a state court can order classwide arbitration if the case falls under the FAA.¹⁶⁹ Two owners of Blue Cross health plans instigated classwide arbitration against Blue Cross to which the company argued that each claim must be resolved through binding arbitration consistent with the arbitration agreements.¹⁷⁰ After lower court proceedings, the question remaining for the appellate court was whether the FAA prohibits classwide arbitration under the circumstances.¹⁷¹

The court began its justification by touting California's use of classwide arbitration in franchising contracts containing arbitration agreements.¹⁷² It denounced binding arbitration agreements appearing in adhesion contracts if the drafter may insulate herself from class proceedings.¹⁷³ Next the court stated that consolidation of arbitration proceedings is authorized in California civil procedure which bolsters the argument for classwide arbitration.¹⁷⁴ The court stated:

In these respects, an order for classwide arbitration in an adhesion context would call for considerably less intrusion upon the contractual aspects of the relationship. The members of a class subject to classwide arbitration would all be parties to an agreement with the party against who their claim is asserted; each of those agreements would contain sub-

168. *Id.*

169. *Blue Cross of Ca. v. Super. Ct.*, 78 Cal. Rptr. 2d 779, 781 (Cal. Ct. App. 1998).

170. *Id.* There were two arbitration agreements containing the following language:

Any dispute between you and Blue Cross of California and/or its affiliates must be resolved by binding arbitration, if the amount in dispute exceeds the jurisdictional limit of the Small Claims Court. Any such dispute will be resolved not by law or resort to court process, except as California law provides for judicial review of arbitration proceedings. Under this coverage, both you and Blue Cross of California and its affiliates are giving up the right to have any dispute decided in a court of law before a jury. . . . Any dispute or claim, of whatever nature, arising out of, in connection with, or in relation to this Agreement or breach thereof, or in relation to care of delivery of care, including any claim based on contract, tort or statute, must be resolved by arbitration if the amount sought exceeds the jurisdictional limit of the small claims court. Any disputes regarding a claim for damages within the jurisdictional limits of the small claims court will be resolved in such court. The arbitration is begun by the Member making written demand on Blue Cross. The arbitration will be conducted by the American Arbitration Association according to its commercial rules of arbitration. The arbitration shall be held in the state of California. The Member and Blue Cross agree to be bound by the arbitration provision and acknowledge that they are giving up their right to a trial by court or jury. The arbitration findings will be final and binding except to the extent that California or Federal law provide for the judicial review of arbitration proceeding.

Id.

171. *Id.* at 781-82. There was no dispute whether the provisions of the agreement fell under the FAA.

Id. The transactions clearly involved commerce. *Id.*

172. *Id.* at 785 (citing *Keating v. Super. Ct.*, 31 Cal.3d 584 (Cal. 1982)).

173. *Id.*

174. *Id.* at 785-86.

stantially the same arbitration provision; and if any of the members of the class were dissatisfied with the class representative, or with the choice of arbitrator, or for any other reason would prefer to arbitrate on their own, they would be free to opt out and do so. Moreover, the interests of justice that would be served by ordering classwide arbitration are likely to be even more substantial in some cases than the interests that are thought to justify consolidation.¹⁷⁵

The court discussed factors within a trial court's discretion that should be considered when determining whether to order classwide arbitration.¹⁷⁶ It explained that the focus should be on the alternatives to ordering classwide arbitration.¹⁷⁷ If the alternative is that hundreds will be forced to proceed through individual arbitrations, then classwide arbitration should be chosen.¹⁷⁸ If gross unfairness is the alternative to ordering classwide arbitration, then it is justified.¹⁷⁹ The court ended by admitting there is a greater need for court involvement in classwide arbitration than in individual arbitrations; therefore, courts must consider all of the factors relevant to typical class actions as well as the special characteristics of arbitration proceedings.¹⁸⁰

The court considered the federal appellate court's approach to cases where the agreement is silent regarding classwide arbitration.¹⁸¹ Primarily, two cases were discussed—*Champ v. Siegel Trading Co., Inc.*¹⁸² and *New England Energy Inc., v. Keystone Shipping Co.*¹⁸³ In *Champ*, the Seventh Circuit adopted the reasoning of other circuits that classwide arbitration should not be ordered if the court was effectively reading a new term into an otherwise silent agreement.¹⁸⁴ The main

175. *Id.* at 786.

176. *Id.* at 786-87.

177. *Id.* at 786.

178. *Id.*

179. *Id.*

180. *Id.* at 787.

181. *Id.* at 788. Federal courts overwhelmingly disagree with allowing classwide arbitration where the agreement does not explicitly provide such options. *Johnson v. West Suburban Bank*, 225 F.3d 366, 377 n.4 (3d Cir. 2000); *Deiulemar Compagnia Di Navigazione S.p.A. v. M/V Allegra*, 198 F.3d 473, 481-82 (4th Cir. 1999); *Iowa Grain Co. v. Brown*, 171 F.3d 504, 510 (7th Cir. 1999); *Sims v. Unicor Mortgage, Inc.*, No. 4: 98CV25-D-B, 1998 WL 34016832, at *3 (N.D. Miss. Apr. 27, 1998); *Howard v. Klynveld Peat Marwick Goerdeler*, 977 F. Supp. 654, 665 n.7 (S.D.N.Y. 1997); *McCarthy v. Providential Corp.*, No. C94-0627, 1994 WL 387852, at *8 (N.D. Cal. July 19, 1994). See Andrea Lockridge, Note, *The Silent Treatment: Removing the Class Action from the Plaintiff's Toolbox Without Ever Saying a Word*, 2003 J. DISP. RESOL. 255 (stating that courts do not allow classwide arbitration where the agreement does not specifically allow such an option).

182. 55 F.3d 269 (7th Cir. 1995).

183. 855 F.2d 1 (1st Cir. 1988).

184. *Champ*, 55 F.3d at 274-77. The court stated:

The Second, Fifth, Sixth, Eighth, Ninth, and Eleventh Circuits have held that absent an express provision in the parties' arbitration agreement, the duty to rigorously enforce arbitration agreements "in accordance with the terms thereof" a set forth in section 4 of the FAA bars district courts from applying Rule 42(a) to require consolidated arbitration, even where consolidation would promote the expeditious resolution of related claims. (citing, *Gov't of U.K. v. Boeing Co.*, 998 F.2d 68, 74 (2d Cir. 1993); *Am. Centennial Ins. v. Nat'l Cas. Co.*, 951 F.2d 107, 108 (6th Cir. 1991); *Baessler v. Cont'l Grain Co.*, 900 F.2d 1193, 1195 (8th Cir. 1990); *Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp.*, 873 F.2d 281, 282 (11th Cir. 1989) (per curiam); *Del E. Webb Constr. v. Richardson Hosp. Auth.*, 823 F.2d 145, 150 (5th Cir. 1987); *Weyerhaeuser Co. v. W. Seas Shipping Co.*, 743 F.2d 635, 637 (9th Cir. 1984).

contention the Seventh Circuit had with classwide arbitration where the parties did not explicitly agree, was that arbitration does not occur in a court of law and Federal Rule of Procedure 23 only applies to judicial proceedings.¹⁸⁵ Moreover, the federal rule sanctioning class actions is one of the “niceties” abandoned when the parties agreed to arbitration.¹⁸⁶

In *New England Energy*, the First Circuit analyzed consolidation rather than classwide arbitration.¹⁸⁷ Regardless, the California court preferred its analysis.¹⁸⁸ The *New England Energy* court found that the FAA did not preempt all state law on arbitration, rather it preempts only state law that directly conflicts.¹⁸⁹ The court did not consider an order consolidating arbitrations as conflicting when the order merely requires a different form of arbitration rather than no arbitration.¹⁹⁰

In *Blue Cross*, the California appellate court cited its state supreme court which held that the procedural provisions of the FAA are inapplicable if state procedures are consistent with the “rights granted by Congress.”¹⁹¹ The court did this while showing why sections 3 and 4 of the FAA do not apply to state courts. Specifically, the court stated that “a state procedure that serves to further, rather than defeat, ‘full and uniform effectuation of the federal law’s objectives’—to ensure that arbitration agreements are enforced according to their terms—is to be followed in California, rather than section 4 of the act.”¹⁹²

The court next looked to the U.S. Supreme Court for indirect support via *Volt Information Sciences v. Leland Standard Jr. University*.¹⁹³ If the parties agreed to be bound by the law of California, the court argued that *Volt* offered support for their decision.¹⁹⁴ “There is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate.”¹⁹⁵ Moreover, in *Volt* the Supreme Court praised California for legislating consolidation into arbitration which cures contradictory outcomes from the many arbitral proceedings that occur instead of fewer consolidation proceedings.¹⁹⁶ Before concluding, the court avoided the question of the parties’ intention regarding classwide arbitration.¹⁹⁷

185. *Id.* at 275-77.

186. *Id.* at 276.

187. *New England Energy*, 855 F.2d at 3-5.

188. *Id.*

189. *Id.*

190. *Blue Cross of Ca. v. Super. Ct.*, 78 Cal. Rptr. 2d 779, 790 (Cal. Ct. App. 1998). The court stated:

There is no attempt here to divert a case from arbitration to court. Massachusetts seeks only to make more efficient the process of arbitrating. Although the Supreme Court has held that agreements to arbitrate must be enforced “even if the result is ‘piecemeal’ litigation,” the Court also has recognized the Act’s endorsement of “speedy and efficient decisionmaking.” We fail to see why a state should be prevented from enhancing the efficiency of the arbitral process, so long as the state procedure does not directly conflict with a contractual provision.

Id.

191. *Id.* at 792.

192. *Id.* at 791 (citations omitted).

193. 489 U.S. 468 (1989).

194. *Blue Cross of Ca.*, 78 Cal. Rptr. 2d at 792.

195. *Id.* (quoting *Volt*, 489 U.S. at 476).

196. *Id.* The Supreme Court noted that the FAA is without provisions for dealing with:

[T]he special practical problems that arise in multiparty contractual disputes when some or all of the contracts at issue include agreements to arbitrate. California has taken the lead in fashioning

According to this court, the *Keating* rule allowing classwide arbitration via a silent arbitration agreement “can facilitate the enforcement of arbitration agreements by making classwide arbitration available in appropriate cases.”¹⁹⁸ California, Pennsylvania, and South Carolina are the only state courts that agree on this point.¹⁹⁹ These courts claim that their approach facilitates the intended agreements of the parties, which is perplexing when the vast majority of courts disagree with such construction. Moreover, it seems odd to tout agreement facilitation

a legislative response to this problem, by giving courts authority to consolidate or stay arbitration proceedings in these situations in order to minimize the potential for contradictory judgments.

Id. (quoting *Volt*, 489 U.S. at 476 n. 5).

197. *Id.* at 793. The court stated:

This argument is premature. The only issue before this court is whether the *Keating* rule is pre-empted by the act. No order has been entered certifying a class. No order has been entered requiring classwide arbitration. Whether classwide arbitration is appropriate in this matter is a question left to the trial court’s discretion upon consideration of the variety of factors. Moreover, under *Keating*, an arbitration agreement that is silent as to classwide arbitration is amenable to such procedure. Further, there has been no showing that an order compelling classwide arbitration would conflict with the agreement to proceed under [American Arbitration Association] rules.

Id. (citations omitted).

198. *Id.* at 794.

199. California has remained consistent in supporting classwide arbitration. In 2002, a California state appeals court cited *Blue Cross* when stating the “well established” practice of ordering classwide arbitration when the agreement is silent on the subject. *Sanders v. Kinko’s, Inc.*, 121 Cal.Rptr. 766, 769 (Cal. App. 2002). In Pennsylvania, the state Supreme Court likewise faced an agreement that failed to contain an express clause regarding classwide arbitration. *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860, 862-63 (Pa. 1991). The court identified three alternate courses the litigation could follow. *Id.* at 867. It could order “compelled individual arbitration, class action in a court of law, or compelled classwide arbitration.” *Id.* The court made its decision in favor of classwide arbitration stating:

[T]he last choice best serves the dual interest of respecting and advancing contractually agreed upon arbitration agreements while allowing individuals who believe they have been wronged to have an economically feasible route to get injunctive relief from large institutions employing adhesion contracts. The availability of class suits in arbitration proceedings precludes either party from forcing the other to litigate in a position less advantageous than that for which they contracted. Allowing the suit to proceed through the court would defeat the purpose of the arbitration agreement, allowing plaintiffs to escape obligated arbitration in order to be heard in the sympathetic province of a jury trial. Future litigants might feel encouraged to join classes together for this single purpose when they otherwise would have been satisfied with individually litigating their claim.

Compelling individual arbitration would force individuals already straitjacketed by an industry-wide practice of arbitration agreements to fight alleged improprieties at an exorbitant economic cost. Individual arbitration would be small deterrent to companies certain that few proceedings will be instituted against them. Because the principles of *res judicata* and collateral estoppel are not applicable to arbitration proceedings, each plaintiff would be forced to fully litigate his complaint.

In conclusion, the Shearson client agreement’s plain language allows for an interpretation which comports with federal and state policies favoring arbitration. These policies dictate broad arbitral powers, including equitable decrees. As Shearson has contended, this dispute must be resolved in the manner contracted for by the parties. Fairness mandates, however, that the Dickler Group, bound by adhesion form contracts to arbitration agreements, be able to protect their interests by proceeding as a class through arbitration. We therefore reverse the trial court and remand for class certification proceedings. Following this decision, the court must compel arbitration for the class if it has been certified or individually if it has not been certified.

Id. Arbitration agreements in Pennsylvania now contain clauses that specifically prohibit classwide arbitration. See *Lytle v. Citifinancial Servs.*, 810 A.2d 643 (Pa. 2002). Pennsylvania upholds these agreements, thereby eliminating classwide arbitration as a litigation option. *Id.* at 665.

when similarly situated parties to the disputed arbitration agreement (authors of the arbitration agreements) unflinchingly argue they never intended on an outcome remotely comparable to what the court fashioned.

V. STATE CONTRACT LAW DEFENSES AGAINST ARBITRATION AGREEMENTS

Section 2 of the FAA provides that an arbitration agreement falling within the Act's purview will be irrevocable, "save upon such grounds as exist at law or in equity for the revocation of any contract."²⁰⁰ This section reserves a state's power to invalidate arbitration agreements in the same manner they would invalidate any contract, a view which is consistent with the intent of the FAA.²⁰¹ While the FAA will preempt contrary state statutes and public policy defenses that attempt to invalidate arbitration agreements, state law will govern general contract law defenses to the agreement such as duress, fraud, lack of mutuality, and unconscionability.²⁰² Section 2 of the Act also requires federal courts to apply state substantive contract law when determining if a valid agreement to arbitrate exists, irrespective of the federal policy favoring arbitration.²⁰³ Despite these provisions of the FAA, preemption in the area of state contract law has yielded varying results among lower courts' determinations of whether arbitration is appropriate.

A. Severability of Arbitration Clauses

For courts to decide on the enforceability of an arbitration agreement while not being compelled to hear the underlying merits of the claim, the U.S. Supreme Court declared that arbitration clauses are examined separate from their parent contracts.²⁰⁴ This decision resulted from an interpretation of Section 4 of the FAA, which states, "The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement."²⁰⁵ The notion of "severability" causes difficulties in challenging arbitration, requiring that claims of fraud, duress, and other contract defenses must be found in the formation of the arbitration agreement.²⁰⁶ A claim of defect of formation of the parent contract may not invalidate a contained arbitration clause; the merits of the case will remain subject to arbitration.²⁰⁷

Despite the Supreme Court's declaration that arbitration clauses are severable from the contracts in which they are contained, lower courts have struggled with interpreting this decision. Some courts have interpreted the Supreme Court's

200. 9 U.S.C. § 2.

201. *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).

202. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) (stating that "a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement").

203. *Id.*

204. *Prima Paint Corp. v. Flood and Conkling Mfg. Co.*, 388 U.S. 395, 404 (1967).

205. *Id.* at 403 (quoting 9 U.S.C. § 4).

206. *Id.* at 403-04.

207. *Id.* at 404.

holding as requiring an arbitration clause to meet all state contract law requirements to be enforceable, treating the clause as a separate and independent contract.²⁰⁸ Other courts interpret *Prima Paint* to mean merely that courts must decide on enforceability of arbitration first, but that defects in the contract as a whole can be used in making the initial arbitrability decision.²⁰⁹ The Supreme Court also failed to distinguish between contracts that are “voidable” by one of the parties due to defects in inducement, and contracts that are void from inception due to defects in execution.²¹⁰

The Ninth Circuit made a distinction between voidable and void contracts in *Three Valleys Municipal Water District v. E.F. Hutton & Co., Inc.*²¹¹ In *Three Valleys*, several cities entered into a securities agreement with the defendant and signed client agreements which contained arbitration clauses.²¹² Plaintiffs alleged that the signatory did not have the authority to bind them, and therefore contended that they never entered into such agreements.²¹³ Remanding the case for determination of whether the signatory had authority to bind plaintiffs, the court held that severability of the clause for separate examination pursuant to *Prima Paint* only applies when a party seeks to avoid or rescind a contract already in existence, not when a party alleges that no contract exists due to formation defects.²¹⁴ Relying on previous Ninth Circuit decisions as well as others, the court determined that the courts must determine the threshold issue of whether or not a contract exists.²¹⁵

The Eighth Circuit’s view is consistent with that of the Ninth. In *I.S. Joseph Co., Inc. v. Michigan Sugar Co.*, the Eighth Circuit held that a court should determine whether an arbitration clause is enforceable when a party denies existence of a contract.²¹⁶ The Third Circuit also expressly found that *Prima Paint*’s severability doctrine applies to voidable, but not void, contracts. In *Sandvik AB v. Advent International Corp.*, the court drew a line between voidable and void contracts and stated that no arbitration clause can be enforced when a party alleges that no contract is in existence.²¹⁷ State courts have also agreed that severing an arbitration clause for enforceability was not appropriate when the very existence of the larger agreement is disputed.²¹⁸

The Sixth Circuit expressly disagreed with the Ninth Circuit’s view in *Burden v. Check Into Cash of Kentucky, LLC*.²¹⁹ In *Burden*, plaintiffs entered into loan agreements with defendants, which involved an exchange of cash for customers’

208. See *Iwen v. U.S. W. Direct*, 293 Mont. 512 (1999); *Arnold v. United Cos. Lending Corp.*, 204 W.Va. 229 (1998); *Williams v. Aetna Fin. Co.*, 83 Ohio St. 3d 464 (1998).

209. See *supra* notes 18-38 and accompanying text.

210. RESTATEMENT (SECOND) OF CONTRACTS § 7 cmt. a. (1981).

211. 925 F.2d 1136 (9th Cir. 1991).

212. *Id.* at 1137-38.

213. *Id.* at 1138.

214. *Id.* at 1140.

215. *Id.* at 1140-41.

216. 803 F.2d 396, 400 (8th Cir. 1986).

217. 220 F.3d 99, 109 (3d Cir. 2000). See also *Chastain v. Robinson-Humphrey Co., Inc.*, 957 F.2d 851, 855 (11th Cir. 1992).

218. See *Ala. Catalog Sales v. Harris*, 794 So. 2d 312 (Ala. 2000) (holding that courts, not arbitrators, must decide whether contracts containing arbitration clauses were void under Small Loan Act); *Heurtebise v. Reliable Bus. Computers*, 550 N.W.2d 243 (Mich. 1996) (stating that arbitration agreements are unenforceable if not contained within a binding contract).

219. 267 F.3d 483 (6th Cir. 2001).

checks.²²⁰ Checks were held until the payment due date, at which time they were cashed for the loan amount including a “service fee,” which amounted to usurious interest rates under Kentucky law.²²¹ The plaintiffs also alleged violations of the Truth in Lending Act, contending that defendants fraudulently coerced them into agreeing to the loan agreements which contained arbitration clauses.²²² The district court applied the decision in *Three Valleys*. It found that because allegations of fraud would render the contract void, the arbitration clause was not severable and was also void.²²³ The Sixth Circuit decided that the allegation of fraud in the inducement was not distinguishable from fraud in the execution, and that to the extent that the contract challenges did not address the arbitration clause specifically, they were arbitrable.²²⁴ The U.S. Supreme Court denied certiorari, leaving this area of the law unexplained and open to lack of uniformity among the lower federal and state courts.²²⁵

B. Mutuality of Obligations

The contract law defense alleging lack of mutuality is another issue that the various jurisdictions treat differently. Mutuality of obligations, also referred to as mutuality of consideration, is the general requirement that contracts must bind both parties.²²⁶ The majority of courts adhere to the Restatement of Contract’s view that mutuality is satisfied if there is consideration as to the whole agreement, regardless of whether the included arbitration clause itself was one-sided.²²⁷

Mutuality is often an issue when an arbitration clause requires one party to arbitrate all claims, while reserving the other party’s ability to litigate in court. In *Harris v. Green Tree Financial Corp.*, the Third Circuit held that an arbitration clause that was one-sided was enforceable despite lack of mutuality.²²⁸ The Harris’ alleged that Green Tree involved them in a fraudulent home improvement scheme, and brought suit alleging a number of contract law defenses.²²⁹ Green Tree moved to compel arbitration pursuant to a clause contained within the loan agreements.²³⁰ The Third Circuit found that the clause was enforceable, and also denied allegations that the clause was unconscionable merely because the party

220. *Id.* at 486.

221. *Id.* at 485-86. The Kentucky Supreme Court had previously declared that check-cashing services were not exempt from usury laws. *White v. Check Holders, Inc.*, 996 S.W.2d 496 (Ky. 1999).

222. *Burden*, 267 F.3d at 486.

223. *Id.* at 486.

224. *Id.* at 491. *See also* *Large v. Conesco Fin. Servicing Corp.*, 292 F.3d 49 (1st Cir. 2002).

225. *Burden v. Check into Cash of Kentucky, LLC*, 535 U.S. 970 (2002).

226. JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 4-12, 226 (3d. ed., 1987).

227. RESTATEMENT (SECOND) OF CONTRACTS § 79 (1979) (“If the requirement of consideration is met, there is no additional requirement of . . . mutuality of obligation.”). *See Harris v. Green Tree Fin. Corp.*, 183 F.3d 173 (3d Cir. 1999); *Barker v. Golf U.S.A., Inc.*, 154 F.3d 788 (8th Cir. 1998); *Johnson v. Circuit City Stores, Inc.*, 148 F.3d 373, 379 (4th Cir. 1998); *Doctor’s Assocs. v. Distajo*, 66 F.3d 438, 453 (2d Cir. 1995) (noting that “[a] doctrine that required separate consideration for arbitration clauses might risk running afoul” of the federal policy in favor of arbitration); *Parker v. Green Tree Fin. Corp.*, 730 So.2d 168, 170-71 (Ala. 1999) (rejecting claim that arbitration clause is unenforceable due to lack of mutuality of remedy and unconscionability).

228. 183 F.3d at 181.

229. *Id.* at 176.

230. *Id.* at 177.

with no bargaining power was forced to arbitrate while the stronger party could litigate disputes.²³¹

Despite the prevailing majority view, an increasing number of courts have invalidated arbitration agreements that lacked mutuality of obligations. In *Armen-dariz v. Foundation Health Psychcare Services, Inc.*, the California Supreme Court declared that an arbitration clause found within an employment contract was unenforceable due to unconscionability because the terms were one-sided, but the court also mentioned that the terms contravened public policy of the state.²³²

In *Anderson v. Ashby*, the Alabama Supreme Court struck down a one-sided arbitration clause as unenforceable.²³³ The clause required the loan customer to arbitrate all disputes arising from the transaction or the agreement, but in a separate clause, the creditor's right to litigate in a courtroom was retained.²³⁴ The court also chose not to omit this term within the arbitration clause in order to enforce the agreement, despite the attempts of the clause to provide this option as a remedy.²³⁵ This remedial option was not inconsistent with Alabama statutes, which give the court the option to remove or limit an unconscionable term in lieu of invalidation, at its discretion.²³⁶ The Alabama Supreme Court affirmed the lower court's decision to strike the entire clause.²³⁷ The Arkansas Supreme Court similarly struck down a clause that left it optional for one of the parties to litigate or arbitrate.²³⁸ It is unclear whether the Arkansas court's decision in *Showmethemoney Check Cashers, Inc. v. Williams*, would be preempted by the FAA, because the court implied that the mutuality requirement is only applicable to arbitration clauses.²³⁹

Several courts that invalidate arbitration clauses for lack of mutuality do so by deeming such clauses unconscionable.²⁴⁰ The Ninth Circuit, in *Ticknor v. Choice Hotels International, Inc.*, upheld a state court decision invalidating an

231. *Id.* at 184.

232. 24 Cal. 4th 83 (2000).

233. No. 1011740, 2003 WL 21125998 (Ala. May 16, 2003).

234. *Id.* at *2.

235. The clause stated:

Borrower(s) and Lender agree that if any provision of this arbitration clause is invalid or unenforceable under the Federal Arbitration Act, the provision which is found to be invalid or unenforceable shall be inapplicable and deemed omitted, but shall not invalidate the remaining provisions of this arbitration clause, and shall not diminish the parties' obligation to arbitrate the disputes subject to this clause.

Id.

236. See AL. STAT. § 7-2-3-2 (2003), which states in pertinent part:

(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

Id.

237. *Anderson*, 2003 WL 21125998 at *12.

238. 342 Ark. 112, 121 (2000).

239. *Id.* at 120. See also Allyson K. Kennett, Note, *Showmethemoney Check Cashers, Inc. v. Williams: Show Me the Mutuality – A New Demand Based on an Old Doctrine Changes the Rules for Enforceability of Arbitration Agreements in Arkansas*, 54 ARK. L. REV. 621, 634 (2001) (stating that the Arkansas Supreme Court's decision in *Showmethemoney* is a departure from the court's prior precedent on mutuality and that the mutuality requirement is only applicable to arbitration clauses).

240. See *infra* notes 240-60 and accompanying text.

arbitration clause for unconscionability.²⁴¹ The clause involved in *Ticknor* required the party with lesser bargaining power to arbitrate claims, while allowing the stronger party to litigate.²⁴² The court noted that while Montana does not invalidate contracts for lack of mutuality, it could consider mutuality in the unconscionability determination.²⁴³ The court ultimately held that the arbitration clause was unconscionable and unenforceable under Montana state law.²⁴⁴ The state court's interpretation of the unconscionability doctrine was not preempted by the FAA, according to the Ninth Circuit, because it was applicable to all contracts and did not single out arbitration clauses.²⁴⁵ It is clear that in some situations, even though a state may not typically invalidate contracts for lack of mutuality, a lack of mutuality may still be a factor in defeating arbitration.²⁴⁶

C. Unconscionability

An issue that is increasingly litigated is the enforceability of arbitration when the arbitration clause itself is alleged to be unconscionable. The doctrine of unconscionability gives courts the discretion to invalidate contracts that cause one of the parties to be subject to an absence of meaningful choice and unfairly oppressive terms; also known as "procedural" and "substantive" unconscionability, respectively.²⁴⁷ Unconscionability can be a difficult defense to assert, because the very definition of unconscionability is vague and open for interpretation regarding the degree of substantive or procedural unconscionability that needs to be present before a clause will be stricken.²⁴⁸

In *Armendariz v. Foundation Health Psychcare Services, Inc.*, the California Supreme Court held that an arbitration clause within an employment contract was void based on grounds of unconscionability.²⁴⁹ The court first found that the contract was adhesive, because it was imposed on employees without the ability to negotiate terms.²⁵⁰ The clause required employees to arbitrate claims while allow-

241. 265 F.3d 931 (9th Cir. 2001).

242. *Id.* at 940. See also *Anderson*, 2003 WL 21125998 at *9 (holding that an arbitration clause that required weaker party to arbitrate while reserving power to stronger party to litigate was unconscionable and unenforceable).

243. *Ticknor*, 265 F.3d at 940.

244. *Id.* at 941.

245. *Id.* at 942. In determining that federal law did not preempt the decision, the court relied on *Doctor's Assocs. Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

246. See *Ramirez v. Circuit City Stores, Inc.*, 90 Cal.Rptr.2d 916, 920 (1999) (noting that an agreement that allows the stronger party to litigate while requiring the weaker party to arbitrate is presumptively unconscionable).

247. E. ALLEN FARNSWORTH, *CONTRACTS* § 4.28 (2d ed. 1990). See also U.C.C. § 2-302, c. 1.

248. See *Potts v. Baptist Health Sys., Inc.*, 853 So.2d 194, 205 (Ala. 2000). The court noted that state law lacks a clear standard for determining unconscionability, and that case law points to several factors to look to in making this decision:

In addition to finding that one party was unsophisticated and/or uneducated, a court should ask (1) whether there was an absence of meaningful choice on one party's part, (2) whether the contractual terms are unreasonably favorable to one party, (3) whether there was unequal bargaining power among the parties, and (4) whether there were oppressive, one-sided, or patently unfair terms in the contract.

Id.

249. 24 Cal. 4th 83, 83 (Cal. 2000)

250. *Id.* at 114-15.

ing the employer to litigate, and it limited the recovery of damages by the employees, without imposing such limitations on the employer.²⁵¹ The court held that the term was unconscionably one-sided, and declined to sever the unlawful portions of the agreement and enforce the remainder.²⁵² It is interesting to note that a federal district court within the same jurisdiction did not follow the holding in *Armendariz*, although it declined to compel arbitration for other reasons.²⁵³

The Ninth Circuit, in *Ingle v. Circuit City*, declared that an agreement to arbitrate entered into by an employer and employee raises a presumption of substantive unconscionability.²⁵⁴ While a determination of unconscionability generally requires that both substantive and procedural unconscionability be present, “the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.”²⁵⁵ The court also suggested that, in a contract of adhesion, the unconscionable provision should not be severable.²⁵⁶ Therefore, the type of contract in which the arbitration agreement is integrated could affect a court’s determination of whether substantive unconscionability will be found and whether the agreement to arbitrate will be unenforceable.

Many courts that find unconscionability within arbitration clauses tend to place emphasis on the fact that the clauses were found within contracts of adhesion.²⁵⁷ At least one federal jurisdiction has determined that adhesion is a defense that can defeat arbitration in some instances.²⁵⁸ However, many jurisdictions have stated that an arbitration clause is not rendered unenforceable merely due to being contained within a standardized agreement that did not involve negotiation.²⁵⁹

In *Webb v. R. Rowland & Co., Inc.*, the Eighth Circuit held that even though parties had agreed to arbitrate according to the laws of Missouri, federal law nonetheless preempted the arbitration agreement because the contract dealt with interstate commerce and fell within the jurisdiction of the FAA.²⁶⁰ The court also rejected a claim that the clause was invalid due to being contained in a contract of adhesion, stating, “The use of a standard form contract between two parties of admittedly unequal bargaining power does not invalidate an otherwise valid contractual provision.”²⁶¹ To be invalid, the provision at issue must be unconscion-

251. *Id.* at 115-16, 121.

252. *Id.* at 126.

253. See *Circuit City Stores v. Baryasz*, 2001 WL 1218406, *3-4 (N.D. Cal. 2001).

254. 328 F.3d 1165, 1175 (9th Cir. 2003). “Substantive unconscionability centers on the ‘terms of the agreement and whether those terms are so one-sided as to shock the conscience.’” *Id.* at 1172 (quoting *Kinney v. United Health Care Servs.*, 83 Cal. Rptr. 2d 348, 353 (Cal. App. 1999)).

255. *Id.* at 1171. The federal court looked to the California Supreme Court’s decision in *Armendariz*, 99 Cal. Rptr. 2d 745.

256. *Id.* at 1180.

257. A contract of adhesion is a “standard-form contract prepared by one party, to be signed by the party in a weaker position, usually a consumer, who has little choice about the terms.” BLACK’S LAW DICTIONARY 319-20 (7th ed. 1999).

258. See *Ticknor v. Choice Hotels Intern., Inc.*, 265 F.3d 931 (9th Cir. 2001).

259. See *Faber v. Menard, Inc.*, 267 F. Supp. 2d 961, 974 (N.D. Iowa 2003); *Webb v. R. Rowland & Co., Inc.*, 800 F.2d 803, 807 (8th Cir. 1986); *Munoz v. Green Tree Fin. Corp.*, 542 S.E.2d 360, 365 (S.C. 2001); see also FARNSWORTH, *supra* note 247, at § 4.28 (“[T]he fact that the contract is one of adhesion is not, of itself, generally regarded as fatal.”).

260. 800 F.2d at 807. See 9 U.S.C. § 1.

261. *Webb*, 800 F.2d at 807.

able.”²⁶² The clause was held not unconscionable simply due to lack of bargaining power or inability to negotiate terms.²⁶³

In *Faber v. Menard, Inc.*, an Iowa appellate court determined that the FAA preempted a state statute that attempted to exclude arbitration clauses from general enforceability if they were contained in an adhesion contract.²⁶⁴ The court held that federal law preempted the Iowa statute because the FAA does not exclude arbitration agreements merely for being contained in contracts of adhesion.²⁶⁵ The court noted that the plaintiff was still able to assert general contract defenses such as unconscionability, but declared that the clause was not unconscionable merely due to the fact that it was contained in an adhesion contract.²⁶⁶ The majority of courts adhere to the notion that adhesionary contracts alone are not enough to invalidate an arbitration clause, or to cause it to be presumptively unconscionable.²⁶⁷ However, one commenter noted, “[W]hile the Supreme Court pursues its largely pro-arbitration course, lower courts seem ripe for change.”²⁶⁸

D. Conclusion

Due to the powerful preemptive effect of the FAA, challengers to arbitration may be limited to state contract law attacks on the agreement’s validity, an area not superseded by federal law. There remains much confusion in this area. This is due in part to the vague definitions of many contract defenses and the various methods of application. State courts may be trying to retain their public policy arguments against arbitration in a manner not subject to preemption. On the other hand, while federal courts are supposed to faithfully apply state contract law as closely as possible to ensure that state’s rights are not discriminated against in federal forums, they tend to mix their evaluations of arbitration clauses with a healthy dose of the strong federal policy in favor of such agreements.²⁶⁹ Even threshold issues such as severability of arbitration clauses for examination can pose a problem for parties attempting to navigate the quagmire of current arbitration law. Until there is a clear federal declaration regarding these issues, those that are concerned with arbitration should be cautious and thoroughly research the trends within the specific jurisdictions in which they practice.

262. *Id.*

263. *Id.*

264. 267 F. Supp. 2d at 973.

265. *Id.*

266. *Id.* at 274.

267. See *supra* Part V.C.

268. Linde Alle-Murphy, *Are Compulsory Arbitration Clauses in Consumer Contracts Enforceable? A Contractual Analysis*, 75 TEMPLE L. REV. 125, 159 (Spring 2002). Another commenter wondered “if the historical hostility to arbitration will be carried forward under the guise of waiver and unconscionability.” Johnson, *supra* note 76, at 614.

269. See Perry v. Thomas, 482 U.S. 483, 492 (1987) (noting that “[c]ourt[s] may not, then, in assessing the rights of litigants to enforce an arbitration agreement, construe that agreement in a manner different from that in which it otherwise construes nonarbitration agreements under state law”). However, despite this declaration and the fact that parties had agreed to arbitrate under state law, the Supreme Court held that the FAA preempted the state law decision, and that the arbitration agreement was enforceable. *Id.* at 492-93.

VI. PREEMPTION, ARBITRATION, AND FRANCHISE AGREEMENTS

A. Introduction to Franchise Agreements and Arbitration Clauses

After examining how courts have treated FAA preemption with respect to certain legal doctrines and procedural issues, this section analyzes FAA preemption with respect to particular practice areas. Franchise agreements seem to be quite common in arbitration case law, and from this area, one can analyze FAA preemption through a different lens. This section will first give the legal foundation for FAA preemption in the franchise context and then will specifically focus on the validity of arbitration provisions, forum selection clauses. It will also touch briefly on attorneys' fees.

B. The Legal Foundation for Preemption in the Franchise Context

The leading case with regard to preemption and franchise agreements is *Southland Corp. v. Keating*.²⁷⁰ The statute at issue was the California Franchise Investment Law (FIL).²⁷¹ The FIL provided that "[a]ny condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void."²⁷² Although this statute did not specifically refer to arbitration, the California Supreme Court interpreted this statute to require judicial determination of claims "brought under the State statute and accordingly refused to enforce the parties' contract to arbitrate such claims."²⁷³ The Court, in *Southland*, reiterated the oft-repeated purpose of the FAA, to "declare[] a national policy favoring arbitration and withdr[awing] the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."²⁷⁴ The Court then quoted from section 2 of the FAA, which states that

A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*²⁷⁵

The Court found that the FIL was preempted by the FAA, and therefore, was invalid under the Supremacy Clause.²⁷⁶ In a footnote, the Court responded to Justice Stevens' dissent, which emphasized the clause in section 2 of the FAA that allows a party to avoid an arbitration clause on "such grounds as exist at law or in

270. 465 U.S. 1 (1984).

271. CAL. CORP. CODE § 31512 (West 1977).

272. *Id.*

273. *Southland*, 465 U.S. at 10.

274. *Id.*

275. *Id.* (quoting 9 U.S.C. § 2 (1976)) (emphasis added).

276. *Southland*, 465 U.S. at 16.

equity for the revocation of any contract.”²⁷⁷ In this footnote, the Court agreed “that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement.”²⁷⁸ Yet, the Court concluded “that the defense to arbitration found in the [FIL] is not a ground that exists at law or in equity ‘for the revocation of *any* contract’ but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the [FIL].”²⁷⁹ In this bit of dicta, the Court highlighted the fact that the only defenses to nullify an arbitration provision were those defenses that were applicable to *all* contracts, not just those regarding arbitration or those involving a certain area of the law (e.g. franchise agreements).

Since *Southland*, there have been many lower court decisions that have struck down state statutes in the franchise context as being preempted by the FAA. The cases can be broken down into three general categories, including state statutes regarding (1) the validity of franchise agreement arbitration clauses, (2) forum selection clauses in franchise agreement arbitration provisions, and (3) attorneys fees in franchise agreement arbitration provisions.

C. Validity of Franchise Agreement Arbitration Clauses

In *Saturn Distribution Corp. v. Paramount Saturn, Ltd.*,²⁸⁰ the Fifth Circuit Court of Appeals held that the Texas Motor Vehicle Board (TMVB) did “not have exclusive jurisdiction over contractual disputes between franchisors and franchisees in the motor vehicle industry.”²⁸¹ Moreover, the court noted that even if the TMVB did have exclusive jurisdiction over such disputes, the FAA would preempt such a restraint on arbitration.²⁸²

In *Cornhusker International Trucks, Inc. v. Thomas Built Buses, Inc.*,²⁸³ the Nebraska Supreme Court held the Nebraska Uniform Arbitration Act that was amended in 1997 was preempted by the FAA.²⁸⁴ The Nebraska law provided an exception to the validity of arbitration provisions when the provision was between parties that were covered under the Nebraska motor vehicle industry licensing statutes.²⁸⁵ The court in *Cornhusker*, relying on *Southland*, found “that the FAA preempts Nebraska law which conflicts with the FAA . . . and [there are] no grounds at law or in equity for its revocation.”²⁸⁶

In Alabama,²⁸⁷ the Alabama Motor Vehicle Franchise Act prohibited binding arbitration.²⁸⁸ In *Bondy's Ford, Inc. v. Sterling Truck Corp.*,²⁸⁹ the United States

277. *Id.* at 16 n.11(quoting 9 U.S.C. § 2).

278. *Id.*

279. *Id.*

280. *Saturn Distrib. Corp. v. Paramount Saturn, Ltd.*, 326 F.3d 684 (5th Cir. 2003).

281. *Id.* at 687.

282. *Id.*

283. 637 N.W.2d 876 (Neb. 2002).

284. *Id.* at 883.

285. See NEB. REV. STAT. §§ 25-2602.01 and 60-1401.01, *et seq.* (2002)

286. *Cornhusker*, 637 N.W.2d at 883-84.

287. Alabama has been one of the states that treats arbitration harshly. See 1975 ALA. CODE § 8-1-41(3) (stating that an agreement to submit a controversy to arbitration cannot be specifically enforced).

288. 1975 ALA. CODE § 8-20-4(3)(m).

289. 147 F. Supp. 2d 1283 (M.D. Ala. 2001).

District Court for the Middle District of Alabama held that the Alabama statute was preempted by the FAA.²⁹⁰ The party seeking to avoid arbitration argued that an exception to the FAA was carved out by Congress when it enacted the Dealer's Day in Court Act (DDCA).²⁹¹ The court in *Bondy's Ford*, acknowledged that there may be "legal constraints external to the parties' agreement that foreclose the arbitration of . . . claims,"²⁹² but held that the DDCA was not such a legal constraint. In reaching this conclusion, the court noted that "[t]he DDCA enables automobile dealers to bring suit against manufacturers for 'failure . . . to act in good faith in performing or complying with any of the terms or provisions of the franchise, or in terminating, canceling, or not renewing the franchise with said dealer.'"²⁹³ The court found that although a federal right and federal cause of action were created, this did not carve out an exception to the FAA.²⁹⁴ The language of the DDCA is permissive, not mandatory, and thus only opens district courts to plaintiffs, but does not close the door to arbitration.²⁹⁵

The party seeking to avoid arbitration also made an argument that the arbitration provision in the franchise agreement could not be enforced because it was unconscionable.²⁹⁶ The court did acknowledge that an unconscionability defense was a valid defense to the enforcement of arbitration provisions under the FAA and that Alabama law "permit[ed] a court to refuse to enforce any contract that is unconscionable."²⁹⁷ Still, the court found that the party claiming unconscionability did not satisfy the element of being unreasonable, given any reasonable choice.²⁹⁸ The court concluded by stating that the unconscionability argument was "without merit and clearly falls far short of what is required to show that an agreement is unconscionable."²⁹⁹

In *Equipment Manufacturers Institute v. Janklow*,³⁰⁰ a South Dakota statute, the Dealership Act, "prevent[ed] a manufacturer from conditioning the offer, grant, or renewal of a dealership contract on a dealer's agreement to the inclusion of a binding arbitration clause."³⁰¹ The court noted, "The Dealership Act does not prevent the parties from including such an arbitration clause, as long as the manufacturer does not insist upon it as a condition to the offer, grant, or renewal of the dealership contract."³⁰² Although that franchisees and franchisors could freely enter into arbitration and the Dealership Act did not prohibit arbitration in franchise agreements, the court found that the Dealership Act was preempted by the FAA because "the Act still places arbitration clauses on an unequal footing, by

290. *Id.* at 1287.

291. *Id.* at 1286. See 15 U.S.C. §§ 1221-25.

292. *Bondy's Ford*, 147 F. Supp. 2d at 1287.

293. *Id.* (quoting the DDCA).

294. *Id.* at 1287.

295. *Id.*

296. *Id.* at 1291.

297. *Id.* See also 1975 ALA. CODE § 7-2-302 (on unconscionability in contracts and contract clauses).

298. *Bondy's Ford*, 147 F. Supp. 2d at 1292.

299. *Id.*

300. *Equip. Mfrs. Inst. v. Janklow*, 136 F. Supp. 2d 991 (D.S.D. 2001), *aff'd in part and rev'd on other grounds*, 300 F.3d 842 (8th Cir. 2002).

301. *Id.* at 1000. See S.D. CODIFIED LAWS § 37-5-15(2) (2003).

302. *Id.*

refusing to enforce them along with other terms to which the parties mutually agree before a dispute arises.”³⁰³

In New Jersey, the New Jersey Franchise Practices Act (NJFPA) provided that:

(a) It shall be a violation of the Franchise Practices Act . . . for a motor vehicle franchisee to agree to a term or condition in a franchise . . . as a condition to the offer, grant or renewal of the franchise . . . which:

(3) Requires that disputes between the motor vehicle franchisor and motor vehicle franchisee to be submitted to arbitration or to any other binding alternate dispute resolution procedure; provided, however, that any franchise . . . may authorize the submission of a dispute to arbitration . . . if the motor vehicle franchisor and motor vehicle franchisee voluntarily agree to submit the dispute to arbitration . . . at the time the dispute arises.³⁰⁴

The court in *Central Jersey Freightliner, Inc. v. Freightliner Corp.*³⁰⁵ found that there was a “clear conflict between the FAA and the NJFPA.”³⁰⁶ The court noted, “While the New Jersey statute does not operate as a wholesale proscription of arbitration clauses in franchise agreements and creates only a presumption of invalidity, the statute clearly limits the enforceability of arbitration clauses by requiring, at the very least, that a franchisor prove that the franchisee was offered an identical agreement without the arbitration provision.”³⁰⁷ Given this conflict, the court held that the “NJFPA . . . violat[ed] the Supremacy Clause and is preempted by the FAA.”³⁰⁸

Another leading case in the area of FAA preemption of state statutes that invalidate arbitration provisions in franchise agreements is *Doctor's Associates, Inc. v. Casarotto*.³⁰⁹ In *Casarotto*, a Montana statute required that the arbitration clause be “typed in underlined capital letters on the first page of the contract.”³¹⁰ The Court in *Casarotto* found “Montana’s first-page notice requirement, which governs not ‘any contract,’ but specifically and solely contracts ‘subject to arbitration,’ conflicts with the FAA and is therefore displaced by the federal measure.”³¹¹ Because the Montana law placed arbitration agreements in a separate class and limited only their validity, the statute was inconsistent with the FAA, and therefore, preempted.³¹²

In *Saturn Distribution Corp. v. Williams*,³¹³ a Virginia statute prohibited “automobile manufacturers and dealers from entering into agreements that contain

303. *Id.*

304. N.J. STAT. ANN. 56:10-7.3 (West 2001).

305. *Cent. Jersey Freightliner, Inc. v. Freightliner Corp.*, 987 F. Supp. 289 (D.N.J. 1997).

306. *Id.* at 300.

307. *Id.*

308. *Id.*

309. *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996).

310. *Id.* at 683 (citing MONT. CODE ANN. § 27-5-114(4) (1995)).

311. *Doctor's Assocs.*, 517 U.S. at 683.

312. *Id.* at 688.

313. *Saturn Distrib. Corp. v. Williams*, 905 F.2d 719 (4th Cir. 1990).

mandatory alternative dispute resolution provisions.”³¹⁴ In *Williams*, the court held that the state statute was preempted by the FAA because “Virginia law generally permit[ted] contracting parties to make terms nonnegotiable, and singles out arbitration provisions as an exception to that rule.”³¹⁵ While holding that the Virginia statute was preempted by the FAA, the court discussed to which law the statute in question should be compared. The court declared:

In determining whether the Virginia statute impermissibly burdens arbitration provisions, it must be compared to *general* contract law rather than to laws which apply only to contracts subject to the Motor Vehicle Licensing Act, or to miscellaneous statutes which prohibit a narrow assortment of unrelated contractual terms because they violate public policy.³¹⁶

In *Seymour v. Gloria Jean’s Coffee Bean Franchise Corp.*,³¹⁷ the District Court of Minnesota held that the FAA preempted the Minnesota Franchise Act, which prohibited predispute agreements to arbitrate.³¹⁸ The party seeking to avoid arbitration in this case also argued that the arbitration agreement lacked mutuality of obligation, and therefore, the party was not bound by the agreement.³¹⁹ The court rejected this argument, stating “The agreement as a whole does not lack consideration, nor does the agreement in its entirety lack mutuality. The Court finds nothing in the mutuality doctrine which should bar enforcement of the arbitration agreement.”³²⁰

The final case discussed here with respect to the validity of franchise arbitration agreements is *Scanlon v. P & J Enterprises, Inc.*³²¹ In *Scanlon*, the franchisees sued the franchisor for various claims, including breach of contract, fraud, negligence, and tortious interference with a business relationship.³²² The franchisees sought to avoid arbitration and claimed that the underlying claim was fraud in the inducement of the franchise contract, and therefore, they were absolved of having to arbitrate.³²³ The court in *Scanlon* disagreed with that contention and found that the parties were required to arbitrate.³²⁴

D. Forum Selection Clauses in Franchise Agreement Arbitration Provisions

Forum selection clauses in arbitration provisions of franchise agreements have consistently been upheld and state statutes that prohibit or restrict choosing a forum for arbitration have been preempted by the FAA. The most recent case

314. *Id.* at 721 (citing VA. CODE ANN. § 46.1-550.5:24 (Supp. 1989)).

315. *Id.* at 724.

316. *Id.* at 725 (emphasis in original).

317. *Seymour v. Gloria Jean’s Coffee Bean Franchising Corp.*, 732 F. Supp. 988 (D. Minn. 1990).

318. *Id.* at 994.

319. *See id.* at 995 (citing *Hull v. Norcom, Inc.*, 750 F.2d (11th Cir. 1985)).

320. *Id.* at 996.

321. *Scanlon v. P & J Enter., Inc.*, 451 N.W.2d 616 (Mich. Ct. App. 1990).

322. *Id.* at 617.

323. *Id.*

324. *Id.* at 618.

holding that a statute restricting forum selection clauses was preempted by the FAA is *Bradley v. Harris Research, Inc.*³²⁵ In *Bradley*, the California Franchise Relations Act provided that “A provision in a franchise agreement restricting venue to a forum outside [California] is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state.”³²⁶ The party seeking to avoid arbitration “contend[ed] that § 20040.5 [was] not preempted by the FAA because it treat[ed] arbitration and litigation equally and [did] not single out arbitration as a disfavored form of dispute resolution.”³²⁷ The court rejected this argument and stated, “Section 40040.5 applies only to forum selection clauses and only to franchise agreements; it therefore does not apply to ‘any contract.’”³²⁸ Further, the court held that the California statute was preempted by the FAA because it did not apply equally to all contracts.³²⁹

Similarly, in *Flint Warm Air Supply Co., Inc. v. York International Corp.*, a federal district court in Michigan held that the Michigan Franchise Investment Law was preempted by the FAA.³³⁰ The Michigan statute provided:

Each of the following provisions is void and unenforceable if contained in any document relating to a franchise. . . . A provision requiring that arbitration or litigation be conducted outside this state. This shall not preclude the franchisee from entering into an agreement, at the time of arbitration, to conduct arbitration at a location outside this state.³³¹

The court in *Flint* held that the Michigan statute was preempted by the FAA because the statute “impose[d] limitations on the method and manner by which the parties agreed to arbitrate their disputes, . . . [and] the state statute placed greater restrictions on arbitration agreements than on other contracts.”³³² For the same reasons posited in *Bradley*, the court in *Flint* found the restriction on choice of forum clauses in franchise arbitration provisions to be preempted by the FAA.

Another similar case, this time involving the Rhode Island Franchise Investment Act,³³³ is *KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*³³⁴ The Rhode Island statute provided that, “A provision in a franchise agreement restricting jurisdiction or venue to a forum outside this state or requiring the application of the laws of another state is void with respect to a claim otherwise enforceable under this act.”³³⁵ Although the statute did not explicitly single out arbitration, the court in *KKW* held that the statute was preempted by the FAA. The court explained:

325. *Bradley v. Harris Research, Inc.*, 275 F.3d 884, 886 (9th Cir. 2001).

326. *Id.* at 888 (quoting CA. BUS. & PROF. § 20040.5 (1997)).

327. *Id.* at 889.

328. *Id.* at 890.

329. *Id.*

330. *Flint Warm Air Supply Co. v. York Int'l Corp.*, 115 F. Supp. 2d 820, 827 (D. Mich. 2000).

331. *Id.* at 824 (quoting MICH. COMP. LAWS § 445.1527(f) (1999)).

332. *Flint*, 115 F. Supp. 2d at 827.

333. R.I. GEN. LAWS § 19-28.1-14 (1999).

334. *KKW Enters., Inc. v. Gloria Jean's Gourmet Coffee Franchising Corp.*, 184 F.3d 42 (1st Cir. 1999).

335. R.I. GEN. LAWS § 19-28.1-14 (1999).

Because this proscription limits the statute's application to one type of provision, venue clauses, in one type of agreement, franchise agreements, the statute does not apply to *any* contract. Simply stated, because § 19-28.1-14 is not a generally applicable contract defense, it is, if applied to arbitration agreements, preempted by § 2 of the FAA.³³⁶

In *Doctor's Associates, Inc. v. Hamilton*,³³⁷ the Second Circuit "preempted" the New Jersey Supreme Court decision in *Kubis & Perszyk Associates, Inc. v. Sun Microsystems, Inc.*³³⁸ The party seeking to avoid arbitration relied on *Kubis* to defend its position that "a forum selection clause in a franchise agreement which designated an out-of-state judicial forum was presumptively invalid under the state's franchise protection act."³³⁹ Although *Kubis* related to judicial forums, the court in *Hamilton* held that "to the extent that *Kubis* can be read to invalidate arbitral forum selection clauses in franchise agreements, it is preempted by the FAA."³⁴⁰ Although *Hamilton* could have easily been distinguished from *Kubis*, therefore disregarding the need to explicitly preempt, the Second Circuit took advantage of the opportunity to find that the New Jersey law would not be expanded as to be applicable to arbitration.

The final case discussing choice of law clauses in franchise arbitration agreements is *Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc.*³⁴¹ The court in *Alphagraphics* found that the Michigan Franchise Investment Law was preempted.³⁴² The Michigan statute provided that a "provision requiring that arbitration or litigation be conducted outside this state [was void]."³⁴³ The court held because "the state statute placed greater restrictions on arbitration agreements than on other contracts [it . . . was preempted by the FAA]."³⁴⁴ However, the decision in *Alphagraphics* is somewhat different than the previously described cases, *supra*, in that the court in *Alphagraphics* found that the agreement to a choice of law clause in the arbitration agreement was procured by fraud, and because fraud is applicable to all contracts, it is not preempted by the FAA.³⁴⁵ Thus, although the parties were required to arbitrate their claims, the arbitration was to take place in Michigan, and not Arizona where the choice of law clauses provided.³⁴⁶

E. Attorneys Fees in Franchise Agreement Arbitration Provisions

The final area of exploration of preemption and arbitration provisions in franchise agreements is with respect to attorneys' fees. The leading case on preemption and attorneys' fees is *Buzas Baseball, Inc. v. Salt Lake Trappers, Inc.*³⁴⁷ In

336. *KKW Enterprises*, 184 F.3d at 51.

337. *Doctor's Assocs., Inc. v. Hamilton*, 150 F.3d 157 (2d Cir. 1998).

338. 680 A.2d 618 (N.J. 1996).

339. *Hamilton*, 150 F.3d at 162.

340. *Id.* at 163.

341. *Alphagraphics Franchising, Inc. v. Whaler Graphics, Inc.*, 840 F. Supp. 708 (D. Ariz. 1993).

342. *Id.* at 710.

343. *Id.* at 709 (quoting MICH. COMP. LAWS § 445.1527(f) (1999)).

344. *Id.* at 710.

345. *Id.* at 711.

346. *Id.* at 711-12.

347. *Buzas Baseball, Inc. v. Salt Lake Trappers, Inc.*, 925 P.2d 941 (Utah 1996).

Buzas, the arbitration panel found for the Trappers, finding that Buzas Baseball had not complied with the procedures for drafting a lower classification team's territory.³⁴⁸ On appeal, Buzas Baseball argued that the Trappers were not permitted to collect reasonable attorneys' fees because the FAA does "not explicitly provide for attorney fees."³⁴⁹ The Utah Arbitration Act did provide for reasonable attorneys' fees,³⁵⁰ but Buzas argued that the Utah Arbitration Act was preempted by the FAA.³⁵¹ The Utah Supreme Court rejected this argument and found that the Utah Act was not preempted as to attorney fees.³⁵² The court, relying on *Volt*, found that awarding attorneys' fees did not conflict with the federal policy of placing arbitration agreements "upon the same footing as other contracts" and to "overrule the judiciary's longstanding refusal to enforce agreements to arbitrate."³⁵³ The Utah Supreme Court also compared the Utah Act with the Uniform Arbitration Act (UAA)³⁵⁴ and found that the Uniform Act had been held by many jurisdictions to allow for awarding attorneys' fees and that the Utah Act was consistent with the Uniform Act.³⁵⁵ Finally, the court analyzed the policies underlying awarding attorneys' fees, and found those to be consistent with the FAA.³⁵⁶

F. Conclusion

From this survey of FAA preemption in the franchise agreement context, one can see that courts have routinely stuck to the Supreme Court's language that promotes arbitration and lower courts have extended the concept of treating arbitration equally with all other contracts so that almost no state statute or state court decision striking the validity or forum selection clause of an arbitration agreement will withstand FAA preemption. It is interesting to note however that courts are not just blindly preempting state statutes dealing with arbitration, but they are looking at furthering the underlying policies, as is the case with awarding attorneys' fees.

VII. FAA PREEMPTION AND THE REVISED UNIFORM ARBITRATION ACT

A. How was the Uniform Arbitration Act "Revised"?

The prime objective of the revision to the Uniform Arbitration Act (UAA) is to continue to promote arbitration as a desirable alternative to litigation by making

348. *Id.* at 945.

349. *Id.* at 952.

350. *Id.* The Utah Arbitration Act, UTAH CODE ANN. §§ 78-31a-1 to 78-31a-20, was repealed May 15, 2003.

351. *Buzas*, 925 P.2d at 952.

352. *Id.*

353. *Id.*

354. UAA § 1 (1997).

355. *Buzas*, 925 P.2d at 952-53.

356. *Id.* at 953.

the arbitration process efficient, expeditious, economical, fair to the parties, and final.³⁵⁷

The revisions to the UAA address the following issues:³⁵⁸

1. Which forum (arbitrator or court) decides arbitrability of a dispute and by what criteria. Courts are limited to deciding whether an agreement to arbitrate exists or a controversy is subject to an agreement to arbitrate.³⁵⁹

The arbitrator, on the other hand, is responsible for deciding whether an agreement to arbitrate exists and whether a contract containing a valid agreement to arbitrate is enforceable.³⁶⁰

2. Which forum orders provisional remedies such as attachments, restraining orders, etc. A court is responsible for entering orders for provisional remedies before an arbitrator is appointed.³⁶¹ After an arbitrator is appointed, the arbitrator may issue such remedies, and the parties only have recourse to the courts for such remedies in urgent matters, where the arbitrator is not acting timely or cannot provide an adequate remedy.³⁶²

3. The process for initiating arbitration. The Revised Uniform Arbitration Act requires notice in the manner agreed to by the parties, and, in the absence of an agreement, provides a gap-filler—notice shall be given by certified or registered mail, or by service for a civil action, and must describe the nature of the controversy and the remedy sought.³⁶³

4. Authority to consolidate arbitrations. If not prohibited by the agreement of the parties, the court may order consolidation of some or all claims if the parties, claims, or issues are similar, or if prejudice would result from failure to consolidate.³⁶⁴

5. Requiring arbitrators to disclose facts which may affect impartiality. Arbitrators must disclose financial or personal interests in the outcome of the arbitration and relationships with the parties to the agreement to arbitrate or other persons involved in the arbitration proceeding.³⁶⁵

6. Provisions for immunity of arbitrators and arbitration organizations. Arbitrators and arbitration organizations have immunity to the same extent as a judge acting in judicial capacity.³⁶⁶

357. See REV. UNIF. ARBITRATION ACT Policy Statement ¶ 1, available at <http://www.law.upenn.edu/bll/ulc/uarba/arb0500.htm> (last visited Nov. 10, 2003) [hereinafter RUA, Policy Statement].

358. See *id.*

359. UAA § 6(b), 7 U.L.A. 1 (rev. 2000 Supp. 2003).

360. *Id.* § 6(c).

361. *Id.* § 8(a).

362. *Id.* § 8(b).

363. *Id.* § 9(a).

364. *Id.* § 10.

365. *Id.* § 12.

366. *Id.* § 14(a).

7. Whether arbitrators can be required to testify in other proceedings. Arbitrators or representatives of arbitration organizations are only competent to testify to the extent necessary to determine a claim against a party or in a hearing to vacate an award if prima facie evidence for vacatur exists.³⁶⁷
8. Discretion of arbitrators to order discovery, issue protective orders, decide motions for summary dispositions, hold prehearing conferences, and otherwise manage the arbitration process. An arbitrator may conduct arbitration in a manner appropriate for a fair and expeditious disposition of the proceeding.³⁶⁸
9. Provisions for courts to enforce pre-award rulings by the arbitrator. Parties may request the arbitrator to incorporate pre-award rulings into the award, which courts will confirm by issuing an order.³⁶⁹
10. Defining arbitration remedies including provisions for attorney's fees, punitive damages and other exemplary relief. Arbitrators may award such relief if authorized by law in a civil action involving the same claim.³⁷⁰
11. Specifying which sections of RUA are not waivable or those that cannot be restricted unreasonably. This provision is designed to ensure basic fairness, particularly in adhesion contracts where one party has little or no bargaining power to modify the terms of the agreement.³⁷¹
12. Provisions for enforcing subpoenas to witnesses who reside in states other than the arbitration state. Arbitration subpoenas are to be handled in the same manner as subpoenas in a civil action in the adopting state.³⁷²
13. Providing for vacatur when arbitrators fail to disclose facts which could reasonably affect impartiality³⁷³ or the arbitrator displayed evident partiality, corruption, or prejudicial misconduct.³⁷⁴
14. Standards for giving and receiving notice in arbitration proceedings. Notice may be given by taking any action reasonably necessary to inform the other party; notice is received if the recipient has or should have

367. *Id.* § 14(d).

368. *Id.* § 15(a).

369. *Id.* § 18.

370. *Id.* § 21.

371. *Id.* § 4.

372. *Id.* § 17.

373. *Id.* § 12.

374. *Id.* § 23(a)(2).

knowledge of it, or the notice is addressed to the recipient at his place of residence or business.³⁷⁵

Procedural aspects that are new to the Act are definitions to allow traditional terms such as “record” to function in e-arbitration³⁷⁶ and a provision defining the effective date for application of the Act (the Revised Act is not retroactive).³⁷⁷

As of September 21, 2003, eight states had adopted the RUAA, updating their arbitration laws to reflect developments in the field since the original UAA was written in 1956.³⁷⁸ The adopting states are: Hawaii, New Jersey, New Mexico, North Carolina, North Dakota, Nevada, Oregon and Utah.³⁷⁹

B. How Does the RUAA Deal with FAA Preemption?

The U.S. Supreme Court has taken a strong pro-arbitration stance in cases decided under the FAA in the past two decades.³⁸⁰ The Court has held that the FAA usually preempts state law that runs contrary to these federal pro-arbitration policies.³⁸¹ However, state arbitration laws are still relevant, both in cases where the parties choose to be bound by the arbitration law of a particular state and where state arbitration laws are consistent with the Supreme Court’s pro-arbitration position.³⁸² Of course, state arbitration statutes must be careful not to regulate agreements different than other contracts—such statutes are subject to federal preemption.³⁸³ Because both the UAA and the RUAA have the goal of promoting the arbitration process, they are not preempted by the FAA. As one judge plainly stated, “[C]ourts have decided numerous cases under the UAA and should continue to do so with state adoptions of the RUAA.”³⁸⁴ The two key issues that the Supreme Court’s preemption-related opinions have centered upon are enforcement of the agreement to arbitrate and issues of substantive arbitrability.³⁸⁵ In order to reassure states desiring to adopt the RUAA that federal preemption would not be a

375. *Id.* § 2.

376. Also known as Online Dispute Resolution, e-arbitration is not a new form of dispute resolution, but rather a tool to allow the arbitrator and the parties to conduct the arbitration over the internet. For example, see the services offered at E-Arbitration-T, at <http://www.e-arbitration-t.com> (last visited Nov. 10, 2003), and SquareTrade, offering online dispute resolution for E-bay, online auctions, at <http://www.squaretrade.com> (last visited Nov. 10, 2003).

377. See Timothy J. Heinsz, *The Revised Uniform Arbitration Act: Modernizing, Revising, and Clarifying Arbitration*, 2001 J. DISP. RESOL. 1, 9-37.

378. See Staff Reporters, *North Carolina Governor Signs Revised Uniform Arbitration Act*, ADR-WORLD.COM, at <http://www.ADRWorld.com> (Aug. 1, 2003).

379. *Id.* Arbitration websites, such as ADRWorld.com, are excellent sources of up-to-date information on the most recent states considering and adopting the RUAA.

380. Heinsz, *supra* note 377, at 3.

381. *Id.* at 4.

382. *Id.*

383. *Id.* at 5.

384. *Id.* at 5.

385. UAA prefatory note, 7 U.L.A. 1 (rev. 2000 Supp. 2003), citing *Doctor's Assocs. v. Casarotto*, 517 U.S. 681 (1996); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995); *Perry v. Thomas*, 482 U.S. 483 (1987); *Southland Corp. v. Keating*, 465 U.S. 2 (1984); *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983); *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967).

problem under the Revised Act, its drafters kept the strong policy of federal preemption under the FAA as a backdrop to all their discussions.³⁸⁶

To avoid preemption concerns, the Act's drafters ultimately decided to leave many potentially preemption-inducing issues to developing case law and federal legislative action, rather than attempting to fashion a definitive rule.³⁸⁷ This approach of omission was used for the issue of arbitration agreements in adhesion contracts.³⁸⁸ Although there are many critics of arbitration agreements in the consumer, employee, and franchisee contexts, the RUAA drafters did not formulate regulation in those areas in order to "avoid the significant FAA preemption problems raised by singling out some arbitration agreements for particular treatment different from other contract law."³⁸⁹ Another issue the drafters left undeveloped due to preemption concerns was unconscionability.³⁹⁰ General state contract law, rather than a statute specifically geared towards arbitration, is better suited to address the issue and less likely to be preempted for singling out arbitration agreements for stricter treatment.³⁹¹

Finally, the Act's drafters faced disagreement over whether the Revised Act should address the standards and procedures for vacatur, confirmation and modification of arbitration awards.³⁹² The FAA speaks definitively to these standards and procedures; however, the Supreme Court has not yet spoken directly about preemptive effect, if any, of the FAA with regard to these issues.³⁹³ Thus, the RUAA drafters trod lightly when faced with the task of drafting state law provisions relating to these issues. According to the Act's Prefatory Note, it is the drafters' belief that "the Supreme Court's unequivocal stand to date as to the preemptive effect of the FAA provides strong reason to believe that a similar result will obtain with regard to Section 10(a) grounds for vacatur."³⁹⁴ If such a determination is made, the drafters believe that the "FAA preemption of conflicting state law with regard to . . . vacatur (and confirmation and modification) would be certain."³⁹⁵

One of the most difficult questions the RUAA Drafting Committee wrestled with regarding federal preemption was "the question of whether the RUAA should explicitly sanction contractual provisions for 'opt-in' review of challenged arbitration awards beyond that presently contemplated by the FAA and current state arbitration acts."³⁹⁶ There are two types of "opt-in" provisions, depending on the type of review provided—judicial or arbitral. A judicial opt-in provision provides an opportunity for judicial review in a designated state court and grants the court authority to vacate challenged awards, typically for errors of law or fact.³⁹⁷ Arbitral opt-in provisions create an appellate review procedure within the arbitration

386. Heinsz, *supra* note 377, at 5.

387. *Id.* at 7.

388. *Id.*

389. *Id.*

390. *Id.*

391. *Id.*

392. UAA prefatory note (referring to Sections 9, 10, 11, and 12 of the FAA).

393. *Id.*

394. *Id.*

395. *Id.*

396. *Id.*

397. *Id.*

system for the challenged awards. Like the judicial review, these awards are also generally reviewed for errors of law or fact.³⁹⁸

The drafters who favored authorizing the opt-in provisions in the RUAA believed that parties to an arbitration agreement should be free to contract for judicial review if they want it.³⁹⁹ Opt-in provisions are a measure of protection against “bonehead” decisions by an arbitrator.⁴⁰⁰ Many of the drafters thought that approving the opt-in provisions under the RUAA would allow more people to become aware of the possibility of such a review provision.⁴⁰¹ Finally, the proponents argued, parties would be more likely to use arbitration if a more liberal standard of review was available, as opposed to the narrow grounds in the UAA or FAA.⁴⁰²

Drafters on the other side of the debate, however, held firmly to the idea that one of arbitration’s best features is finality. Allowing for review of awards on the whim of either party destroys this feature.⁴⁰³ Another problem with opt-in review is the additional procedural requirements⁴⁰⁴ that would have to be grafted onto the arbitral process in order to enable a judge or arbitral panel to conduct “meaningful review” of an arbitrator’s decision, erasing the benefits of lower costs and higher efficiency from arbitration.⁴⁰⁵ Some drafters feared that sanctioning opt-in provisions would cause the inclusion of such clauses in arbitration agreements to become common practice.⁴⁰⁶ Finally, the opponents argued, if parties are so distrustful of arbitration that they must have an appeals process, then perhaps those parties are better off going to court.⁴⁰⁷ Opponents to the opt-in provisions also pointed out that permitting their use would cause a “substantial risk” of federal preemption of the RUAA, because it would be creating a new ground for vacatur, in addition to the four grounds listed in section 10(a) of the FAA.⁴⁰⁸

Since the four U.S. Courts of Appeals⁴⁰⁹ that have taken up the issue have been evenly split as to the validity of such agreements, and the Supreme Court has

398. *Id.*

399. See RUAA Policy Statement, *supra* note 357, at ¶ 5; Heinz, *supra* note 377, at 27.

400. Heinsz, *supra* note 377, at 27.

401. *Id.*

402. *Id.*

403. See RUAA Policy Statement, *supra* note 357, at ¶ 5; Heinz, *supra* note 377, at 27-28.

404. Heinsz, *supra* note 377, at 27-28 (referring to the “record” and written findings of law and fact by the arbitrator).

405. *Id.* at 28.

406. See RUAA, Policy Statement, *supra* note 357, at ¶ 5arbps0500.htm.

407. Heinsz, *supra* note 377, at 28.

408. *Id.*; See also FAA § 10 (a) (2000). The four grounds are:

- (1) there are separate agreements to arbitrate or separate arbitration proceedings between the same persons or one of them is a party to a separate agreement to arbitrate or a separate arbitration proceeding with a third person;
- (2) the claims subject to the agreements to arbitrate arise in substantial part from the transaction or series of related transactions;
- (3) the existence of common issue of law or fact creates the possibility of conflicting decisions in the separate arbitration proceeding; and
- (4) prejudice resulting from a failure to consolidate is not outweighed by the risk of undue delay or prejudice to the rights of or hardship to parties opposing consolidation.

FAA § 10 (a) (2000).

409. The Fifth and Ninth Circuits have approved the use of opt-in provisions in arbitration agreements. See *LaPine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884 (9th Cir. 1997); *Gateway Techs., Inc. v. MCI Telecomms. Corp.*, 64 F.3d 993 (5th Cir. 1995). The Seventh and Eighth Circuits have disapproved of opt-in provisions. See *UHC Management Co. v. Computer Sciences Corp.*, 148 F.3d 992 (8th Cir. 1998); *Chicago Typographical Union v. Chicago Sun-Times*, 935 F.2d 1501 (7th Cir. 1991).

not ruled on this issue, the drafters chose to omit the clause, thus avoiding any preemption concerns.⁴¹⁰ However, as Professor Heinsz points out, exclusion of this clause from the RUAAs neither limits parties' abilities to include such clauses in jurisdictions that have not disapproved of the practice, nor does it prevent the less-controversial practice of providing for a form of arbitral review.⁴¹¹ Because arbitral review panels do not "entangle courts in the arbitral decision-making process," there is no risk of federal preemption under the FAA.⁴¹²

VIII. CONCLUSION

Originally, the FAA was seen as a body of procedural law that was applicable only in federal courts.⁴¹³ However, due to several Supreme Court decisions, the scope of the FAA has increased tremendously. As a result of a handful of cases, the Supreme Court has explained that the FAA essentially withdraws states' power to compel judicial resolution of claims when parties have validly contracted for arbitration.⁴¹⁴ The powerful preemptive effect of this area of federal law has caused controversy in recent years, resulting in many advocates, as well as opponents, to clamor for reform of the methods by which parties enter into or are subjected to arbitration.⁴¹⁵ It is fairly clear, especially in the situation of state laws that directly address arbitration agreements, that the dangers of FAA preemption are ever-present. As a result, lower courts are forced to use neutral state contract law to enforce states' public policies against arbitration. In an effort to help states comply and avoid FAA preemption, the RUAAs were drafted, but are still in the early stages of adoption. Because of the current lack of uniformity among the states regarding arbitration statutes and case law, as well as the diversity of state contract law construction and application, the future of arbitration remains murky, yet intriguing.

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410. Heinsz, *supra* note 377, at 29-30; See RUAAs Policy Statement, *supra* note 357, at ¶ 5.

411. Heinsz, *supra* note 377, at 30.

412. *Id.*

413. MACNEIL, *supra* note 33.

414. See *supra* Part III.

415. See, e.g., Larry J. Pittman, *The Federal Arbitration Act: The Supreme Court's Erroneous Statutory Interpretation, Stare Decisis, and a Proposal for Change*, 53 ALA. L. REV. 789 (2002) (discussing the history of arbitration and critiquing the three theories of statutory interpretation).

