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### Federal Arbitration Law and State Court Proceedings

Zhaodong Jiang

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# FEDERAL ARBITRATION LAW AND STATE COURT PROCEEDINGS

*Zhaodong Jiang\**

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## I. INTRODUCTION

Arbitration is a method of dispute settlement. In arbitration, parties voluntarily agree to refer their existing or future disputes to a third party—an arbitrator—for determination and they agree in advance to accept the arbitrator's decision as final and binding.<sup>1</sup> The parties look to arbitration as a quicker, less costly alternative to litigation. Parties are free to select the arbitrators, the time and place of proceedings; and the parties may also choose the substantive rules and norms to govern the dispute—including issues of remedy. Moreover, arbitration may avoid some of the problems which may plague parties in litigation, such as hostility, disruption of any ongoing or future business relationship, or negative publicity.<sup>2</sup>

Under the common law, parties could revoke an arbitration agreement at any time prior to an award.<sup>3</sup> To change this rule, legislatures began to enact statutes that made arbitration agreements binding on the parties. In 1920, New York enacted the first arbitration statute in the country that reversed the common-law rule of revocability of arbitration agreements.<sup>4</sup> In 1925, Congress passed the United States Arbitration Act.<sup>5</sup> The USAA provides that arbitration agreements in maritime transactions and in contracts affecting either interstate or foreign com-

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1. This Article focuses on consensual arbitration, i.e., arbitration based on a contractual agreement. It will not discuss arbitration compelled by court order or statute.

2. These advantages were recognized by Congress when it passed legislation regarding voluntary patent arbitration, 35 U.S.C. § 294 (1988). A committee of the United States House of Representatives commented that

[arbitration] is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices; and, arbitrators are frequently better versed than judges and juries in the area of trade customs and the technologies involved in these disputes.

H.R. REP. NO. 542, 97th Cong., 2d Sess. 13, *reprinted in* 1982 U.S. CODE CONG. & ADMIN. NEWS 756, 777.

3. *See infra* notes 20-22 and accompanying text.

4. N.Y. Arbitration Act, ch. 275, 2 N.Y. Laws 803 (1920) (codified as amended at N.Y. CIV. PRAC. L. & R. 7501 (McKinney 1980)). For a review of the statute, see Berkovitz v. Arbib & Houlberg, Inc., 230 N.Y. 261, 130 N.E. 288 (1921).

5. Act of Feb. 12, 1925, ch. 213, 43 Stat. 883 (1925) (current version at 9 U.S.C. §§ 1-208 (1988)). The United States Arbitration Act was first enacted February 12, 1925. *Id.* It was codified in Title 9 of the United States Code in 1947. Act of July 30, 1947, ch. 392, 61 Stat. 669. After amendment in 1954, Act of Sept. 3, 1954, ch. 1263, § 19, 68 Stat. 1233, Congress added chapter 2 of the USAA in 1970. Act of July 31, 1970, Pub. L. No. 91-368, 84 Stat. 692. Section 15 (inapplicability of Act of State doctrine) was added in November of 1988. Act of Nov. 16, 1988, Pub. L. No. 100-669, § 1, 102 Stat. 3969. A second section 15 (appeals) was added later that same month. Act of Nov. 19, 1988, Pub. L. No. 100-702, tit. X, § 1019(a), 102 Stat. 4670.

merce are as valid, enforceable and irrevocable as any other contract.<sup>6</sup> Today, the overwhelming majority of states have enacted arbitration statutes which follow the pattern of the New York and federal arbitration statutes and adopt a policy in favor of the use of arbitration as a means of dispute resolution.<sup>7</sup>

Difficult issues arise from the relationship between the USAA and

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6. 9 U.S.C. § 2 (1988).

7. The Uniform Arbitration Act (UAA) is one of the most important modern arbitration statutes adopted by states. The current UAA was approved in 1955 by the National Conference of Commissioners on Uniform State Laws and the American Bar Association. UNIF. ARBITRATION ACT, 7 U.L.A. 5 (1985).

Fifty jurisdictions have adopted some type of modern arbitration statute with 32 states adopting the UAA. *See* 9 U.S.C. §§ 1-208 (1988); ALASKA STAT. §§ 09.43.010-.180 (1983) (adopting UAA); ARIZ. REV. STAT. ANN. §§ 12-1501 to -1518 (1982) (adopting UAA); ARK. STAT. ANN. §§ 16-108-201 to -224 (1987) (adopting UAA); CAL. CIV. PROC. CODE §§ 1280-1298.8 (West 1980 & Supp. 1989); COLO. REV. STAT. §§ 13-22-201 to -223 (1987) (adopting UAA); CONN. GEN. STAT. ANN. §§ 52-408 to -424 (West 1960); DEL. CODE ANN. tit. 10, §§ 5701-5725 (1975) (adopting UAA); D.C. CODE ANN. §§ 16-4301 to -4314 (1989) (adopting UAA); FLA. STAT. ANN. §§ 682.01-.20 (West Supp. 1989); GA. CODE ANN. §§ 9-9-1 to -83 (Supp. 1989); HAW. REV. STAT. §§ 658-1 to -12 (1985); IDAHO CODE §§ 7-901 to -922 (1979) (adopting UAA); ILL. REV. STAT. ch. 10, para. 101-123 (1987) (adopting UAA); IND. CODE §§ 34-4-2-1 to -22 (1986) (adopting UAA); IOWA CODE ANN. §§ 679A.1-.14 (West 1987) (adopting UAA); KAN. STAT. ANN. §§ 5-401 to -422 (1982) (adopting UAA); KY. REV. STAT. ANN. §§ 417.045-.230 (Michie/Bobbs-Merrill Supp. 1988) (adopting UAA); LA. REV. STAT. ANN. §§ 9:4201-4217 (West 1983); ME. REV. STAT. ANN. tit. 14, §§ 5927-5949 (1980) (adopting UAA); MD. CTS. & JUD. PROC. CODE ANN. §§ 3-201 to -234 (1984) (adopting UAA); MASS. GEN. LAWS ANN. ch. 251, §§ 1-19 (West 1988) (adopting UAA); MICH. STAT. ANN. §§ 600.5001-.5305 (Callaghan 1988) (adopting UAA); MINN. STAT. ANN. §§ 572.08-.30 (West 1988) (adopting UAA); MISS. CODE ANN. §§ 11-15-101 to -143 (Supp. 1988) (adopting statutory rules for arbitrating future disputes which only apply to construction contracts with some exceptions); MO. ANN. STAT. §§ 435.350-.470 (Vernon Supp. 1989) (adopting UAA); MONT. CODE ANN. §§ 27-5-111 to -324 (1989) (adopting UAA); NEB. REV. STAT. §§ 25-2601 to -2622 (Supp. 1988) (adopting UAA); NEV. REV. STAT. ANN. §§ 38.015-.205 (Michie 1987) (adopting UAA); N.H. REV. STAT. ANN. §§ 542:1-10 (1974); N.J. STAT. ANN. § 2A:24-1 (West 1987); N.M. STAT. ANN. §§ 44-7-1 to -22 (1978) (adopting UAA); N.Y. CIV. PRAC. L. & R. 7501-7514 (McKinney 1980); N.C. GEN. STAT. §§ 1-567.1-.20 (1983) (adopting UAA); N.D. CENT. CODE §§ 32-29.2-01 to -20 (Supp. 1989) (adopting UAA); OHIO REV. CODE ANN. §§ 2711.01-.24 (Anderson 1981); OKLA. STAT. ANN. tit. 15, §§ 801-818 (West Supp. 1989) (adopting UAA); OR. REV. STAT. §§ 33.210-.300 (1987); PA. CONS. STAT. ANN. §§ 7301-7320 (Purdon 1982) (adopting UAA); R.I. GEN. LAWS §§ 10-3-1 to -21 (1985); S.C. CODE ANN. §§ 15-48-10 to -240 (Law. Co-op. Supp. 1988) (adopting UAA); S.D. CODIFIED LAWS ANN. §§ 21-25A-1 to -38 (1987) (adopting UAA); TENN. CODE ANN. §§ 29-5-301 to -320 (Supp. 1988) (adopting UAA); TEX. REV. CIV. STAT. ANN. arts. 224 to 238-6 (Vernon Supp. 1989) (adopting UAA); UTAH CODE ANN. §§ 78-31a-1 to -18 (1987) (adopting UAA); VT. STAT. ANN. tit. 12, §§ 5651-5681 (Supp. 1989) (adopting UAA); VA. CODE ANN. §§ 8.01-581.01-.016 (Supp. 1989) (adopting UAA); WASH. REV. CODE ANN. §§ 7.04.010-.220 (1961); WIS. STAT. ANN. §§ 788.01-.18 (West 1981); WYO. STAT. §§ 1-36-101 to -119 (1988) (adopting UAA). Puerto Rico has also adopted a similar arbitration statute. P.R. LAWS ANN. tit. 32, §§ 3201-3229 (1968). A few states, such as Alabama and West Virginia, have not adopted any such arbitration statutes.

state arbitration statutes. This Article focuses on one of those federal-state relationship issues—application of the federal arbitration law in state court proceedings.<sup>8</sup> Under common law, the enforcement of arbitration agreements or awards was treated as procedural or remedial, and arbitration cases were decided under the law of the forum.<sup>9</sup> However, the enactment of the USAA has raised the issue of whether the federal arbitration law should be applied to state court proceedings. Most importantly, the outcome of a dispute may turn on whether federal or state arbitration law applies because differences between federal and state laws still exist.<sup>10</sup> The United States Supreme Court has addressed the applicability of a number of provisions in the federal arbitration statute to state court proceedings.<sup>11</sup> Recently, in *Volt Information Sciences, Inc. v.*

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8. For discussions on application of state law in federal cases, see, e.g., Sturges & Murphy, *Some Confusing Matters Relating to Arbitration Under the United States Arbitration Act*, 17 LAW & CONTEMP. PROBS. 580 (1952); Note, *Federal Arbitration Act and Application of the "Separability Doctrine" in Federal Courts*, 1968 DUKE L.J. 588; Note, *Incorporation of State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391 (1980); Note, *Scope of the United States Arbitration Act in Commercial Arbitration: Problems in Federalism*, 58 NW. U.L. REV. 468 (1963); Note, *Commercial Arbitration in Federal Courts*, 20 VAND. L. REV. 607 (1967); Note, *Erie, Bernhardt, and Section 2 of the United States Arbitration Act: A Farrago of Rights, Remedies, and a Right to a Remedy*, 69 YALE L.J. 847 (1960). For discussions of the issue of application of federal arbitration law to state court proceedings, see, e.g., Atwood, *Issues in Federal-State Relations under the Federal Arbitration Act*, 37 U. FLA. L. REV. 61 (1985); Hirshman, *The Second Arbitration Trilogy: the Federalization of Arbitration Law*, 71 VA. L. REV. 1305 (1985); Note, *The Federal Arbitration Act in State Courts: Converse Erie Problems*, 55 CORNELL L. REV. 623 (1970); Note, *Preemption of State Law under the Federal Arbitration Act*, 15 U. BALT. L. REV. 129 (1985). This Article will not discuss the issues particular to application of Chapter Two of the USAA—arbitration rules governing international commercial arbitration—to state court proceedings.

9. See, e.g., *Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109 (1924) (New York state court could apply state arbitration law in maritime case because arbitration regarded as procedural).

10. There are significant differences between federal arbitration law and various state arbitration laws. Some states require that arbitration agreements include notice of existence of the agreements. See, e.g., MO. ANN. STAT. § 435.460 (Vernon Supp. 1989); S.C. CODE ANN. § 15-48-10 (Law. Co-op. Supp. 1989). In a number of states, arbitration agreements regarding particular contracts or claims are excluded. See, e.g., GA. CODE ANN. §§ 9-9-2(c)(6), (7) (Supp. 1989) (consumer contracts); IOWA CODE § 679A.1(2)(b) (1987) (employment contracts); KAN. STAT. ANN. § 5-401(c)(2) (Supp. 1988) (employment contracts); MICH. COMP. LAWS § 600.5005 (1987) (title to estates); MONT. CODE ANN. § 27-5-114(2)(a) (1989) (personal injury or tort); OKLA. STAT. ANN. tit. 15, § 818 (West 1989). State arbitration statutes may give courts the power to decide particular issues, such as whether the claim is barred by a statute of limitations. See DEL. CODE ANN. tit. 10, § 5702(c) (1975); GA. CODE ANN. § 9-9-5 (Supp. 1989); N.Y. CIV. PRAC. L. & R. 7502(b) (McKinney Supp. 1989). State arbitration statutes may give courts the discretion to delay arbitration when the issues are related to a pending court action. See, e.g., CAL. CIV. PROC. CODE § 1281.2(c) (West 1982).

11. Compare *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 26 (1983) (Brennan, J.) ("[S]tate courts, as much as federal courts, are obliged to grant stays of litigation under § 3 of the Arbitration Act.") with *Southland Corp. v. Keating*, 465 U.S. 1, 16 n.10

*Board of Trustees*,<sup>12</sup> the Supreme Court permitted a California court to apply a California rule pursuant to a choice-of-law clause, even though the case fell within the federal arbitration statute.<sup>13</sup> The California rule gave the court discretion to stay arbitration where third parties and non-arbitrable issues were involved in the dispute.<sup>14</sup> The case raised a critical issue of federal-state relations: To what extent should parties be allowed to choose a state law that overrides federal law, and how should parties' intent be construed?<sup>15</sup>

This Article first discusses the circumstances underlying the enactment of arbitration statutes. It then examines the central provision in the USAA, section 2, and its applicability to state court proceedings. Section 2 creates a body of federal substantive law governing the validity, enforceability, and irrevocability of arbitration agreements where the underlying transaction is maritime or where the underlying contract evidences a transaction involving interstate commerce.<sup>16</sup> Federal and state courts generally agree that section 2 applies to state court proceedings.<sup>17</sup> The second part of this Article focuses on the proper reach of section 2 and examines the role of choice-of-law clauses in the determination of validity and enforceability of arbitration agreements and the role of state law under section 2.

The third part of the Article deals with the application of sections 3 and 4 of the USAA to state court proceedings. These two sections constitute a regulatory scheme to enforce federally created arbitration rights. The provisions of sections 3 and 4 differ and their applicability to state proceedings varies.<sup>18</sup> For reasons outlined below, the specific enforcement provisions contained in sections 3 and 4 should apply to state court proceedings.<sup>19</sup> The Article argues that provisions of the federal statute touching the division of functions between courts and arbitrators, interpretation of arbitration agreements, and coexistence of arbitrable and non-arbitrable issues, should apply to state court proceedings unless the parties have clearly agreed otherwise.

The fourth part of the Article discusses the application of federal

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(1984) (Burger, C.J.) ("In holding that the Arbitration Act preempts a state law that withdraws the power to enforce arbitration agreements, we do not hold that §§ 3 and 4 of the Arbitration Act apply to proceedings in state courts.").

12. 109 S. Ct. 1248 (1989).

13. *Id.* at 1253-56.

14. *Id.* at 1253.

15. *Id.* at 1251.

16. 9 U.S.C. § 2 (1988). See *infra* notes 42-69 and accompanying text.

17. See *infra* notes 48-49 and accompanying text.

18. See 9 U.S.C. §§ 3-4 (1988). See also *infra* notes 164-71 and accompanying text.

19. See *infra* notes 164-80 and accompanying text.

rules and procedures to pre-award proceedings in state courts. Specifically, it focuses on preliminary injunctive relief, consolidation and appellate review.

The last part of the Article addresses the application of USAA post-award rules and procedures to state court proceedings. The Article suggests that whether and how federal arbitration law should apply depends on the analysis of two issues: (1) whether the federal policy in favor of arbitration and enforcement of arbitration rights is thwarted; and (2) what the parties agreed to, especially with regard to choice of law.

## II. THE ENACTMENT OF STATE ARBITRATION STATUTES AND THE USAA

Historically, the common law did not favor arbitration agreements which were revocable at any time prior to an award.<sup>20</sup> Commentators criticized the common law's hostility toward enforcement of arbitration agreements,<sup>21</sup> but due to the weight of precedent and the absence of stat-

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20. The common-law rule of revocability of arbitration agreements originated from English common law. See, e.g., Jones, *Historical Development of Commercial Arbitration in the United States*, 12 MINN. L. REV. 240 (1927-28); Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595 (1928); Wolaver, *The Historical Background of Commercial Arbitration*, 83 U. PA. L. REV. 132 (1934). The rule maintained that to enforce an arbitration agreement was to oust the courts of jurisdiction. As a court's jurisdiction is created by law, it was considered against public policy for private parties to change the statutory judicial power through contract. See, e.g., *United States Asphalt Ref. Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006, 1008 (S.D.N.Y. 1915). One reason behind the "ousting of jurisdiction" theory was the fact that judicial salaries at that time depended on litigation fees. Sayre, *supra*, at 611. Furthermore, courts did not trust arbitration. Courts feared that arbitration would not protect the legal or equitable rights of the parties in the same way as courts because arbitrators did not possess the same authority as judges and were not bound by the same rules of law. See *Tobey v. County of Bristol*, 23 F. Cas. 1313, 1320-21 (C.C.D. Mass. 1845) (No. 14,065). Also, use of arbitration meant loss of the right to litigate, and courts were worried that a stronger party might take advantage of a weaker party by forcing the latter to agree to arbitration instead of litigation. See *Arbitration of Interstate Commercial Disputes, Hearing on S. 1005 and H.R. 646 Before the Joint Committee of the Subcomm. on the Judiciary*, 68th Cong., 1st Sess. 15 (1924) (remarks of Julius Cohen). Finally, courts sometimes felt unable to enforce an arbitration agreement due to a lack of adequate authority. See *Tobey*, 23 F. Cas. at 1320-21. For instance, where the arbitration agreement provided that the arbitrator would be mutually selected by the parties and one party refused to participate in the selection, the court hesitated to compel a party to make a potentially impracticable or inequitable selection. *Id.*

21. See *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978, 984 (2d Cir. 1942) (stating that while adhering to common law, earlier courts, nevertheless, criticized judicial hostility toward enforcement of arbitration agreements). See also generally J. COHEN, *COMMERCIAL ARBITRATION AND THE LAW* (1918). Interestingly, the common law was not hostile to enforcement of arbitration awards. For example, in *Burchell v. Marsh* the Court stated that there exists a "presumption . . . in favor of the validity of the award." 58 U.S. 344, 351 (1854). There were several reasons for the difference in judicial attitudes toward enforcement of awards. First, early English cases generally favored enforcement of awards. See, e.g.,

utes to the contrary, courts were unwilling to change the common-law rule allowing revocability of arbitration agreements.<sup>22</sup>

Therefore, various legislatures were left to adopt rules favoring binding arbitration. With the enactment of New York's arbitration statute in 1920,<sup>23</sup> and the USAA in 1925,<sup>24</sup> the common-law rule of revocability began to lose favor.

The New York arbitration statute,<sup>25</sup> the USAA and the arbitration statutes in the overwhelming majority of states contain the following general features:

(1) The validity, enforceability and revocability of an agreement to arbitrate existing or future disputes are to be determined by the rules governing the validity, enforceability and revocability of any other contract.<sup>26</sup>

(2) The statutes set down rules and procedures for judicial actions in pre-award proceedings.<sup>27</sup> They were intended to make procedures for enforcement of arbitration agreements summary and simple.<sup>28</sup> For example, except for a few instances where the existence and validity of arbi-

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Price v. Williams, 30 Eng. Rep. 388 (1791) (parties, by choosing private judges, placed dispute beyond reach of any principle of law; error of mistake of law not reason for disturbing award). Second, many of the concerns that militated against enforcement of arbitration agreements in pre-award proceedings no longer existed in post-award proceedings. For example, one reason for courts' refusal to compel arbitration was the difficulty in forcing a resisting party to select an arbitrator. No such difficulty exists if both parties selected an arbitrator and the dissatisfied party challenged the award afterward. Moreover, the issue of whether arbitration provided an adequate solution to the dispute could be addressed through judicial review. Finally, while a party could revoke the arbitration agreement before an award was made, the party's failure to revoke was considered a waiver of the right to revocation. *Burchell*, 58 U.S. at 349. The United States Supreme Court echoed the sentiments of the common-law courts on the issue when the Court said: "Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes, [arbitration] should receive every encouragement from courts of equity." *Id.*

However, courts were limited regarding enforcement procedures. For instance, a judgment of court could not be entered directly on an award. See W. STURGES, *A TREATISE ON COMMERCIAL ARBITRATIONS AND AWARDS* 674 (1930).

22. See *United States Asphalt Ref. Co.*, 222 F. at 1010-11 (courts would not enforce arbitration agreements unless compelled to such action by statute).

23. N.Y. Arbitration Act, ch. 275, 2 N.Y. Laws 803 (1920) (codified as amended at N.Y. CIV. PRAC. L. & R. 7501 (McKinney 1980)). For a review of the statute, see Berkovitz v. Arbib & Houlberg, Inc., 230 N.Y. 261, 130 N.E. 288 (1921).

24. Act of Feb. 12, 1925, ch. 213, 43 Stat. 883 (1925) (current version at 9 U.S.C. §§ 1-208 (1988)).

25. N.Y. CIV. PRAC. L. & R. 7501-7514 (McKinney 1980).

26. See, e.g., 9 U.S.C. § 2 (1988); N.Y. CIV. PRAC. L. & R. 7501 (McKinney 1980) (originally enacted as C.P.A. 1920 § 1448). When amended in 1963 this exact language was omitted as "unnecessary." 1963 N.Y. Laws ch. 532, § 7.

27. See, e.g., CAL. CIV. PROC. CODE § 1290 (West 1982).

28. *Id.*



tration agreements are concerned, enforcement or denial of enforcement of arbitration agreements is decided upon motion papers, affidavits and other exhibits in a summary fashion.<sup>29</sup> The statutes also provide the courts with the power to decide matters which are necessary to arbitration proceedings.<sup>30</sup> For example, they contain rules governing the appointment of arbitrators by courts if parties are unable to reach an agreement.<sup>31</sup>

(3) The statutes give arbitrators power regarding such matters as calling witnesses and the structure of depositions,<sup>32</sup> but they also authorize courts to provide assistance in arbitration proceedings in some circumstances.<sup>33</sup>

(4) The statutes simplify procedures and practice in post-award proceedings. A party which is successful at arbitration is no longer required to bring an action upon the award; unlike under common-law arbitration rules,<sup>34</sup> the party may simply file a motion for judgment on the award.<sup>35</sup>

(5) Under the statutes, an award is deemed to be valid and enforceable unless the opposing party shows that it should be vacated or otherwise disturbed.<sup>36</sup> The grounds for vacation, modification or correction of awards under modern arbitration statutes are limited.<sup>37</sup>

Distinctions between the USAA and the various state arbitration statutes can be outcome determinative. Thus, understanding how and when the USAA will apply to state court proceedings is important to resolution of the arbitrated dispute.

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29. See Cohen & Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 271-72 (1926).

30. See, e.g., N.Y. CIV. PRAC. L. & R. 7503(a), 7504 (McKinney 1980); N.J. STAT. ANN. § 2A:24-5 (West 1987).

31. One reason for Justice Story's refusal in *Tobey v. County of Bristol* specifically to enforce arbitration agreements was that the court had no power to force the parties to select arbitrators or to select arbitrators for the parties. 23 F. Cas. 1313, 1320-22 (C.C.D. Mass. 1845) (No. 14,065). Many modern arbitration statutes provide courts with such power. See, e.g., 9 U.S.C. § 5 (1988); N.Y. CIV. PRAC. L. & R. 7504 (McKinney Supp. 1989).

32. See Cohen & Dayton, *supra* note 29, at 272.

33. Under section 7 of the USAA, for instance, if a person summoned by an arbitrator to testify in an arbitration proceeding refuses or neglects to comply with the summons, a federal court may, upon petition, compel the attendance of the person before the arbitrator or punish the person for contempt. 9 U.S.C. § 7 (1988).

34. See generally *United States Asphalt Ref. Co.*, 222 F. at 1010-11.

35. See Cohen & Dayton, *supra* note 29, at 272.

36. *Id.* at 272-73. See, e.g., N.H. REV. STAT. ANN. § 542:8 (1974); N.J. STAT. ANN. § 2A:24-8 (West 1987); N.Y. CIV. PRAC. L. & R. 7511 (McKinney 1980).

37. See, e.g., 9 U.S.C. §§ 10, 11 (1988); CAL. CIV. PROC. CODE §§ 1286.2, 1286.6 (West 1982).

### III. SECTION 2 OF THE USAA: SUBSTANTIVE FEDERAL LAW

Federal arbitration law interacts with state court proceedings in three ways. First, the federal substantive law governing validity, enforceability and irrevocability of arbitration agreements binds state courts.<sup>38</sup> Second, rules and procedures intended to be part of an enforcement scheme under federal law and which affect enforcement of federal arbitration rights also bind state courts,<sup>39</sup> but may be displaceable by a clear choice-of-law agreement.<sup>40</sup> Finally, certain federal rules and procedures may not apply to state court proceedings because they are not necessary to enforce arbitration rights.<sup>41</sup>

Section 2 of the USAA provides:

A written provision in any maritime transaction or a 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.<sup>42</sup>

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38. See, e.g., *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984); *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32 (1983).

39. See generally *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 409 (2d Cir. 1959), cert. denied, 364 U.S. 801 (1960); *A/S J. Ludwig Mowinckles Rederi v. Dow Chem. Co.*, 25 N.Y.2d 576, 579, 255 N.E.2d 774, 776-77, 307 N.Y.S.2d 660, 663-64, cert. denied, 398 U.S. 939 (1970). These federal rules and procedures may also give way to state rules and procedures if the latter are more favorable to enforcement of arbitration rights than the former. See *Downing v. Allstate Ins. Co.*, 124 Mich. App. 727, 732, 335 N.W.2d 139, 141, appeal denied, vacated in part, 419 Mich. 932, 355 N.W.2d 111 (1983).

40. See, e.g., *Volt Information Sciences, Inc. v. Board of Trustees*, 109 S. Ct. 1248, 1253 (1989).

41. See generally *Kress Corp. v. Edward C. Levy Co.*, 102 Ill. App. 3d 264, 269, 430 N.E.2d 593, 596-97 (1981).

42. 9 U.S.C. § 2 (1988). Section 1 provides:

"Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.

*Id.* § 1 (1988).

An initial question is whether section 2 creates a body of federal substantive law governing the validity, enforceability and revocation of arbitration agreements in transactions involving interstate commerce and admiralty. If so, the Supremacy Clause mandates that section 2 applies in state court proceedings as well.<sup>43</sup> Congress' authority to enact the USAA was based on Congress' power under the Commerce Clause to regulate interstate and foreign commerce.<sup>44</sup> The legislative history of the USAA suggests that under a broad definition of Congress' power to regulate commerce, the USAA would make all arbitration agreements in transactions involving commerce or admiralty valid, enforceable and irrevocable as a matter of federal law, and thus applicable to the states.<sup>45</sup> Despite questions that occasionally have been raised as to the applicability of section 2 of the USAA to state court proceedings,<sup>46</sup> the prevailing view is that Congress' commerce power supports creation by section 2 of a body of federal substantive law governing the validity and enforceability of arbitration agreements in transactions involving interstate commerce or admiralty.<sup>47</sup> Therefore, section 2 is binding on state courts.

#### A. Reach of Section 2

Section 2 applies to state court proceedings only where the arbitration agreement in question is "in any maritime transaction or a contract evidencing a transaction involving commerce."<sup>48</sup> The question of appli-

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43. U.S. CONST. art. VI, cl. 2. See also Baum & Pressman, *The Enforcement of Commercial Arbitration Agreements in the Federal Courts*, 8 N.Y.U. L.Q. REV. 428, 459-60 (1931); 13B C. WRIGHT, A. MILLER & E. COOPER, *FEDERAL PRACTICE AND PROCEDURE* § 3569, at 173 (1984).

44. U.S. CONST. art. I, § 8; *Southland Corp. v. Keating*, 465 U.S. 1, 11 (1983). The legislative history of the USAA indicates that the arbitration legislation was founded "upon the Federal control over interstate commerce and . . . admiralty." H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924). See also *Southland Corp.*, 465 U.S. at 11 ("The Federal Arbitration Act rests on the authority of Congress to enact substantive rules under the Commerce Clause.").

45. At the time the USAA was prepared, it was argued that the commerce power of Congress was broad enough to support the legislation. See *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Joint Committee of the Subcomm. on the Judiciary*, 68th Cong., 1st Sess. 38 (1924). See also Atwood, *supra* note 8, at 77-78.

46. See *Perry v. Thomas*, 482 U.S. 483, 494-95 (1987) (O'Connor, J., dissenting); *Southland Corp.*, 465 U.S. at 21-36 (O'Connor, J., dissenting). See also *Alabama Oxygen Co. v. York Int'l*, 433 So. 2d 1158, 1162-67 (Ala. 1983), *vacated*, 465 U.S. 1016 (1984), *on remand*, 452 So. 2d 860, 861 (1984) (Embry, J., dissenting).

47. *Southland Corp.*, 465 U.S. at 12 (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967)) ("The statement . . . that the Arbitration Act was an exercise of the Commerce Clause power clearly implied that the substantive rules of the Act were to apply in state as well as federal courts."); *Moses H. Cone Mem. Hosp.*, 460 U.S. at 25 n.32 ("The Arbitration Act . . . creates a body of federal substantive law establishing and regulating the duty to honor an agreement . . .").

48. 9 U.S.C. § 2 (1988). Section 1 of the USAA provides that "nothing herein contained

cation of section 2 in most state arbitration cases turns on the issue of whether the underlying contract evidenced a transaction involving interstate or foreign commerce.<sup>49</sup>

### 1. The "transaction" concept

The USAA does not define the term "transaction." Case law determining which contractual relationships or matters constitute transactions within the meaning of section 2 is scarce. The legislative history of the USAA suggests that the legislation is aimed primarily at enforcement of arbitration agreements made between merchants.<sup>50</sup>

An argument may be made that not all contractual relationships and matters are transactions within the meaning of section 2. For example, some contractual relationships and matters may not fall under section 2 because they are normally regulated by state law and policy—where federal interests are weak and where no policy reasons compel application of federal arbitration law. Examples of such relationships and matters include child support, alimony, medical malpractice, certain insurance matters, and consumer transactions. Those relationships or

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shall apply to contracts of employment of seamen, railroad employees or any other class of workers." *Id.* § 1. The scope of this exclusion clause has been a controversial subject. Some federal courts interpreted the clause as being limited to "workers engaged in the movement of interstate or foreign commerce." *Pietro Scalzitti Co. v. International Union of Operating Eng'rs, Local No. 150*, 351 F.2d 576, 580 (7th Cir. 1965) (quoting *Tenney Eng., Inc. v. United Elec., Radio & Mach. Workers of Am. Local 437*, 207 F.2d 450, 452 (3d Cir. 1953)). Other federal cases preferred a much broader scope of section 1. *See, e.g., United Elec., Radio & Mach. Workers of Am. v. Miller Metal Prods., Inc.*, 215 F.2d 221, 224 (4th Cir. 1954) (section applied to workers engaged in production of goods shipped in interstate or foreign commerce as well as workers transporting such goods). The prevailing view is that collective bargaining agreements are "contracts of employment" within the meaning of the exclusion clause. *See American Postal Workers Union, AFL-CIO v. United States Postal Serv.*, 823 F.2d 466, 471-73 (11th Cir. 1987). However, the modern view is that managerial or other white-collar employment contracts are not excluded under section 1. *See Dickstein v. duPont*, 443 F.2d 783, 785 (1st Cir. 1971) (employment of registered representative in brokerage firm not excluded). State cases have followed this federal trend. *See, e.g., Donmoor, Inc. v. Sturtevant*, 449 So. 2d 869 (Fla. Dist. Ct. App. 1984) (salespersons not excluded).

49. Arbitration cases in state courts occasionally involve admiralty. *See, e.g., Vigo S.S. Corp. v. Marship Corp.*, 26 N.Y.2d 157, 257 N.E.2d 624, 309 N.Y.S.2d 165, *cert. denied sub nom. Frederick Snare Corp. v. Vigo S.S. Corp.*, 400 U.S. 819 (1970).

50. *See Hearings on S. 4213 and S. 4214 Before the Subcomm. of the Senate Committee on the Judiciary*, 67th Cong., 4th Sess. 9-11 (1923) (proposed federal arbitration legislation was intended to apply in transactions between merchants). *See also Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, where it was pointed out that the USAA was intended to have a limited application to contracts between merchants for the interstate shipment of goods and that the principal support for the legislation came from trade associations dealing in groceries and other perishables and from commercial and mercantile groups in the major trading centers. 388 U.S. 395, 409 (1967) (Black, J., dissenting).

matters may involve commerce under a broad definition. For instance, child support and alimony payments may be interstate, or medical services may involve interstate travel or payments. However, these matters are normally subject to state regulation. Thus, no overriding federal policy exists to regulate arbitration issues in those contractual relationships and matters, even though commerce is involved.<sup>51</sup> Whether a particular contractual relationship or matter is a transaction under section 2 should be determined on the basis of federal interest and the development of federal law and policy.<sup>52</sup>

## 2. Whether commerce is involved

Once a court determines that an underlying contract evidences a transaction within the meaning of section 2, the next issue is whether the transaction involves either interstate or foreign commerce within the meaning of section 1.<sup>53</sup> In practice, the following questions significantly

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51. One area where federal law might yield to state regulations is insurance. Under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1982), Congress gave the states primary responsibility for regulating the business of insurance, and exempted the business from the application of federal law in certain circumstances. *Id.* § 1012(a), (b). Under that statute, a contract or transaction is exempted from a federal law, if: (1) the federal law in question was not intended to relate to the business of insurance; (2) the contract transaction is the "business of insurance"; and (3) the application of the federal law would invalidate, impair or supersede state law governing the contract or transaction. *Id.* It has been argued that since the USAA was not specifically intended to regulate the business of insurance, and arbitration of insurance claims is the "business of insurance," the USAA did not preempt the state law which explicitly made arbitration agreements in insurance contracts invalid or unenforceable. Lamson, *The Impact of the Federal Arbitration Act and the McCarran-Ferguson Act on Uninsured Motorist Arbitration (Special Section: Insurance Law)*, 19 CONN. L. REV. 241, 245 (1987).

52. An area which is traditionally occupied by state legislatures may become subject to federal regulations if federal interest in the area becomes significant. *See* Motor Vehicle Mfrs. Ass'n of the United States, Inc. v. Abrams, 697 F. Supp. 726 (S.D.N.Y. 1988) (consumer protection and warranty law is field traditionally occupied by states but Congress entered in 1975 with passage of Magnuson-Moss Act; therefore, state dispute-resolution mechanisms for consumer disputes are preempted by federal law in field).

53. *See* *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 200-01 (1955). A linguistic question arises here: Is there any difference between "involving commerce," as the term is applied to section 2, and "affecting commerce," as used in other federal statutes? For the federal statutes using "affecting," see the Federal Employers' Liability Act of 1908, § 1, 45 U.S.C. § 51 (1982); National Labor Relations Act of 1935, § 2, 29 U.S.C. § 152(7) (1982). Most courts have seemed to ignore this difference. *See, e.g., Bernhardt*, 350 U.S. at 201 (commerce would be involved if employee were working in commerce, producing goods for commerce, or engaging in activity that affected commerce). Only a few cases suggested, however, that "involving commerce" was intended to have a narrower scope than "affecting commerce." *Thayer v. American Fin. Advisers, Inc.*, 322 N.W.2d 599, 603-04 (Minn. 1982) (USAA used narrower language of "involving" as opposed to "affecting"); *see also* *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 400-01 (1967) (Black, J., dissenting) (Congress failed to use "affecting," statutory language Congress normally uses when it wishes to exercise its full powers over commerce).

affect the judicial determination of involvement of commerce:

First, could certain types of transactions be presumed to involve commerce within the meaning of section 2 or should the party seeking application of section 2 have the burden of proving the involvement of commerce no matter what transaction is involved?<sup>54</sup> For instance, is any construction contract presumed to evidence a transaction involving commerce or should the court require specific proof each time a construction contract is involved? Since construction projects normally involve interstate travel, purchases of materials, or other activities across state borders,<sup>55</sup> any construction contract may be presumed to involve commerce, and the burden to prove the contrary rests on the party resisting application of the USAA. On the other hand, since a construction contract itself may not indicate interstate activities, an argument exists that the party seeking application of the USAA should show involvement of interstate commerce.<sup>56</sup>

The second question is how involvement of commerce should be proved. Two tests have been developed. The first test looks to the parties' intent to determine whether they intended their transaction to involve interstate commerce.<sup>57</sup> The second test asks whether the

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54. The answer to the question appears to be simple in some cases. *See, e.g.,* Krauss Bros. Lumber Co. v. Louis Bossert & Sons, Inc., 62 F.2d 1004, 1006 (2d Cir. 1933) (contract clearly involved commerce if it required one to ship goods from Newark to Manhattan).

55. *See* Northwest Mechanical, Inc. v. Public Utils. Comm'n, 283 N.W.2d 522, 523-24 (Minn. 1979). *See also* Trident Tech. College v. Lucas & Stubbs, Ltd., 286 S.C. 98, 104, 333 S.E.2d 781, 785 (1985), *cert. denied*, 474 U.S. 1060 (1986) (contract to design and supervise construction of campus); University Casework Sys., Inc. v. Bahre, 172 Ind. App. 624, 362 N.E.2d 155 (1977) (contract to construct university facility in Indiana). *See Note, Preemption of State Law under the Federal Arbitration Act*, 15 U. BALT. L. REV. 129, 151 (1985) ("[I]t is difficult to imagine any contract arising from a major construction project that would not involve sufficient interstate commerce to fulfill the terms of the federal Act.").

56. *Higley South, Inc. v. Park Shore Dev. Co.*, 494 So. 2d 227, 230 n.1 (Fla. Dist. Ct. App. 1986) ("We . . . reject the notion that we should find . . . commerce . . . from the nature and magnitude of the construction undertaken by [general contractor]. Common knowledge or surmise cannot substitute for proof or, as in this case, a pleading alleging the presence of interstate commerce.").

57. The intent test was first suggested by Chief Judge Lumbard in *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382 (2d Cir.) (Lumbard, C.J., concurring), *cert. denied*, 368 U.S. 817 (1961). The case involved a construction contract between general contractors (Connecticut and New Jersey corporations) and subcontractors (New York corporation and residents) concerning a housing project in Florida. *Id.* at 383. The Court of Appeals for the Second Circuit held that the facts found by the lower court supported the finding that the transaction involved commerce. *Id.* at 384. Chief Judge Lumbard, in a concurring opinion, agreed on the result reached by the majority, but he suggested different reasons and approaches to the definition of commerce. *Id.* at 385 (Lumbard, C.J., concurring). He argued that since there was no indication that Congress in enacting the USAA had intended to affect state law, the concept of commerce under the USAA should be narrowly defined. *Id.* at 386-87 (Lumbard, C.J., concurring). He then suggested a test to determine commerce based on the

underlying transaction actually involved interstate commerce.<sup>58</sup> Use of one test to the exclusion of the other may lead to a finding that interstate commerce is not involved in a given case.<sup>59</sup> Simultaneous use of the two tests, on the other hand, would promote a finding that interstate commerce is involved.<sup>60</sup>

Finally, a court must decide what degree of interstate commerce is sufficient to invoke the application of sections 1 and 2. Some courts have adopted a position in favor of finding involvement of interstate commerce.<sup>61</sup> According to this position, a transaction between residents of different states involves interstate commerce because it will involve interstate travel, payment or other contacts.<sup>62</sup> On the other hand, some courts have required that "substantial interstate activity" be proved before the USAA will be applied.<sup>63</sup>

More often than not, federal law is more favorable to enforcement of arbitration agreements or awards than state law. Therefore, the federal

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parties' intention as manifested in the agreement rather than on what in fact happened. *Id.* at 387 (Lumbard, C.J., concurring).

58. *Cf. id.* at 384-85.

59. In *Action CATV, Inc. v. Wildwood Partners, Ltd.*, the court found that contracts to construct a community antenna television system and to manage the system did not involve commerce. 508 So. 2d 1274 (Fla. Dist. Ct. App. 1987). The court used the parties' intent test as suggested by Chief Judge Lumbard in *Metro. Id.* at 1276. In contrast, the court in *Withers-Busby Group v. Surety Indus., Inc.* found that although the parties had contemplated extensive business in the future on a nationwide scale, the case did not involve interstate commerce because there was no evidence that such business ever materialized. 538 S.W.2d 198, 199 (Tex. Ct. App. 1976).

60. *See* C.P. Robinson Constr. Co. v. National Corp. for Hous. Partnerships, 375 F. Supp. 446, 450 (M.D.N.C. 1974) (involvement of commerce based on both subjective and objective elements); *Burke County Pub. Schools Bd. of Educ. v. Shaver Partnership*, 303 N.C. 408, 417-20, 279 S.E.2d 816, 823 (1981) (commingled two tests to determine involvement of commerce; concluding that "[t]he contractual provisions, the parties' circumstances at the time of the agreements, and the actual manner of performance, considered together, make clear that the parties in making the contract contemplated substantial interstate activity.").

61. *See, e.g.,* *Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 243 (5th Cir. 1986) ("Citizens of different states engaged in performance of contractual operations in one of those states are engaged in a contract involving commerce under the [USAA]. Such a contract necessitates interstate travel of both personnel and payments.").

62. *Id.*

63. *See, e.g.,* *Riverfront Properties, Ltd. v. Max Factor III*, 460 So. 2d 948, 953-54 (Fla. Dist. Ct. App. 1984) (contract in question did not evidence degree of interstate activity necessary to invoke USAA, although contract contemplated use of interstate banking and communication facilities); *T.J. Paramore v. Inter-Regional Fin. Group Leasing Co.*, 68 N.C. App. 659, 663, 316 S.E.2d 90, 92 (1984) ("In the situation presented by the record the parties could not have contemplated that 'substantial interstate activity' would be required in carrying out the contract. All the 'activity' under the contract was to occur in North Carolina and the only thing that was to happen elsewhere was that defendant was to receive the rental payments at its office in Great Falls, Montana.").

policy favoring arbitration would be better served by a broad definition of involvement of commerce allowing federal law to apply instead of state law.<sup>64</sup> Under such a broad definition of involvement of commerce, transactions like architectural service contracts, construction contracts, and investment contracts could be deemed to involve interstate commerce, unless contrary proof is provided, because those transactions may involve interstate activities like interstate personal travel, payment, purchase of goods or communication. Where proof is required to show interstate activities, such requirement should not be unduly strict. Courts should find involvement of interstate commerce where it can be shown that either the parties have contemplated interstate activities or the underlying contract evidences a transaction that actually involved commerce regardless of the parties' intent. Furthermore, proof of substantial interstate activities should not be required because such a requirement would only add uncertainty as to the amount of interstate activity required.

A broad definition of commerce would provide state courts with a useful ground for enforcing arbitration agreements and awards where state law is not helpful. For instance, in some state cases courts could find involvement of interstate commerce and apply federal law rather than struggling with state law that did not support the enforcement of arbitration agreements.<sup>65</sup> Where the underlying contract evidences a transaction under section 2, any strict definition of involvement of commerce in order to preserve application of those state rules disfavoring arbitration should be rejected.<sup>66</sup>

In a few cases, state courts have found that commerce was not in-

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64. See, e.g., *Prima Paint Corp.*, 388 U.S. at 400 (federal law favored arbitration of fraudulent inducement of container contract while New York law might deny arbitration of issue); *R.J. Palmer Constr. Co. v. Wichita Band Instrument Co.*, 7 Kan. App. 2d 363, 642 P.2d 127 (1982) (Kansas law did not enforce arbitration agreement with regard to "claim in tort"); *Burke County Pub. Schools Bd. of Educ.*, 303 N.C. at 417-18, 279 S.E.2d at 822-23 (arbitration agreement was not enforceable under applicable state law); *Caudill v. Board of Educ.*, 47 A.D.2d 610, 364 N.Y.S.2d 7 (1975) (under New York law, whether claim was time-barred was for court to decide).

65. See *Board of Educ. v. W. Harley Miller, Inc.*, where, under West Virginia law, the agreement to arbitrate future disputes in a construction contract was revocable. 221 S.E.2d 882, 884 (W. Va. 1975). The court justified enforcement of the agreement on the ground that the agreement was a condition precedent to bringing an action. *Id.* at 885. Interestingly, the court could have enforced the agreement under section 2 of the USAA by finding that the contract evidenced a transaction involving commerce under the broad definition of commerce. In *Joseph L. Wilmotte & Co. v. Rosenman Bros.*, an Iowa corporation purchased steel products from a New York seller. 258 N.W.2d 317, 319 (Iowa 1977). Under Iowa law the arbitration agreement was not enforceable. *Id.* at 325. The court held that the agreement was enforceable by finding that New York law applied. *Id.* at 326-29. The court could have applied section 2 of the USAA by finding that interstate commerce was involved.

66. Federal law and policy control state court determinations of whether contracts evi-



volved and the USAA did not apply.<sup>67</sup> In those cases, application of state law instead of federal law better served the policy favoring arbitration, because state law appeared to be more favorable than federal law to enforcement of arbitration agreements or arbitration awards.<sup>68</sup> Even if the result obtained from application of state law is more favorable to arbitration, a denial of involvement of commerce is not the best justification for application of state law. Courts may justify application of state law either on the ground that the underlying contract does not evidence a transaction within the meaning of section 2 or by arguing that the federal rule in question is not necessary for enforcement of federal arbitration rights and that state law is consistent with the federal policy favoring arbitration.<sup>69</sup> To hold that commerce is not involved only adds confusion to the matter.

### B. Parties' Choice of State Law

Parties to a contract often agree that the law of a particular state governs their contract. Generally, parties' choice-of-law agreements are recognized and enforced by courts.<sup>70</sup> However, the question arises whether a choice-of-law agreement could prevent application of section 2

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dence transactions involving commerce. See, e.g., *R.J. Palmer Constr. Co.*, 7 Kan. App. 2d at 365, 642 P.2d at 129.

67. *Downing v. Allstate Ins. Co.*, 124 Mich. App. 727, 733, 335 N.W.2d 139, 141, *appeal denied, vacated in part*, 419 Mich. 932, 355 N.W.2d 111 (1983).

68. See *Downing*, where the court of appeal found an automobile insurance contract did not evidence a transaction involving commerce, because every event relevant to the case took place in Michigan. 124 Mich. App. at 733, 335 N.W.2d at 141. The court thus refused to apply the three-month limit for bringing a vacatur action under section 12 of the USAA. *Id.* at 733, 335 N.W.2d at 141-42. The court instead applied the 20-day limit under state arbitration law and barred the action for vacatur. *Id.* at 731-32, 335 N.W.2d at 141.

69. See *id.* at 733, 335 N.W.2d at 141 (contract did not evidence transaction involving interstate commerce); *Supak & Sons Mfg. v. Pervel Indus.*, 593 F.2d 135, 137 (4th Cir. 1979) (federal statute did not conflict with New York and North Carolina decisional law).

70. The parties' choice of applicable law, or "party autonomy," as it is often called, was disfavored by American courts in the past. See *E. Gerli & Co. v. Cunard S.S. Co.*, 48 F.2d 115 (2d Cir. 1931) (Hand, J.); J. BEALE, *THE CONFLICT OF LAWS* 1079-86 (1935). Today, party autonomy is generally recognized and parties' choice-of-law agreements are enforceable in court. See *Lauritzen v. Larson*, 345 U.S. 571, 592-93 (1953); *Hal Roach Studios, Inc. v. Film Classics, Inc.*, 156 F.2d 596, 598 (2d Cir. 1946). See also generally *RESTATEMENT (SECOND) OF CONFLICT OF LAWS* § 187 (1986). Party autonomy is subject, however, to limitations. A common limitation is that the jurisdiction whose law is chosen by the parties should have a certain relationship or contact with the transaction, parties or contract. See *Farris Eng'g Corp. v. Service Bureau Corp.*, 406 F.2d 519 (3d Cir. 1969); *A.S. Rampell, Inc. v. Hyster Co.*, 3 N.Y.2d 369, 144 N.E.2d 371, 165 N.Y.S.2d 475 (1957). Where the transaction involves more than \$250,000, New York no longer requires that the choice of New York law bear a reasonable relationship to New York. See *N.Y. GEN. OBLIG. LAW* § 5-1401(1) (McKinney 1989).

where the underlying contract evidences a transaction involving commerce.

A number of federal and state cases oppose the idea that the parties' choice-of-law agreements could displace otherwise applicable federal law regarding the validity and enforceability of arbitration agreements.<sup>71</sup> In *Commonwealth Edison Co. v. Gulf Oil Corp.*,<sup>72</sup> the party resisting arbitration argued that termination of a contract pursuant to a force majeure clause<sup>73</sup> terminated the contract's arbitration agreement.<sup>74</sup> This party based its argument on Illinois law, which the parties had designated as the law governing the validity, interpretation and performance of the contract and each of its provisions.<sup>75</sup> The trial court rejected this argument and the Seventh Circuit affirmed.<sup>76</sup> The court of appeals stated:

Parties are not free to burden the arbitration process under the Federal Act by adopting state law which shifts the determination of disputes from arbitrators to courts. To allow parties to so contract would undermine the provisions of the Federal Act. Congress, in enacting the Federal Arbitration Act, exercised its power over admiralty and interstate commerce. Any arbitration contract involving one of those areas is governed by the Federal Act. To permit the parties to contract away the application of the Act by adopting state law to govern their agreement would be inconsistent with the Act itself and with the holding in *Prima Paint*.<sup>77</sup>

On the other hand, a few cases have held that the federal law should not preempt the state law chosen by the parties to apply under an arbitra-

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71. See, e.g., *Medical Dev. Corp. v. Industrial Molding Corp.*, 479 F.2d 345 (10th Cir. 1973); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995 (8th Cir. 1972); *American Airlines, Inc. v. Louisville & Jefferson County Air Bd.*, 269 F.2d 811 (6th Cir. 1959). See also *Missouri ex rel. Saint Joseph Light & Power Co. v. Donelson*, 631 S.W.2d 887, 891-92 (Mo. App. 1982) (applying USAA despite choice of Missouri law by parties); *Tennessee River Pulp & Paper Co. v. Eichleay*, 637 S.W.2d 853, 858 (Tenn. 1982) (application of USAA in state courts is not altered by contractual provision calling for application of Tennessee law).

72. 541 F.2d 1263 (7th Cir. 1976).

73. *Id.* at 1266.

74. *Id.*

75. *Id.* at 1268-69.

76. *Id.* at 1274.

77. *Id.* at 1269. See also *Collins Radio Co.*, 467 F.2d at 997 (parties' choice-of-law clause designated Texas law shall apply); *Burke County Pub. Schools Bd. of Educ. v. Shaver Partnership*, 303 N.C. 408, 279 S.E.2d 816 (1981) (parties' choice-of-law clause designated North Carolina law shall apply); *Mamlin v. Susan Thomas, Inc.*, 490 S.W.2d 634 (Tex. Ct. App. 1973) (parties' choice-of-law clause designated New York law shall apply); *Pinkis v. Network Cinema Corp.*, 9 Wash. App. 337, 512 P.2d 751 (1973) (parties' choice-of-law clause designated New York law shall apply).

tion agreement.<sup>78</sup> In *Mid-Atlantic Toyota v. Charles A. Bott, Inc.*,<sup>79</sup> an agreement between a Pennsylvania car dealer and a Maryland car distributor provided for arbitration of any claim by the dealer.<sup>80</sup> Section XIVG of the agreement included the following language:

The parties acknowledge and agree that this Agreement is [made] or is deemed to have been made in the County of Howard, State of Maryland, and shall be governed by and construed according to the laws thereof. If any provision herein contravenes the laws of any state or other jurisdiction wherein this Agreement is to be performed, such provision shall be deemed to be modified to conform to such laws, and all other terms and provisions shall remain in full force and effect.<sup>81</sup>

After disputes arose, the dealer filed a complaint with the Pennsylvania State Board of Vehicle Manufacturers, Dealers and Salespersons, an agency empowered by Pennsylvania law to hear and determine the dealer's complaint.<sup>82</sup> The Board determined that it had jurisdiction over this case despite the arbitration clause between the parties.<sup>83</sup> The court rejected the argument that state law could not invalidate an arbitration agreement, relying on the United States Supreme Court's decision in *Southland Corp. v. Keating*.<sup>84</sup> The *Mid-Atlantic Toyota* court pointed to the choice-of-law provision in the agreement, stating: "[I]n this case, the parties have stipulated that their Agreement is to be deemed modified by the laws of any state in which it is to be performed. Thus, to the extent that the arbitration clause conflicts with [Pennsylvania law], the latter must be considered controlling."<sup>85</sup>

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78. See, e.g., *Cindy's Candle Co. v. WNS, Inc.*, 714 F. Supp. 973, 975-77 (N.D. Ill. 1989) (applying Texas law, as chosen by parties, to determine validity of arbitration agreements).

79. 101 Pa. Commw. 46, 515 A.2d 633 (1986).

80. *Id.* at 50, 515 A.2d at 635.

81. *Id.*

82. *Id.* at 48-49, 515 A.2d at 634.

83. *Id.* at 49, 515 A.2d at 635.

84. *Id.* at 50-51, 515 A.2d at 635 (citing *Southland Corp. v. Keating*, 465 U.S. 1 (1984)). See *infra* notes 96-112 and accompanying text for a discussion of *Southland Corp. v. Keating*.

85. *Mid-Atlantic Toyota*, 101 Pa. Commw. at 51, 515 A.2d at 636 (footnote omitted). Another reason for the court in this case to refuse to apply *Southland Corp.* was that the *Mid-Atlantic Toyota* case involved state administrative proceedings, whereas *Southland Corp.* only dealt with state judicial proceedings. *Id.* at 52, 515 A.2d at 636. This distinction seems weak in light of the strong federal policy in favor of arbitration. *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984). Despite state courts' reluctance to interfere with administrative proceedings as a matter of public policy, state courts are bound to apply federal law and policy to uphold an arbitration agreement governed by the USAA under the federal Constitution's Supremacy Clause. See U.S. CONST., art. VI, cl. 2. Section 3 of the USAA addresses stay of judicial proceedings. 9 U.S.C. § 3 (1988). Arguably, a stay of state administrative proceedings was not contemplated by the drafters of the USAA. *Id.* In such a case, the party seeking arbitration

The policy in favor of arbitration is mainly based on the policy in favor of enforcement of the parties' agreement.<sup>86</sup> The court's interpretation of the choice-of-law clause in *Mid-Atlantic Toyota* is problematic. The clause provided that the contract should be modified if applicable state laws conflicted with its provisions.<sup>87</sup> Although this language is stronger than a regular choice-of-state-law clause, it is still doubtful that the parties had actually intended this state-law-controlling provision to apply to anything other than the substantive part of their contract.<sup>88</sup> To suggest, on the one hand, that the parties had expressed their willingness to arbitrate their future disputes, but on the other hand, intended the validity and enforceability of their arbitration clause to be governed by a particular state rule that would invalidate the arbitration clause would be unreasonable. Arbitration agreements would be defeated too easily under the vagaries of state law whenever the parties refer to state law. As a matter of policy, choice-of-law provisions should not be interpreted as intending to displace the application of federal law to arbitration agreements.<sup>89</sup>

However, the suggestion is not that the parties' choice-of-law clause should have no effect whatsoever on the determination of the formation and validity of an arbitration agreement. Section 2 of the USAA allows application of those state contract rules and principles which do not

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has three options: (1) It may initiate the arbitration proceeding despite pending administrative proceedings, and proceed with an ex parte arbitration proceeding; (2) it may initiate an arbitration proceeding, and upon refusal of the other party to participate, may further institute an action under 15 U.S.C. § 4 (1988) to compel the resisting party to arbitrate; or (3) it may directly petition a federal or state court under 15 U.S.C. § 4 (1988) to compel arbitration. Use of any of these options avoids the technical problems posed by section 3. See *infra* notes 158-277 and accompanying text for a discussion of the relationship of sections 3 and 4 of the USAA to state court proceedings.

86. *Mid-Atlantic Toyota*, 101 Pa. Commw. at 52, 515 A.2d at 636.

87. *Id.* at 50, 515 A.2d at 635.

88. *Id.* at 50-51, 515 A.2d at 635-36.

89. In *Scherk v. Alberto Culver Co.*, the contract had a choice-of-law clause providing for application of Illinois law. 417 U.S. 506, 508 (1974). The Court did not consider the possibility that enforceability of the arbitration agreement would be governed by Illinois law instead of federal law. *Id.* at 510-21. In accord is *Shearson/American Express, Inc. v. McMahon*, where in light of the federal policy favoring arbitration, Justice O'Connor interpreted the non-waiver provision in the Securities Exchange Act of 1934 as invalidating the inconsistent substantive contract provisions but not the arbitration agreement in an investment contract. 482 U.S. 220, 227-31 (1987). The recent United States Supreme Court decision in *Volt Information Sciences, Inc. v. Board of Trustees*, did not deal with the effect of the parties' choice-of-law clause on the validity and enforceability of arbitration agreements where commerce is involved. 109 S. Ct. 1248 (1989). The Court merely held that the parties' choice-of-law clause would displace the federal law with regard to the issue of whether a court had discretion to stay arbitration where the case involved non-arbitrating third parties. *Id.* at 1254-56.

thwart the enforcement of arbitration agreements.<sup>90</sup>

### C. *Application of State Law Under Section 2*

Section 2 of the USAA does not describe how the issues of validity, enforceability and formation of arbitration agreements should be decided. The last sentence of section 2 provides that an arbitration agreement can be revoked on such grounds as exist in law or equity.<sup>91</sup> Section 2, therefore, does not exclude application of state law. Thus, the question becomes which type of state rules may apply under section 2.

In commenting on the role of state law under section 2, Justice Thurgood Marshall wrote:

[S]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally. A state-law principle that takes its meaning precisely from the fact that a contract to arbitrate is at issue does not comport with this requirement of § 2. A court 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.<sup>92</sup>

Under this test, the state rules that single out arbitration agreements and make them invalid, unenforceable and revocable are excluded from section 2.<sup>93</sup> Excluded state rules include those that allow a party to revoke an arbitration agreement or allow a party to maintain a lawsuit with regard to a particular issue or claim despite the existence of an arbitration agreement.<sup>94</sup> Alternatively, state rules that set particular, unfavora-

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90. 9 U.S.C. § 2 (1988). *See also infra* notes 91-95 and accompanying text. A choice-of-law clause can also affect the application of rules and procedures in judicial proceedings. *See infra* notes 228-77 and 338-49 and accompanying text.

91. 9 U.S.C. § 2 (1988).

92. *Perry v. Thomas*, 482 U.S. 483, 492-93 n.9 (1987) (emphasis added) (citation omitted).

93. *Id.*

94. *See, e.g., id.* at 484 (limiting California statute which provides that actions for collection of wages may be maintained without regard to arbitration agreement); *Knoxville Hotel Properties, Ltd. v. Hardin Constr. Co.*, 546 F. Supp. 34 (E.D. Tenn. 1982) (state statute that allowed owner to revoke arbitration agreement held inapplicable to contracts affecting interstate commerce); *Missouri ex. rel. St. Joseph Light & Power Co. v. Donelson*, 631 S.W.2d 887, 890 (Mo. Ct. App. 1982) (party could not bypass arbitration proceeding even though contract was governed by state law). State law might not be preempted by federal regulatory rules governing arbitration in particular areas. For instance, the United States Supreme Court refused to interfere with application of a California law that invalidated arbitration of wage claims between an employer and an employee in the securities industry pursuant to federal regulations. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 139-40

ble requirements for the validity and enforceability of arbitration agreements are similarly excluded from section 2.<sup>95</sup>

### 1. *Southland Corp. v. Keating*

In *Southland Corp. v. Keating*,<sup>96</sup> the issue was whether disputes arising under the California Franchise Investment Law<sup>97</sup> were arbitrable where the USAA was applicable.<sup>98</sup>

The California statute 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."<sup>99</sup> The California Supreme Court interpreted this provision as requiring judicial determination of claims arising under the Franchise Investment Law.<sup>100</sup> Therefore, the court refused to enforce the parties' agreement to arbitrate such claims.<sup>101</sup>

The United States Supreme Court reversed on the ground that the state court's interpretation directly conflicted with section 2 of the USAA and violated the federal Constitution's Supremacy Clause.<sup>102</sup> One issue raised in the case was how to interpret the saving clause under section 2.<sup>103</sup> Under the saving clause, arbitration agreements are treated exactly as any other contract.<sup>104</sup> In *Southland Corp.*, the non-waiver provision in the California statute did not address the validity of arbitra-

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(1973). However, since the USAA could apply in such cases, state law would eventually be preempted by the USAA. See *Perry*, 482 U.S. at 492 n.9.

95. See, e.g., *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 723 F.2d 155, 158 (1st Cir. 1983) (Puerto Rico rule required that arbitration agreement involving local dealer must be arbitrated in Puerto Rico and governed by local law), *aff'd in part and rev'd in part*, 473 U.S. 614 (1985); *Collins Radio Co. v. Ex-Cell-O Corp.*, 467 F.2d 995, 997 n.2 (8th Cir. 1972) (Texas rule required that arbitration agreements, in order to be "valid, enforceable and irrevocable," must be signed by parties' attorneys, not simply by parties themselves); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Melamed*, 405 So. 2d 790, 792-93 (Fla. Dist. Ct. App. 1981) (USAA prevailed over Florida rule which denied enforcement of arbitration agreement incorporating law of another state).

96. 465 U.S. 1 (1984).

97. CAL. CORP. CODE §§ 31000-31516 (West 1977).

98. *Southland Corp.*, 465 U.S. at 3.

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

100. *Keating v. Superior Court*, 31 Cal. 3d 584, 645 P.2d 1192, 183 Cal. Rptr. 360 (1982), *appeal dismissed in part, rev'd in part sub nom.* *Southland Corp. v. Keating*, 465 U.S. 1 (1984).

101. *Id.* at 604, 645 P.2d at 1203-04, 183 Cal. Rptr. at 371-72.

102. *Southland Corp.*, 465 U.S. at 10.

103. *Id.*

104. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (Congress' intent behind saving clause of section 2 to make arbitration agreements enforceable as any other contract).

tion agreements.<sup>105</sup> The non-waiver provision could arguably be a general ground for contract revocation under the saving clause since the provision could also be used to invalidate contract provisions other than arbitration agreements.<sup>106</sup>

To the Court, though, the non-waiver provision clearly did not govern contracts in general.<sup>107</sup> Rather, the Court's holding indicates its sentiment that the provision only invalidated contracts subject to the California Franchise Law if the contracts were contrary to a particular state policy.<sup>108</sup> To a majority of the Court, the provision was not a ground that existed at law or in equity for revoking any contracts within the meaning of the saving clause.<sup>109</sup>

In light of *Southland Corp.*, the saving clause of section 2 of the USAA<sup>110</sup> may not apply to state rules that protect essentially local, parochial interests. Such rules include those governing contracts by a party doing business in the state without proper licensing or registration<sup>111</sup> or those restricting the capacity of certain classes of persons or entities to contract.<sup>112</sup>

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105. *Southland Corp.*, 465 U.S. at 16. See also CAL. CORP. CODE § 31512 (West 1977).

106. See *Southland Corp.*, 465 U.S. at 20 (Stevens, J., concurring).

107. *Id.* at 16 n.11.

108. *Id.*

109. *Id.*

110. 9 U.S.C. § 2 (1988).

111. See, e.g., CAL. BUS. & PROF. CODE § 7031 (West Supp. 1989); N.M. STAT. ANN. §§ 53-17-1, 60-13-12 (1978). Some states have not recognized the validity of an arbitration proceeding when a party was an unlicensed or unregistered business according to state law. See, e.g., *Franklin v. Nat. C. Goldstone Agency*, 33 Cal. 2d 628, 204 P.2d 37 (1949); *Shaw v. Kuhnel & Assoc.*, 102 N.M. 607, 698 P.2d 880 (1985); *In re Schwartz*, 74 A.D.2d 638, 425 N.Y.S.2d 41 (1980); *Anton Sattler, Inc. v. Cummings*, 103 Misc. 2d 4, 425 N.Y.S.2d 476 (1980). The courts in these cases did not discuss whether the USAA should apply. However, restrictive state laws should not prevent enforcement of federally created arbitration rights. See *Ommani v. Doctor's Assocs., Inc.*, 789 F.2d 298, 299-300 (5th Cir. 1986) (if state-law certification is prerequisite to doing business in state and is interpreted as denying party its right to enforcement of federal arbitration, then state law might be preempted); *Grand Bahama Petroleum Corp. v. Asiatic Petroleum Co.*, 550 F.2d 1320 (2d Cir. 1977) (New York law precluding nonqualifying foreign corporation from suing in state court does not affect arbitration rights under federal law). See also *Murray v. J & S Constr. Co.*, 607 F. Supp. 45, 47-48 (D. Miss. 1985) (Mississippi's door-closing statute does not bar enforcement of award from arbitration proceeding).

112. See, e.g., OHIO REV. CODE ANN. § 735.05 (Baldwin 1989). For instance, some state or local laws impose additional requirements on a governmental entity's capacity to contract, and arbitration agreements may not be enforced for failure to comply with these requirements. See, e.g., *City of Zanesville v. Mohawk Data Sciences Corp.*, 97 A.D.2d 64, 468 N.Y.S.2d 271 (1983) (enforcement of arbitration agreement made without city council's approval denied). Some cases reject state or local restrictions on a governmental entity's capacity to contract as obstacles to enforcement of arbitration agreements. See, e.g., *Board of County Comm'rs v.*

## 2. Contracts of adhesion or unconscionability

Where a case involves a state rule which clearly is a ground in law or equity for the revocation of any contract, the issue arises as to how to interpret and apply the state rule under section 2. One illustration of this issue is the rules governing adhesion contracts and unconscionability.

The issues surrounding contracts of adhesion arise when a standardized form of agreement, drafted by one party having superior bargaining power, is presented to another party whose choice is either to accept or reject the contract without the opportunity to negotiate its terms.<sup>113</sup> Not all standardized contracts are unenforceable contracts of adhesion.<sup>114</sup> Generally, such a contract is unenforceable against the weaker party if it is (1) not within the reasonable expectations of that party, or (2) within the reasonable expectations of the party, but when considered in its context is unduly oppressive, unconscionable or against public policy.<sup>115</sup> In practice, the terms "contract of adhesion" and "unconscionability" refer to the same problems.<sup>116</sup> If a state statutory or decisional rule departs from the above-mentioned general rules governing contracts of adhesion and unconscionability and, as a result, arbitration agreements become more vulnerable under the state rule than under the general rule, then the state rule is beyond the scope of the saving clause of section 2 of the USAA.<sup>117</sup>

Generally, unconscionability analysis is comprised of two elements: substance and procedure.<sup>118</sup> The procedural issue is whether an arbitra-

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Kimball, 860 F.2d 683 (6th Cir. 1988); *Evans Elec. Constr. Co. v. University of Kan. Medical Center*, 230 Kan. 298, 634 P.2d 1079 (1981).

113. See, e.g., *M/V Am. Queen v. San Diego Marine Constr. Corp.*, 708 F.2d 1483, 1489 (9th Cir. 1983).

114. See E. FARNSWORTH, *CONTRACTS* § 4.26, at 294-95 (1982).

115. See, e.g., *Waggoner v. Dallaire*, 649 F.2d 1362, 1367 (9th Cir. 1981), *cert. denied*, 475 U.S. 1064 (1986); *Blalock Mach. & Equip. Co. v. Iowa Mfg. Co.*, 576 F. Supp. 774, 778-79 (N.D. Ga. 1983).

116. See, e.g., *Rozeboom v. Northwestern Bell Tel. Co.*, where the Supreme Court of South Dakota used the terms "contract of adhesion" and "unconscionability" interchangeably. 358 N.W.2d 241 (S.D. 1984). See also generally Note, *Unconscionability Refined: California Imposes New Duties on Commercial Parties Using Form Contracts*, 35 HASTINGS L.J. 161 (1983).

117. *Southland Corp.*, 465 U.S. at 16 n.11. For example, adhesion contracts are excluded from Iowa's arbitration statute. Iowa Code § 679A.1(2)(a) (1983). In *Mutual Serv. Casualty Ins. Co. v. District Court*, the Supreme Court of Iowa, in applying the contract-of-adhesion exclusion provision, refused to enforce an arbitration clause in an insurance policy against the insurance company which had drafted and prepared the policy. 372 N.W.2d 261, 264 (Iowa 1985). This decision departed from the general contract-of-adhesion rule, which only protects the weaker or adherent party. See Note, *supra* note 116, at 163-65 n.8. The result in *Mutual Serv. Casualty* made an arbitration agreement more vulnerable than the general contract-of-adhesion rule would, and therefore would be unacceptable under the saving clause of section 2.

118. See E. FARNSWORTH, *supra* note 114, § 4.28, at 314-15.



tion agreement is an unenforceable contract of adhesion because the weaker party has not been informed of the existence of the arbitration agreement or has not specifically consented to the arbitration agreement which is part of a standardized contract.<sup>119</sup> Federal cases suggest that, like most other provisions in a contract, an arbitration provision is valid and enforceable as long as the parties have consented to the contract as a whole and there is no statutory requirement that a party be informed of the existence of the arbitration agreement or specifically consent to the agreement.<sup>120</sup> According to federal cases, an arbitration agreement is not invalid under the general rules of adhesion contracts and unconscionability simply because the adherent party could not negotiate the contract or specifically consent to the arbitration agreement.<sup>121</sup> Therefore, state rules requiring specific consent to arbitration clauses generally<sup>122</sup> or dealing with a particular type of arbitration<sup>123</sup> may not apply under the saving clause.<sup>124</sup>

One issue regarding substantive unconscionability is whether an agreement to arbitrate which deprives the adherent party of its right to court action is beyond that party's reasonable expectations or is unduly oppressive, unconscionable and against public policy.<sup>125</sup> Under the strong federal policy in favor of arbitration, there is nothing unreasona-

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119. See generally *Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 223 (1987); *Geldermann, Inc. v. Commodity Futures Trading Comm'n*, 836 F.2d 310 (7th Cir. 1987), cert. denied, 109 S. Ct. 54 (1988).

120. See, e.g., *Kline v. Henrie*, 679 F. Supp. 464 (M.D. Pa. 1988) (arbitration agreement between investor and broker valid despite investor's claim that she had not realized she signed an arbitration agreement); *Bigge Crane & Rigging Co. v. Docutel Corp.*, 371 F. Supp. 240, 243 (E.D.N.Y. 1973) ("The focus of this court is not on whether there was subjective agreement to all clauses in the underlying contract but whether there was agreement to the contract embodying the clause in question.").

121. In most cases, contract-of-adhesion or unconscionability claims are directed to the contract as a whole, not to the arbitration agreement specifically. Under the doctrine of separability, as adopted by the United States Supreme Court in *Prima Paint Corp.*, such a claim would be decided by the arbitrators. 388 U.S. at 406-07. See *infra* notes 184-95 and accompanying text for a discussion of the separability doctrine.

122. For instance, the Missouri arbitration statute requires inclusion of the following statement in ten-point capital letters adjacent to or above the signature line: "THIS CONTRACT CONTAINS A BINDING ARBITRATION PROVISION WHICH MAY BE ENFORCED BY THE PARTIES." MO. REV. STAT. § 435.460 (1980).

123. Some state statutes require that patients specifically consent to arbitration agreements in medical service contracts. E.g., CAL. CIV. PROC. CODE § 1295 (West 1982); see also LA. REV. STAT. ANN. § 9:4235 (West 1983).

124. As discussed above, if an agreement involves relationships or matters which are primarily state concerns, such as medical malpractice disputes, the USAA may not apply because the underlying contract does not evidence a transaction involving commerce within the meaning of section 2. See *supra* notes 50-52 and accompanying text.

125. *Perry*, 482 U.S. at 492 n.9.

ble, oppressive or unconscionable about the use of arbitration itself.<sup>126</sup> Thus, if a state law provides that a particular agreement to arbitrate is unconscionable, that law does not qualify under the saving clause of section 2.<sup>127</sup>

Another issue is whether specific provisions within an arbitration agreement could be unconscionable or otherwise unenforceable as a contract of adhesion.<sup>128</sup> California courts in investor-broker arbitration cases have held that the provisions for arbitration under the Constitution and Rules of the Board of Governors of the New York Stock Exchange (NYSE) or the Code of Arbitration Procedure of National Association of Securities Dealers (NASD) do not meet the level of integrity requisite to withstand a challenge of unconscionability.<sup>129</sup> In those cases, the courts held that arbitration clauses were unenforceable because any panel selected by the brokers would be biased against investors.<sup>130</sup>

In *Graham v. Scissor-Tail, Inc.*,<sup>131</sup> the California Supreme Court refused to recognize the validity of an arbitration proceeding conducted according to an arbitration clause in a standard contract known as the

126. *Id.* See, e.g., *Brick v. J.C. Bradford*, 677 F. Supp. 1251, 1254 (D.D.C. 1987) (nothing unconscionable per se in agreement to arbitrate in securities or commodities disputes). In *Sewer v. Paragon Homes, Inc.*, the court held:

[A]n agreement to arbitrate in New York [does not pose] unconscionable difficulties. While the parties are thus to utilize a forum and rules of decision different from those they would have had if the matter had been litigated [in the Virgin Islands], this is the sort of business arrangement that is fairly left to the contracting parties. Its burdens are not excessive.

351 F. Supp. 596, 601-02 (D.V.I. 1972). *But see* *Graham v. Scissor-Tail, Inc.*, 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 6 (1981) (arbitration clause which required weaker party to accept arbitration with stronger party as judge found unconscionable).

127. As Justice Marshall said in *Perry*, "[A] court [may not] rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." 482 U.S. at 492 n.9.

128. See generally *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988); *Lewis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 183 Cal. App. 3d 1097, 228 Cal. Rptr. 345 (1986); *Lewis v. Prudential-Bache Secs., Inc.*, 179 Cal. App. 3d 935, 225 Cal. Rptr. 69 (1986).

129. *Lewis*, 183 Cal. App. 3d at 1097, 228 Cal. Rptr. at 345; *Prudential*, 179 Cal. App. 3d at 935, 225 Cal. Rptr. at 69.

130. E.g., *Lewis*, 183 Cal. App. 3d at 1106, 228 Cal. Rptr. at 350-51 (agreement to arbitrate under NYSE or NASD rules not enforceable); *Prudential*, 179 Cal. App. 3d at 944-45, 225 Cal. Rptr. at 75 (agreement to arbitrate under NYSE rules not enforceable); *Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 64 Cal. App. 3d 899, 906, 135 Cal. Rptr. 26, 30 (1976) (court invalidated portion of agreement providing for arbitration under NYSE rules). In these cases, however, the courts held that arbitration may proceed in a neutral arbitration forum. *Lewis*, 183 Cal. App. 3d at 1107, 228 Cal. Rptr. at 351; *Prudential*, 179 Cal. App. 3d at 946, 225 Cal. Rptr. at 76.

131. 28 Cal. 3d 807, 623 P.2d 165, 171 Cal. Rptr. 604 (1981).

American Federation of Musicians (AFM) Form B Contract.<sup>132</sup> The contract was between plaintiff, a musical concert promoter, and defendant, a professional musician and member of the AFM.<sup>133</sup> The arbitration agreement provided for arbitration of disputes by the International Executive Board of the AFM.<sup>134</sup> The court found that the provision constituted an unenforceable contract of adhesion because arbitration before one party's union's executive board lacked "minimum levels of integrity," and an agreement providing for such arbitration was unconscionable.<sup>135</sup> However, the court did not completely invalidate the arbitration clause, ordering arbitration to take place before a neutral arbitrator.<sup>136</sup>

In the above cases, the California courts apparently interpreted and applied generally accepted principles regarding contracts of adhesion, to find portions of the arbitration agreements unenforceable. Does their interpretation and application of these general principles apply to analysis of the saving clause of section 2 of the USAA?

Cases in which courts refused to enforce arbitration provisions under the NYSE or NASD rules contradict federal case law. Federal cases have upheld arbitration proceedings conducted under NYSE and NASD rules.<sup>137</sup> The United States Court of Appeals for the Ninth Circuit, in *Cohen v. Wedbush, Noble, Cook, Inc.*,<sup>138</sup> recognized that unconscionability could be a ground for invalidating an arbitration agreement.<sup>139</sup> However, the court opposed the application of California courts' interpretation and application of the unconscionability rule to securities arbitration cases, stating that "[t]he strong federal policy favoring arbitration, coupled with the extensive regulatory oversight performed by the SEC in this area, compel the conclusion that agreements to arbitrate disputes in accordance with SEC-approved procedures are not unconscionable as a matter of law."<sup>140</sup>

It seems rather clear that although state rules regarding contracts of adhesion can still apply under the saving clause of section 2,<sup>141</sup> determination of whether a particular arbitration forum is acceptable is an issue

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132. *Id.* at 812, 623 P.2d at 167, 171 Cal. Rptr. at 607.

133. *Id.*, 171 Cal. Rptr. at 606.

134. *Id.* at 812-13, 623 P.2d at 168, 171 Cal. Rptr. at 607.

135. *Id.* at 825, 623 P.2d at 176, 171 Cal. Rptr. at 615.

136. *Id.* at 831, 623 P.2d at 180, 171 Cal. Rptr. at 619.

137. *See, e.g., Drayer v. Krasner*, 572 F.2d 348, 359-60 (2d Cir.), *cert. denied*, 436 U.S. 948 (1978) (court held composition of NYSE arbitration panel to be within rule of reason and not in violation of antitrust laws).

138. 841 F.2d 282 (9th Cir. 1988).

139. *Id.* at 286.

140. *Id.*

141. 9 U.S.C. § 2 (1988).

for the federal courts.<sup>142</sup> If federal case law does not indicate whether the agreement to arbitrate in a particular forum is unconscionable, state courts should decide the issue in light of the federal interest and policy favoring arbitration.

Although the USAA does not expressly allow a court to change the parties' choice of arbitrators, arbitration rules, or arbitration forum, federal case law indicates that a court may determine whether the parties' choice is enforceable.<sup>143</sup> Therefore, a state court should apply the state contract-of-adhesion rule to invalidate arbitration clauses to the extent that application of state law does not conflict with federal precedents. However, the state court should not refuse altogether to enforce the agreement to arbitrate.

### 3. Formation of arbitration agreements under the Uniform Commercial Code

Section 2-207 of the Uniform Commercial Code (UCC) governs the formation of contracts, including arbitration agreements between merchants.<sup>144</sup>

One frequently litigated issue in arbitration cases is whether inclusion of an arbitration agreement is a material alteration within the mean-

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142. California cases have recognized that federal interpretation of contract-of-adhesion rules preempts state court interpretation. *Heily v. Superior Court*, 202 Cal. App. 3d 255, 258-59, 248 Cal. Rptr. 673, 675 (1988) (where USAA applied, court was not permitted to apply state contract-of-adhesion or unconscionability rule to entertain challenges raising institutional bias of arbitration panels); *Tonetti v. Shirley*, 173 Cal. App. 3d 1144, 1148, 219 Cal. Rptr. 616, 618 (1985) (California adhesion contract rule held inapplicable to enforcement of arbitration agreement).

143. *See, e.g., Merritt-Chapman & Scott Corp. v. Pennsylvania Turnpike Comm'n*, 387 F.2d 768, 773-74 (3d Cir. 1967) (obligation to arbitrate valid even though named arbitrator was disqualified because arbitration would be ordered before qualified arbitrator).

144. U.C.C. § 2-207 (1989). It provides in part:

- (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.
- (2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless:
  - (a) the offer expressly limits acceptance to the terms of the offer;
  - (b) they materially alter it; or
  - (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

*Id.* Essentially, section 2-207 deals with two situations: first, where a written confirmation sent after an agreement has been reached orally or by other informal means includes the terms so far agreed upon and additional terms not discussed; second, where a written "acceptance" following an offer includes additional or different terms. *Id.* comment (1). Arbitration agreements are often a part of those additional or different terms. The question is how section 2-207 applies to the determination of the formation of arbitration agreements between merchants.

ing of section 2-207(2)(b).<sup>145</sup> For example, the Court of Appeals of New York in *Marlene Industries Corp. v. Carnac Textiles, Inc.*,<sup>146</sup> held that "the inclusion of an arbitration agreement materially alters a contract for the sale of goods, and thus, pursuant to section 2-207 (subd. [2], par. [b]), it will not become a part of such a contract unless both parties explicitly agree to it."<sup>147</sup> The same rule has been adopted in other states.<sup>148</sup> On the other hand, a Michigan court adopted the position that whether an arbitration agreement is a material alteration within section 2-207 should be decided on a case by case basis.<sup>149</sup>

At the federal level, no open opposition exists to acceptance of UCC rules governing formation of arbitration agreements under section 2. One open question is whether the UCC should be regarded as a state law or as federal common law. While a sizable number of federal cases dealing with the issue have regarded the UCC as state law in arbitration cases,<sup>150</sup> it has been suggested that the UCC apply in federal arbitration cases as federal law.<sup>151</sup> The next question is how state interpretation and application of section 2-207 should be treated under the USAA. The

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145. See, e.g., *Duplan Corp. v. W.B. Hosiery Mills*, 442 F. Supp. 86 (S.D.N.Y. 1977); *Marlene Indus. Corp. v. Carnac Textiles*, 45 N.Y.2d 327, 380 N.E.2d 239, 408 N.Y.S.2d 410 (1978); *Frances Hosiery Mills v. Burlington Indus.*, 285 N.C. 344, 204 S.E.2d 834 (1974); *Just Born, Inc. v. Stein, Hall & Co.*, 59 Pa. D. & C.2d 407 (1971).

146. 45 N.Y.2d 327, 380 N.E.2d 239, 408 N.Y.S.2d 410 (1978).

147. *Id.* at 333, 380 N.E.2d at 242, 408 N.Y.S.2d at 413. Prior to *Marlene Industries*, New York courts were divided on the issue. See *Helen Whiting, Inc. v. Trojan Textile Corp.*, 307 N.Y. 360, 367, 121 N.E.2d 367, 370 (1954) (use of arbitration became custom and usage in textile industry); *Gaynor-Stafford Indus. v. Mafco Textured Fibers*, 52 A.D.2d 481, 485, 384 N.Y.S.2d 788, 791 (1976) (arbitration clause not material alteration, but became part of contract because arbitration was widely used in textile industry); *Trafalgar Square, Ltd. v. Reeves Bros., Inc.*, 35 A.D.2d 194, 197, 315 N.Y.S.2d 239, 242 (1970) (using section 2-201 of U.C.C. to justify existence of arbitration agreement). Cf. *In re Doughboy Indus., Inc.*, 17 A.D.2d 216, 220, 233 N.Y.S.2d 488, 493 (1962) (arbitration agreement must be clear and direct and should not depend solely on conflicting forms which cross one another but never meet).

148. See, e.g., *Windsor Mills, Inc. v. Collins & Aikman Corp.*, 25 Cal. App. 3d 987, 101 Cal. Rptr. 347 (1972); *Frances Hosiery Mills, Inc. v. Burlington Indus.*, 285 N.C. 344, 204 S.E.2d 834 (1974); *Just Born, Inc. v. Stein, Hall & Co.*, 59 Pa. D. & C.2d 407 (1971).

149. *American Parts Co., Inc. v. American Arbitration Ass'n*, 8 Mich. App. 156, 171, 154 N.W.2d 5, 14 (1967).

150. See, e.g., *Coastal Indus. v. Automatic Steam Prods. Corp.*, 654 F.2d 375 (5th Cir. 1981); *Supak & Sons Mfg. Co. v. Pervel Indus.*, 593 F.2d 135 (4th Cir. 1979); *C. Itoh & Co. (Am.) v. Jordan Int'l Co.*, 552 F.2d 1228 (7th Cir. 1977); *Duplan Corp. v. Davis Hosiery Mills*, 442 F. Supp. 86 (S.D.N.Y. 1977); *Valmont Indus. v. Mitsui & Co. (U.S.A.)*, 419 F. Supp. 1238 (D. Neb. 1976).

151. See, e.g., *Lea Tai Textile Co. v. Manning Fabrics, Inc.*, 411 F. Supp. 1404, 1405 (S.D.N.Y. 1975) (applying U.C.C. as federal common law in holding that arbitration agreement was material alteration). See also *Genesco, Inc. v. Kakiuchi & Co.*, 815 F.2d 840, 845 (2d Cir. 1987) (citing U.C.C. section 2-207 as generally accepted principle of contract law dispositive of whether arbitration agreement is enforceable under USAA).

application by federal courts of case law within a single state may lead to different results because case law within a state may vary as to whether an arbitration agreement is a material alteration or not.<sup>152</sup> Moreover, since application of section 2-207 varies from state to state, the application by a federal court of state interpretations of section 2-207 has produced different results.<sup>153</sup>

The issues raised by section 2-207 of the UCC illustrate lack of uniformity that can result from application of state rules under section 2 of the USAA. In fact, as a product of the efforts for unification of contract law among states, the UCC may be regarded as a perfect model of state rules applicable to arbitration agreements under the USAA. Unfortunately, the UCC does not always result in uniformity of rules in arbitration cases among states or even between courts in the same state.<sup>154</sup> Lack of uniformity of interpretation of the UCC at state court levels results in uncertainty in federal court section 2 cases. State courts, in turn, receive no clear guidance from federal law as to when they are bound by the federal substantive law under section 2. The federal courts could detach themselves from any particular state interpretation of the UCC. In the face of uncertainty and lack of uniformity of state law, federal courts should be able to develop a set of federal rules for interpretation of the UCC in arbitration cases.<sup>155</sup> Another way to deal with the problem would be for federal courts to rely upon those state interpretations of the

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152. See, e.g., *Graniteville Co. v. Star Knits of Cal.*, 680 F. Supp. 587, 589 n.2 (S.D.N.Y. 1988) (following New York cases in examining usage of trade to determine whether arbitration clause constitutes material alteration); *Imptex Int'l Corp. v. Lorprint, Inc.*, 625 F. Supp. 1572, 1572 n.2 (S.D.N.Y. 1986) (same). Compare *Hart Ski Mfg. Co. v. Maschinenfabrik Hennecke, GmbH*, 711 F.2d 845, 846 (8th Cir. 1983) (rejecting *In re Doughboy Indus., Inc.*, 17 A.D.2d 216, 233 N.Y.S.2d 488 (1962), which held arbitration agreement to be material alteration) with *Thallon & Co. v. M. & N. Meat Co.*, 396 F. Supp. 1239, 1243-44 (E.D.N.Y. 1975) (following New York case law to hold arbitration agreement was material alteration). See also *Coastal Indus.*, 654 F.2d at 379-80 (applying New York case law to hold arbitration agreement was material alteration); *Fairchild-Noble Corp. v. Pressman-Gutman Co.*, 475 F. Supp. 899 (S.D.N.Y. 1979) (same).

153. For example, one group of federal cases holds that whether an arbitration agreement is a material alteration is a question of fact to be decided on a case by case basis. *Hart Ski Mfg. Co.*, 711 F.2d at 846; *N & D Fashions, Inc. v. DHJ Indus.*, 548 F.2d 722, 726 (8th Cir. 1976); *Dorton v. Collins & Aikman Corp.*, 453 F.2d 1161, 1169 n.8 (6th Cir. 1972). Other federal courts have applied state law in holding arbitration agreements to be material alterations. See, e.g., *Supak & Sons*, 593 F.2d at 137 (applying New York and North Carolina law). Finally, some federal courts apply state law and hold that an arbitration agreement is not a material alteration. *Schulze & Burch Biscuit Co. v. Tree Top, Inc.*, 831 F.2d 709, 714-15 (7th Cir. 1987) (applying Illinois law).

154. See generally Annotation, *What Are Additional Terms Materially Altering Contract Within Meaning of UCC § 2-207 (2)(b)?*, 72 A.L.R. 3d 479, 482-505 (1976 & Supp. 1989).

155. See, e.g., *Hart Ski Mfg. Co.*, 711 F.2d at 846 (federal law governs whether agreement to arbitrate has been made and federal policy favors arbitration).

UCC which support the federal policy favoring arbitration.<sup>156</sup> Alternatively, federal courts could develop independent federal rules without referring to or following the UCC.<sup>157</sup>

#### IV. SECTIONS 3 AND 4 OF THE USAA

Section 3 of the USAA deals with enforcement of arbitration agreements in a pending lawsuit.<sup>158</sup> Section 4 of the USAA deals with petitions for enforcement of an arbitration agreement where one party refuses to arbitrate.<sup>159</sup>

In *Bernhardt v. Polygraphic Co. of America*,<sup>160</sup> the United States Supreme Court held that section 3 is part of the regulatory scheme to enforce the kind of agreement which sections 1 and 2 brought under federal regulation.<sup>161</sup> The Court held, however, that the USAA did not create federal question jurisdiction for the federal courts, and that a case brought in federal court for enforcement of a section 2 arbitration agreement had to otherwise satisfy the requirement of federal subject matter jurisdiction.<sup>162</sup> Thus, in some cases, enforcement of arbitration agree-

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156. See, e.g., *Schulze & Burch Biscuit Co.*, 831 F.2d at 715.

157. See, e.g., *Genesco, Inc.*, 815 F.2d at 845.

158. 9 U.S.C. § 3 (1988). Section 3 provides:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default with such arbitration.

*Id.*

159. 9 U.S.C. § 4 (1988). Section 4 provides:

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, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. . . . 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 . . . .

*Id.*

160. 350 U.S. 198 (1956).

161. *Id.* at 201. Prior to *Bernhardt*, lower federal courts held that a court could apply section 3 even though the arbitration agreement in question did not fall under section 2. See, e.g., *Wilson & Co. v. Fremont Cake & Meal Co.*, 77 F. Supp. 364, 374-75 (D. Neb. 1948). Also prior to *Bernhardt*, courts held that section 4 was available only while the arbitration agreement was governed by section 2. See, e.g., *id.* at 375.

162. *Bernhardt*, 350 U.S. at 198 (applying *Erie* doctrine, indicating no federal question jurisdiction). Section 3 provides for a stay by a "court in which such suit is pending," and section 4 provides that enforcement may be ordered by "any United States district court

ments covered by sections 1 and 2 would be left to state courts.<sup>163</sup> The issues to be discussed are whether and how a state court should apply provisions under sections 3 and 4, if the arbitration agreement falls within section 2.

#### *A. Specific Enforcement of Arbitration Agreements*

Sections 3 and 4 of the USAA provide only one method for enforcement of arbitration agreements covered by section 2—specific enforcement.<sup>164</sup> Could a state court, in enforcing an arbitration agreement governed by section 2 of the USAA, choose a method of enforcement other than specific enforcement?

The language used in sections 3 and 4 and the legislative history of the USAA seem to suggest that the sections are aimed primarily at federal court proceedings.<sup>165</sup> Section 4 refers to the “United States district court;”<sup>166</sup> this language indicates that Congress intended to limit the application of the section to federal courts.<sup>167</sup>

Section 3 is somewhat less clear; it refers to the “courts of the United States.”<sup>168</sup> Arguably, “courts of the United States” under section 3 means federal district courts, because state courts are courts “in” but not “of” the United States, as commonly designated in federal law.<sup>169</sup> Sections 3 and 4 constitute part of the same regulatory scheme under the USAA; thus, “courts of the United States” under section 3 and “United States district court[s]” under section 4 should be interpreted similarly.<sup>170</sup> The legislative history of the USAA also suggests that sections 3

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which, save for such agreement, would have jurisdiction.” 9 U.S.C. §§ 3-4 (1988). *See, e.g.*, *Moses H. Cone Mem. Hosp. v. Mercury Constr. Co.*, 460 U.S. 1, 25 n.32 (1983).

163. A state court might have to decide whether to enforce an arbitration agreement governed by section 2 of the USAA if there is no independent federal subject matter jurisdiction, if the case has been brought in the state court and no request for removal has been made, or if the parties have agreed that the state court has exclusive jurisdiction to compel arbitration. *Cf. Monte v. Southern Del. County Auth.*, 321 F.2d 870, 875 (3d Cir. 1963) (Steel, J., concurring).

164. 9 U.S.C. §§ 3-4 (1988).

165. *See Southland Corp. v. Keating*, 465 U.S. 1, 25-30 (1983) (O'Connor, J., dissenting) (“Congress did not intend the [USAA] to govern state-court proceedings . . .”).

166. 9 U.S.C. § 4 (1988).

167. In 1954, “United States district court” was inserted by Congress in § 4 to replace “court of the United States.” Act of Sept. 3, 1954, ch. 1263, § 19, 68 Stat. 1226, 1233. This amendment reflected the premise that such a proceeding would be brought only in a federal court and specifically in a district court. H.R. REP. NO. 1981, 83d Cong., 2d Sess. 8; S. REP. NO. 2498, 83d Cong., 2d Sess. 9, *reprinted in* 1954 U.S. CODE CONG. & ADMIN. NEWS 3991, 3998.

168. 9 U.S.C. § 3 (1988).

169. *See Southland Corp.*, 465 U.S. at 29-30 n.18 (O'Connor, J., dissenting).

170. *Id.* at 29 n.17 (O'Connor, J., dissenting).



and 4 were intended to regulate federal procedures for enforcement of arbitration agreements covered by section 2.<sup>171</sup>

If the specific enforcement provisions under sections 3 and 4 did not apply to state courts, the state courts would be free to choose and develop their own methods for enforcement, such as an award of compensatory or punitive damages for violation of the arbitration agreement, or award of litigation costs to a party who is willing to arbitrate.<sup>172</sup> Such results clearly thwart the basic advantages of arbitration<sup>173</sup> and therefore would run counter to the federal policy favoring arbitration. The very essence of the policy encouraging use of arbitration is to remove cases from courtrooms.<sup>174</sup> Therefore, specific enforcement is the only method that promotes the policy favoring arbitration in cases involving breach of an arbitration agreement.<sup>175</sup>

Recent Supreme Court cases conclude that specific enforcement is the only method of enforcement available to state courts where an arbitration agreement is covered by section 2.<sup>176</sup> The Court indicated that specific enforcement is part of the federal substantive law under section 2 of the USAA.<sup>177</sup> It held that when section 2 speaks of enforceability and irrevocability of arbitration agreements, it creates an obligation on a court, whether federal or state, to specifically enforce such agreements.<sup>178</sup>

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171. The House Report on the USAA stated: "The matter is properly the subject of federal action. Whether an agreement for arbitration shall be enforced or not is a question of procedure . . . ." H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924). After the enactment of the USAA, the American Bar Association, which had participated in drafting the legislation, stated that "[t]he statute establishes a procedure in the Federal courts for the enforcement of arbitration agreements. . . . A federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the federal courts." Committee on Commerce, Trade and Commercial Law, American Bar Association, *The United States Arbitration Law and its Application*, 11 A.B.A. J. 153, 154 (1925) [hereinafter Committee on Commerce, *The United States Arbitration Law*].

172. See *Southland Corp.*, 465 U.S. at 31-32 (O'Connor, J., dissenting).

173. See *supra* note 2 and accompanying text for a discussion of the benefits of arbitration.

174. See Committee on Commerce, *The United States Arbitration Law*, *supra* note 171, at 155-56.

175. Congress seemed unimpressed by the common-law practice of awarding damages for breach of arbitration agreements and therefore did not allow for damage awards in the federal arbitration statute. S. REP. NO. 536, 68th Cong., 1st Sess. 2 (1924).

176. *Southland Corp.*, 465 U.S. at 10, 14-15.

177. *Id.* at 10-12.

178. *Id.* at 16 & n.10. When confronted with the issue of applicability of sections 3 and 4 to state court proceedings where the arbitration agreements fell within section 2, state courts have almost unanimously held that those sections are applicable. See *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 67 Cal. App. 3d 19, 24-25, 136 Cal. Rptr. 378, 380-81 (1977) (section 4); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Melamed*, 405 So. 2d 790, 793 (Fla. Dist. Ct. App. 1981) (section 3); *GAF Corp. v. Werner*, 66 N.Y.2d 97, 104, 485 N.E.2d 977, 982, 495 N.Y.S.2d 312, 317 (1985) (sections 3 and 4), *cert. denied*, 475 U.S. 1083 (1986);

Thus, sections 3 and 4 should be applied to arbitration agreements governed by the USAA under sections 1 and 2.

Like federal courts, state courts are faced with crowded court dockets, and have the same incentive to encourage use of arbitration by specifically enforcing arbitration agreements.<sup>179</sup> Moreover, application of sections 3 and 4 by state courts where commerce is involved would have the wholesome effect of promoting uniformity of arbitration rules and discouraging forum shopping.<sup>180</sup>

### *B. Division of Functions Between Courts and Arbitrators*

Court functions are limited under both sections 3 and 4.<sup>181</sup> Under section 3, upon a party's petition, a court should stay a lawsuit pending an arbitration proceeding if the court decides that: (1) there is an arbitration agreement; (2) the issue involved in the lawsuit or proceeding is referable to arbitration under the agreement; and (3) the applicant for the stay is not in default in proceeding with such arbitration.<sup>182</sup> Under section 4, a court should grant a petition to compel arbitration upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not at issue.<sup>183</sup> All other issues should be left for the arbitrators to decide. The question arises whether a state court should be bound by such a division of functions between the court and arbitrators where the arbitration agreement is governed by the USAA.

#### 1. The doctrine of separability

In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*,<sup>184</sup> the issue was whether a claim of fraud in the inducement of an entire contract was to

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AAACon Auto Transp., Inc. v. Newman, 77 Misc. 2d 1069, 1071, 356 N.Y.S.2d 171, 173-74 (1974) (section 4); C.P. Assocs. v. Pickett, 697 S.W.2d 828, 830-31 (Tex. Ct. App. 1985) (section 3); Galtney v. Underwood Neuhaus & Co., 700 S.W.2d 602, 604 (Tex. Ct. App. 1985) (section 3); Merrill Lynch, Pierce, Fenner & Smith, Inc., v. McCollum, 666 S.W.2d 604, 608-09 (Tex. Ct. App. 1984) (sections 3 and 4), *cert. denied*, 470 U.S. 1024 (1985).

179. For a demonstration of state judges' support for the use of arbitration, see Lavorato, *Alternative Dispute Resolution: One Judge's Experience*, 42 ARB. J., June 1987, at 64; McDonald & Bivins, *Alternative Dispute Resolution and the Courts*, 42 ARB. J., June 1987, at 58; Spatt, *Res Judicata and Collateral Estoppel*, 42 ARB. J., June 1987, at 61.

180. The North Carolina Supreme Court has said: "Parties in a state court to a contract evidencing [sic] an interstate transaction should not be permitted to avoid arbitration when, had the action been brought in federal court, they would have been compelled to arbitrate." *Burke County Pub. Schools Bd. of Educ. v. Shaver Partnership*, 303 N.C. 408, 422 n.16, 279 S.E.2d 816, 824-25 n.16 (1981).

181. 9 U.S.C. §§ 3-4 (1988).

182. *Pioneer Supply Co. v. American Meter Co.*, 484 F. Supp. 227, 229 (W.D. Okla. 1979).

183. *See Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 403-04 (1967).

184. 388 U.S. 395 (1967).

be decided by the court or referred to the arbitrators.<sup>185</sup> After examining the language of sections 3 and 4, the United States Supreme Court concluded that the statutory language did not permit the court to consider claims of fraud in the inducement of the contract and the claims should be arbitrated.<sup>186</sup> The Court adopted what Justice Black in dissent defined as the doctrine of separability.<sup>187</sup> Under this doctrine, when the validity of a contract is challenged generally, but the arbitration clause is not challenged specifically, the claim should be decided through arbitration.<sup>188</sup>

The doctrine of separability primarily addresses how courts are to conduct themselves with respect to enforcement of arbitration agreements once the validity and enforceability of the agreements is beyond dispute.<sup>189</sup> Arguments have been made that the doctrine may not apply to state court proceedings.<sup>190</sup> If the doctrine does not apply, as when the arbitration agreement is governed by the USAA, and a state court is allowed to decide a claim attacking the contract generally, enforcement of the arbitration right under federal law could be delayed or even denied.<sup>191</sup> Moreover, if a court determined that the contract was fraudulently induced and therefore invalid, the arbitration agreement would also become invalid.<sup>192</sup>

Therefore, the decision whether to apply the doctrine of separability involves the substantive issue of the validity and enforceability of the arbitration agreement with regard to attacks upon container contracts.<sup>193</sup> By adopting the doctrine of separability, the Supreme Court in *Prima Paint Corp.* made it clear that as a matter of federal law a court has no power to pass on the validity and enforceability of container contracts.<sup>194</sup> Therefore, several state courts have held that the doctrine of separability applies to state court proceedings where an arbitration agreement is gov-

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185. *Id.* at 402.

186. *Id.* at 404.

187. *Id.* at 399-400; *id.* at 409 (Black, J., dissenting).

188. The Supreme Court rejected application of New York law to the issue of whether the fraudulent inducement claim was to be decided by a court or arbitrators. *Id.* at 404-05.

189. *Id.* at 405.

190. See Atwood, *supra* note 8, at 92.

191. See, e.g., *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 410 (2d Cir. 1959) (action to recover for fraudulent misrepresentation inducing purchase agreement), *cert. denied*, 364 U.S. 801 (1960).

192. See, e.g., *Freeman v. Duluth Clinic*, 334 N.W.2d 626 (Minn. 1983); *Shaw v. Kuhnel & Assocs.*, 102 N.M. 607, 698 P.2d 880 (1985).

193. "Container contract" as used herein refers to an underlying contract which contains an arbitration clause.

194. *Prima Paint Corp.*, 388 U.S. at 403-04.

erned by the USAA.<sup>195</sup>

## 2. Statutes of limitations

Neither section 3 nor section 4 expressly allows a court to decide whether claims subject to arbitration are barred by statutes of limitations.<sup>196</sup> Federal case law suggests that arbitrators decide this issue.<sup>197</sup> However, the arbitration statutes in some states expressly authorize the court to decide the issue of whether a claim is time-barred under the applicable statute of limitations.<sup>198</sup>

Whether a claim is time-barred affects the enforceability of the arbitration agreement.<sup>199</sup> Federal courts, by letting the arbitrators decide the issue of statute of limitations, do not recognize statutes of limitations as grounds for revocation of an arbitration agreement.<sup>200</sup> Therefore, where interstate commerce is involved, the state court should let arbitrators decide the effect of statutes of limitations, even though the state arbitration law provides for judicial determination of the issue.<sup>201</sup>

### C. *Interpretation of the Scope of Arbitration Agreements*

Under both sections 3 and 4, a court should decide whether the scope of the parties' arbitration agreement is broad enough to cover particular issues.<sup>202</sup> Some authorities support the view that the issue of in-

195. See, e.g., *Konewko v. Kidder, Peabody & Co.*, 173 Ill. App. 3d 939, 528 N.E.2d 1 (1988), *cert. denied*, 539 N.E.2d 915 (1989); *Sentry Sys., Inc. v. Guy*, 98 Nev. 507, 654 P.2d 1008 (1982); *Aerojet-Gen. Corp. v. Non-Ferrous Metal Ref., Ltd.*, 37 A.D.2d 531, 322 N.Y.S.2d 33 (1971); *Pinkis v. Network Cinema Corp.*, 9 Wash. App. 337, 512 P.2d 751 (1973).

196. 9 U.S.C. §§ 3-4 (1988).

197. See, e.g., *Hanes Corp. v. Millard*, 531 F.2d 585 (D.C. Cir. 1976); *Reconstruction Fin. Corp. v. Harrison & Crosfield*, 204 F.2d 366 (2d Cir. 1953). On the other hand, the issue of whether the contractual right to arbitration is barred by a statute of limitations is normally decided by courts. See *Reconstruction Fin. Corp.*, 204 F.2d at 369.

198. See, e.g., DEL. CODE ANN. tit. 10, § 5702(c) (1974); GA. CODE ANN. § 9-9-5 (Supp. 1989); N.Y. CIV. PRAC. L. & R. 7502(b) (McKinney Supp. 1989).

199. *A/S J. Ludwig Mowinckels Rederi v. Dow Chem. Co.*, 25 N.Y.2d 576, 580, 255 N.E.2d 774, 776-77, 307 N.Y.S.2d 660, 662, *cert. denied*, 398 U.S. 939 (1970).

200. *Id.* at 581, 255 N.E.2d at 777, 307 N.Y.S.2d at 663.

201. Some state courts have held that federal law preempted state law in authorizing courts to decide whether the claim subject to arbitration was barred by the statute of limitations. See *A/S J. Ludwig Mowinckels Rederi*, 25 N.Y.2d at 579, 255 N.E.2d at 776-77, 307 N.Y.S.2d at 663-64; *Caudill v. Board of Educ.*, 47 A.D.2d 610, 364 N.Y.S.2d 7 (1975). See also *ADC Constr. Co. v. McDaniel Grading, Inc.*, 177 Ga. App. 223, 338 S.E.2d 733 (1985).

202. Section 3 provides for stay of court proceedings if the court is satisfied that the issue involved "is referable to arbitration under such an agreement." 9 U.S.C. § 3 (1988). Similarly, section 4 requires a court to inquire as to the making of an arbitration agreement, which includes the issue of the scope of the agreement. See *id.* § 4. See also *I.S. Joseph Co. v. Michigan Sugar Co.*, 803 F.2d 396, 399 (8th Cir. 1986).

interpretation, like the issues of validity and enforceability, should be governed by federal law where the arbitration agreement falls under section 2 of the USAA.<sup>203</sup>

In *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*,<sup>204</sup> the Second Circuit held that the USAA created federal substantive rules not only for validity, revocability and enforceability of arbitration agreements falling within the Act, but also for interpretation and construction of those agreements.<sup>205</sup>

We hold that the body of law . . . is substantive not procedural in character and that it encompasses questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements affecting interstate commerce or maritime affairs, since these two types of legal questions are inextricably intertwined.<sup>206</sup>

*Robert Lawrence Co.* clearly exhibited "a liberal policy of promoting arbitration."<sup>207</sup> As part of the scheme of enforcement of federal arbitration rights, federal rules for interpretation of arbitration agreements should apply to state court proceedings.<sup>208</sup>

203. See, e.g., *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 409 (2d Cir. 1959), cert. denied, 364 U.S. 801 (1960).

204. *Id.*

205. *Id.*

206. *Id.*

207. *Id.* at 410. See also *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 385 (2d Cir.), cert. denied, 368 U.S. 817 (1961). The United States District Court for the District of New Jersey has said:

What emerges [after *Robert Lawrence Co.*] is this principle, that in interpreting the scope of an arbitration clause, that is, in endeavoring to determine what the parties intended would be arbitrable, federal courts are not to apply the traditional rules of contract construction, but rather a federal rule that seemingly requires a clearly expressed intent *not* to arbitrate an issue before such issue can be ruled one for judicial determination; and, further, that if the issue is a doubtful one, the doubt is to be resolved in favor of arbitration.

*Singer Co. v. Tappan Co.*, 403 F. Supp. 322, 329 (D.N.J. 1975), *aff'd*, 544 F.2d 513 (3d Cir. 1976). See also *Falcone Bros. Partnership v. Bear Stearns & Co.*, 699 F. Supp. 32, 34 (S.D.N.Y. 1988) (federal law governing interpretation of arbitration agreement displaced well-established *contra proferentum* principle).

The *Robert Lawrence* court's use of section 2 of the USAA to justify its decision is problematic. Interpretation of the scope of an arbitration agreement is addressed in sections 3 and 4, but not section 2. 9 U.S.C. §§ 2, 3, 4 (1988). Moreover, application of section 2 cannot be displaced by a party's choice-of-law clause. See *supra* notes 70-90 and accompanying text. However, rules and procedures under sections 3 and 4 (except for specific enforcement) may be displaced by the state law chosen by the parties. See *infra* notes 228-77 and accompanying text. The parties should be able to choose a particular state law to apply to interpretation of the scope of an arbitration agreement. See *infra* notes 270-73 and accompanying text.

208. In *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, the United States Supreme Court held that the USAA "establishes that, as a matter of federal law, any doubts concerning

#### D. "Procedural" Rules in General

Chief Justice Burger, in *Southland Corp. v. Keating*,<sup>209</sup> wrote that section 4 of the USAA, which states that the Federal Rules of Civil Procedure apply in federal court proceedings to compel arbitration,<sup>210</sup> does not apply in such state court proceedings.<sup>211</sup> This opinion appears to be based on the assumption that no compelling federal interest requires the state courts to apply federal procedural rules in enforcing an arbitration agreement governed by federal law. An examination of the so-called procedural rules in sections 3 and 4 suggests that some of them facilitate enforcement of the arbitration rights created by section 2<sup>212</sup> and that their application significantly affects implementation of federal interests under the USAA.<sup>213</sup>

Some procedural provisions under sections 3 and 4 may not be applicable to state court proceedings. Section 4 of the USAA provides that

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the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or like defense to arbitrability." 460 U.S. 1, 24-25 (1983). Several state courts have employed federal rules of interpretation of arbitration agreements. See *Konewko v. Kidder, Peabody & Co.*, 173 Ill. App. 3d 939, 944, 528 N.E.2d 1, 4-5, *cert. denied*, 535 N.E.2d 915 (1989); *ADC Constr. Co. v. McDaniel Grading, Inc.*, 177 Ga. App. 223, 226-28, 338 S.E.2d 733, 737-38 (1985). See also *Flanagan v. Prudential-Bache Secs., Inc.*, 67 N.Y.2d 500, 506, 495 N.E.2d 345, 348, 504 N.Y.S.2d 82, 85, *cert. denied*, 479 U.S. 931 (1986) (state courts are bound by federal arbitration statute regarding interpretation of arbitrability, without uniformity in federal court decisions).

209. 465 U.S. 1 (1984).

210. 9 U.S.C. § 4 (1988).

211. *Southland Corp.*, 465 U.S. at 16 n.10.

212. 9 U.S.C. §§ 3-4 (1988). See *Cohen & Dayton*, *supra* note 29, at 271-72.

213. *Cohen & Dayton*, *supra* note 29, at 271-72. In *A/S J. Ludwig Mowinckels Rederi v. Dow Chem. Co.*, the Court of Appeals of New York noted that while the underlying arbitration agreement was governed by the substantive federal law, the state court could not apply its own rules of procedure if those rules would significantly affect the result of the case. 25 N.Y.2d 576, 581, 255 N.E.2d 774, 776-77, 307 N.Y.S.2d 660, 663, *cert. denied*, 398 U.S. 939 (1970). Unlike *Southland Corp.*, where the United States Supreme Court emphasized the distinction between substantive and procedural laws, the Court of Appeals of New York distinguished between rules which are outcome determinative and rules which are not. *Southland Corp.*, 465 U.S. at 16; *A/S J. Ludwig Mowinckels Rederi*, 25 N.Y.2d at 582, 255 N.E.2d at 777, 307 N.Y.S.2d at 664. See also *McClellan v. Barrath Constr. Co.*, 725 S.W.2d 656, 658 (Mo. Ct. App. 1987) ("The procedural provisions of the Federal Arbitration Act are not binding on state courts, provided applicable state procedures do not defeat the rights created by Congress."). The United States Supreme Court recently held that even though Congress has not completely displaced state regulations in the area of arbitration, "state law may nonetheless be preempted 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.'" *Volt Information Sciences, Inc. v. Board of Trustees*, 109 S. Ct. 1248, 1254 (1989). The application of federal arbitration law should not depend on the characterization of rules as "substantive" or "procedural," but rather should emphasize federal rules in the implementation of congressional purposes and objectives.

arbitration hearings and proceedings shall be ordered within the district in which the petition is filed.<sup>214</sup> Under this provision, a court cannot order arbitration outside its district even though the arbitration agreement provides for arbitration elsewhere.<sup>215</sup> This provision seeks to save resources through geographic concentration of all proceedings—both arbitral and judicial.<sup>216</sup> Although saving resources is a legitimate interest, the provision does not address the concern for enforcement of parties' arbitration agreements. While federal courts feel bound by this limitation, several state courts have not felt similarly compelled.<sup>217</sup>

On the other hand, those provisions that could affect enforcement of arbitration rights should apply to state court proceedings. In *Dean Witter Reynolds, Inc. v. Byrd*,<sup>218</sup> the United States Supreme Court held that where arbitrable and non-arbitrable issues coexisted in a case, a federal court should take a bifurcated approach.<sup>219</sup> The Court held that a lower court should stay legal proceedings with regard to arbitrable issues, or order arbitration of those issues while allowing non-arbitrable issues to be litigated.<sup>220</sup> Whether a court following *Dean Witter* adopts the bifurcated approach or not will affect the parties' substantive right to arbitration under section 2 of the USAA. Without bifurcation of proceedings, enforcement of the parties' right to arbitration might be delayed or even

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214. 9 U.S.C. § 4 (1988).

215. See, e.g., *National Iranian Oil Co. v. Ashland Oil, Inc.*, 817 F.2d 326 (5th Cir. 1987); *Snyder v. Smith*, 736 F.2d 409 (7th Cir.), cert. denied, 469 U.S. 1037 (1984); *Couler Int'l Ltd. v. Saint-Tropez West*, 547 F. Supp. 176 (S.D.N.Y. 1982).

216. See *Econo-Car Int'l, Inc. v. Antilles Car Rentals*, 499 F.2d 1391, 1394 (3d Cir. 1974). Federal courts have not treated the section 4 limitation as absolute. In *Dupuy-Busching Gen. Agency v. Ambassador Ins. Co.*, the Fifth Circuit considered the Mississippi federal district court's compelling arbitration in New Jersey according to the parties' agreement despite the section 4 limitation. 524 F.2d 1275 (5th Cir. 1975). The Fifth Circuit held that section 4 could be asserted as a counterclaim, thereby affirming the trial court's ruling. *Id.* at 1277.

217. See, e.g., *Ex parte Redshaw, Inc.*, 524 So. 2d 367 (Ala. Civ. App. 1987) (ordered arbitration in Pittsburgh, Pennsylvania according to agreement governed by USAA); *Donmoor, Inc. v. Sturtevant*, 449 So. 2d 869 (Fla. Dist. Ct. App. 1984) (Florida court ordered arbitration in New York under agreement governed by USAA).

218. 470 U.S. 213 (1985).

219. *Id.* at 217.

220. *Id.* at 221. Prior to *Dean Witter*, lower federal courts espoused one approach called the "intertwining doctrine" in securities arbitration cases if the case involved both arbitrable and non-arbitrable issues. *Id.* at 216. Under this doctrine, the court decided both arbitrable and non-arbitrable issues. See, e.g., *Belk v. Merrill Lynch, Pierce, Fenner & Smith*, 693 F.2d 1023 (11th Cir. 1982); *Miley v. Oppenheimer & Co.*, 637 F.2d 318 (5th Cir. 1981). The Supreme Court in *Dean Witter* rejected this doctrine. 470 U.S. at 216-17. Although *Dean Witter* dealt with non-arbitrability due to public policy or to legal restraints external to the contracts, its holding is also applicable to cases where non-arbitrability is based on contract. See *Energy Group, Inc. v. Liddington*, 192 Cal. App. 3d 1520, 238 Cal. Rptr. 202 (1987).

lost.<sup>221</sup> Therefore, the bifurcation approach should apply to state court proceedings where the arbitration agreement is governed by section 2 of the USAA.<sup>222</sup>

Applicability of some other provisions in sections 3 and 4 may depend on the degree of involvement of federal policy and interests in each case. For example, the USAA contains venue provisions.<sup>223</sup> These provisions are primarily aimed at federal court proceedings and were not intended to apply to state court proceedings.<sup>224</sup> However, if a state law denies the court jurisdiction or venue to enforce an arbitration agreement that is otherwise enforceable under the USAA, the state law should be preempted. For example, Florida law does not give state courts jurisdiction to enforce arbitration agreements if the agreements call for arbitration according to foreign law or to the law of another state.<sup>225</sup> If such an agreement is governed by the USAA, the Florida court should have jurisdiction or venue to enforce it despite the contrary state law.<sup>226</sup> The same should also be true with regard to other procedural matters.<sup>227</sup>

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221. Under the intertwining doctrine, the Court denied arbitration altogether even though the arbitration agreement was valid and enforceable and there were arbitrable issues. *Dean Witter*, 470 U.S. at 216. Even under the bifurcation approach, a court may stay arbitration until the litigation of non-arbitrable issues has been completed. *See Lippus v. Dahlgren Mfg. Co.*, 644 F. Supp. 1473, 1483 (E.D.N.Y. 1986). Such an approach is questionable under *Dean Witter*.

222. *See, e.g., Liddington*, 192 Cal. App. 3d at 1520, 238 Cal. Rptr. at 202. The court found that the arbitration agreement was governed by federal law, and it held that federal law preempted California law authorizing courts to stay arbitration pending resolution of related litigation. *Id.* at 1528, 238 Cal. Rptr. at 207 (citing CAL. CIV. PROC. CODE § 1281 (West 1982)). *See also GAF Corp. v. Werner*, 66 N.Y.2d 97, 485 N.E.2d 977, 495 N.Y.S.2d 312 (1985), where the court held that an arbitrator's consideration of issues involved in lawsuits was not a basis for stay of arbitration. *Id.* at 101, 485 N.E.2d at 979, 495 N.Y.S.2d at 314.

223. Section 4 provides that the federal district court should order arbitration within the district in which the petition for arbitration has been filed. 9 U.S.C. § 4 (1988).

224. *See AAACon Auto Transp. v. Newman*, 77 Misc. 2d 1069, 356 N.Y.S.2d 171 (1974).

225. FLA. STAT. § 682.02 (1987). *See Williams v. Hardy*, 468 So. 2d 429 (Fla. Dist. Ct. App. 1985) (court had no jurisdiction to enforce provision for arbitration in New York under New York law).

226. *Donmoor, Inc. v. Sturtevant*, 449 So. 2d 869 (Fla. Dist. Ct. App. 1984) (court had jurisdiction to enforce agreement for arbitration in New York despite contrary state law because USAA applied to agreement).

227. For instance, under section 4, if the making of the arbitration agreement is in issue, the court "shall proceed summarily to the trial thereof." 9 U.S.C. § 4 (1982). The United States Supreme Court said that section 4 "call[s] for an expeditious and summary hearing, with only restricted inquiry into factual issues." *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 22 (1983). Although federal rules regarding how a trial should be conducted may not apply to state court proceedings, state courts should be bound by the federal requirement of expeditious and summary hearing and restricted inquiry into factual issues.



*E. Choice-of-Law Clauses and Rules Governing Pre-Award  
Judicial Proceedings*

As discussed above, a choice-of-law clause cannot displace application of federal substantive law to determine the validity, enforceability and irrevocability of an arbitration agreement in a contract evidencing a transaction involving commerce.<sup>228</sup> Additionally, federal substantive law implies that specific enforcement is the only method for enforcement under the federal law.<sup>229</sup> Therefore, a choice-of-law clause cannot be used to displace the specific enforcement rules of sections 3 and 4 of the USAA.<sup>230</sup>

The issue arises as to the effect of a choice-of-law clause on matters in pre-award proceedings other than specific enforcement. The United States Supreme Court recently passed on the issue in the context of a conflict between federal law and California law regarding a court's discretion to stay arbitration where the case involved third parties and non-arbitrable issues.<sup>231</sup> The Court held that under federal law where arbitrable and non-arbitrable issues arise in the same case, a court has no discretion to stay arbitration pending the outcome of a lawsuit.<sup>232</sup> In contrast, California Code of Civil Procedure section 1281.2<sup>233</sup> gives courts discretion to stay arbitration proceedings pending resolution of related court actions involving non-arbitrating parties.<sup>234</sup>

In *Volt Information Sciences, Inc. v. Board of Trustees*,<sup>235</sup> Stanford University and Volt were parties to a contract under which Volt was to

228. See *supra* notes 70-90 and accompanying text.

229. See 9 U.S.C. §§ 3-4 (1988). See also *supra* notes 176-78 and accompanying text.

230. 9 U.S.C. §§ 3-4 (1988).

231. See *Volt Information Sciences, Inc. v. Board of Trustees*, 109 S. Ct. 1248, 1251-52 (1989).

232. *Id.* at 1254-55.

233. CAL. CIV. PROC. CODE § 1281.2 (West 1982).

234. *Id.* Section 1281.2 provides in pertinent part:

On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that:

. . . .  
(c) 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 or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact.

. . . .  
(4) In such cases the court may stay arbitration pending the outcome of the court action or special proceeding.

*Id.*

235. 109 S. Ct. 1248 (1989).

build a system of electrical conduits for the University.<sup>236</sup> The contract provided for mandatory arbitration of all disputes arising from the contract or its breach.<sup>237</sup> It also provided: "The Contract shall be governed by the law of the place where the Project is located."<sup>238</sup> After Volt sought arbitration of its compensation claims, Stanford University filed a lawsuit against Volt and two other companies involved in design and management of the project.<sup>239</sup> The contracts between the University and these two other firms did not contain arbitration agreements.<sup>240</sup> The trial court denied Volt's petition to stay the lawsuit and to compel arbitration and, pursuant to California Code of Civil Procedure section 1281.2(c), granted the University's motion to stay arbitration.<sup>241</sup>

The California Court of Appeal affirmed in a two-to-one decision.<sup>242</sup> The court recognized that the case was governed by the USAA.<sup>243</sup> However, because the contract contained a choice-of-law clause, the court held that the parties were free to choose a state law to govern the issue of whether arbitration should be compelled where third parties were involved.<sup>244</sup> The court said:

[I]f the parties here had expressly stated in their agreement that they wished to arbitrate only those disputes between themselves which did not involve third parties not bound by the arbitration agreement, this provision would presumably be enforceable. In our view they accomplished the same thing by choosing to be governed by California law, thus incorporating the California rules of civil procedure governing arbitration agreements.<sup>245</sup>

On appeal, the United States Supreme Court affirmed.<sup>246</sup> Chief Justice Rehnquist, who wrote the majority opinion, held that the California court's construction of the choice-of-law clause as incorporating California arbitration rules into the parties' arbitration agreement was not re-

236. *Id.* at 1251.

237. *Id.*

238. *Id.*

239. *Id.*

240. *Id.*

241. *Id.* at 1251 n.2.

242. *Board of Trustees v. Volt Information Sciences, Inc.*, 195 Cal. App. 3d 349, 240 Cal. Rptr. 558 (1987), *aff'd*, 109 S. Ct. 1248 (1989). The court of appeal opinion was depublished by order of the California Supreme Court; hereinafter, all citations to the California Court of Appeal opinion are to the California Reporter.

243. *Id.* at 559.

244. *Id.*

245. *Id.* at 561.

246. *Volt*, 109 S. Ct. at 1256.

viewable because it was a question of state law.<sup>247</sup> The Court rejected the argument that the state court's decision interfered with Volt's federal arbitration right.<sup>248</sup> The Court explained that since section 4 of the USAA expressly provided that arbitration be conducted according to the parties' agreement, including their choice-of-law clause, Volt could enforce its arbitration right only under California arbitration law.<sup>249</sup> The Court also found that the federal policy favoring arbitration did not require arbitration under a specific set of procedural rules.<sup>250</sup> Finally, the Court held that the California rule giving the state court discretion to stay arbitration was not preempted by the USAA because its application in this case was based on the parties' agreement and was therefore consistent with the federal arbitration policy of enforcing the parties' agreement.<sup>251</sup>

In dissent, Justice Brennan asserted that the California court's construction of the choice-of-law clause should be reviewable because (1) the state court's decision denied enforcement of a federal right, and (2) the construction of the choice-of-law clause involved federal law.<sup>252</sup> Furthermore, Justice Brennan rejected the state court's construction of the choice-of-law clause.<sup>253</sup> First, he stated that the purpose of a choice-of-law clause was normally to address the relationship between the laws of different states rather than to address any interaction between state and federal law.<sup>254</sup> He reasoned that no basis existed for believing that the parties had intended their choice-of-law clause to displace application of federal arbitration law.<sup>255</sup>

Second, Justice Brennan observed, the parties' choice-of-law clause referred to "the law of the place."<sup>256</sup> Such a reference, he said, should not be interpreted as excluding application of federal law.<sup>257</sup> Finally, Justice Brennan expressed grave concern that if a state court could freely interpret any choice-of-law clause as an expression of the parties' intent to exclude the application of federal law, the federal arbitration statute would become a nullity.<sup>258</sup>

Justice Brennan noted that the parties could agree that a particular

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247. *Id.* at 1253-54.

248. *Id.* at 1253.

249. *Id.*

250. *Id.* at 1254.

251. *Id.* at 1255.

252. *Id.* at 1257-60 (Brennan, J., dissenting).

253. *Id.* at 1260 (Brennan, J., dissenting).

254. *Id.* (Brennan, J., dissenting).

255. *Id.* at 1261 (Brennan, J., dissenting).

256. *Id.* (Brennan, J., dissenting).

257. *Id.* at 1261-62 (Brennan, J., dissenting).

258. *Id.* at 1262 (Brennan, J., dissenting).

state arbitration law would govern pre-award proceedings, and that such an agreement would be enforceable even though the case was otherwise governed by the USAA.<sup>259</sup> In addition, Justice Brennan considered whether the parties' choice-of-law clause in this case warranted application of the California law giving a court discretion to stay arbitration where non-arbitrating third parties are involved.<sup>260</sup> As noted above,<sup>261</sup> the majority did not address this issue, because it held that the state court's construction of the clause as incorporating the California arbitration rules into the parties' arbitration agreement was not reviewable.<sup>262</sup>

Had the parties in *Volt* intended the California arbitration rules to apply? As Justice Brennan observed, nothing indicated that the parties in this case generally or specifically intended that the California rule giving a court discretion to stay arbitration would apply.<sup>263</sup> Generally, as Justice Brennan pointed out, a choice-of-law clause addresses the issue of application of the law of one state instead of another; it should have no effect on the federal-state relationship because federal law is considered "intertwined" with state law.<sup>264</sup> This case involved a standardized contract and choice-of-law clause.<sup>265</sup> The clause did not even mention Cali-

259. *Id.* at 1259 (Brennan, J., dissenting). Justice Brennan agreed with the majority that federal policy called for enforcing an arbitration agreement according to the parties' terms. *Id.* at 1257 (Brennan, J., dissenting). He also opined that the California rule giving the court discretion to stay arbitration could be given effect if "the parties somehow agreed that federal law was to play no role in governing their contract." *Id.* at 1256 n.2 (Brennan, J., dissenting).

260. *Id.* at 1259 (Brennan, J., dissenting).

261. See *supra* notes 245-50 and accompanying text.

262. *Volt*, 109 S. Ct. at 1252 n.4. Both the United States Supreme Court and the California Court of Appeal conceded that the USAA would have applied absent the choice-of-law clause. *Id.* at 1254; *Board of Trustees*, 240 Cal. Rptr. at 559. Under the USAA, arbitration could go forward because the trial court would not be authorized to stay arbitration. *Volt*, 109 S. Ct. at 1254; *Board of Trustees*, 240 Cal. Rptr. at 560. The Supreme Court did not clearly decide the applicability of sections 3 and 4 to state court proceedings, but assumed that they might apply. *Volt*, 109 S. Ct. at 1254. Justice Brennan believed that the federal policy favoring arbitration would be frustrated by interpreting the parties' choice-of-law clause so as to displace the USAA. *Id.* at 1259 (Brennan, J., dissenting). The majority's view on this point was unclear. On the one hand, the majority agreed that federal law did not permit undue delay or denial in enforcement of the arbitration agreement by granting a stay of arbitration. *Id.* at 1254 n.5. On the other hand, the majority believed that the California rule would generally foster the policy underlying the USAA. *Id.*

263. *Volt*, 109 S. Ct. at 1260 (Brennan, J., dissenting).

264. *Id.* (Brennan, J., dissenting). In the state court decision, the dissent pointed out that "under California law, federal law governs matters recognizable in California courts upon which the United States has definitely spoken. . . . [T]he mere choice of California law is not a selection of California law over federal law." *Board of Trustees*, 240 Cal. Rptr. at 563-64 (Capaccioli, J., dissenting).

265. *Volt*, 109 S. Ct. at 1254. In *Volt*, the contract in question was a standard form contract provided by the American Institute of Architects and endorsed by the Associated General Contractors of America. *Id.* The parties probably did not consider the ramifications of apply-

fornia.<sup>266</sup> Under these circumstances, it is highly doubtful that the clause truly expressed the parties' intent to have California arbitration law apply.

Where the parties had arguably not agreed that the California rule giving the court discretion to stay arbitration applied, the relevant rule in the USAA should not have been displaced. The application of the USAA would provide certain and uniform results in like cases. Most significantly, as Justice Brennan pointed out, a loose interpretation of the choice-of-law clause in favor of application of state arbitration law would endanger the effectiveness of the federal arbitration statute.<sup>267</sup>

State courts have the responsibility to fashion proper rules of interpretation which avoid undermining federal arbitration law because the interpretation of the choice-of-law clause in arbitration cases is a question of state law and may not be subject to Supreme Court review.<sup>268</sup> If a choice-of-law clause does not clearly indicate that the arbitration law of a particular state should apply to enforcement proceedings, the federal rule should govern the issue of court discretion to stay arbitration.<sup>269</sup>

The same rationale should also apply to other matters in pre-award proceedings such as interpretation of the scope of arbitration agreements, and division of functions between the court and arbitrators. Parties are

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ing California law to pre-award judicial proceedings when adopting the form contract with its choice-of-law clause.

266. *Id.* at 1261 (Brennan, J., dissenting). The clause generally stated "the law of the place . . ." *Id.* (Brennan, J., dissenting).

267. *Id.* at 1262 (Brennan, J., dissenting).

268. *Id.* at 1252-54.

269. A few months prior to its decision in *Volt*, the California Court of Appeals reached a different result in a similar case. In *Energy Group, Inc. v. Liddington*, the Liddingtons contracted for installation of energy-saving systems. 192 Cal. App. 3d 1520, 1522, 238 Cal. Rptr. 202, 203 (1987). The contract contained an arbitration clause, *id.* at 1523 n.3, 238 Cal. Rptr. at 203 n.3, and also provided that the contract would be governed by California law. *Id.* at 1524, 238 Cal. Rptr. at 204. Later, a bank which had financed the Liddingtons' project filed a complaint against the Liddingtons on the promissory note which evidenced the debt. *Id.* at 1523, 238 Cal. Rptr. at 203. The defendants, in turn, cross-complained against various third parties including the contractor's assignee, *id.*, and the assignee filed a petition to compel arbitration under section 3 of the USAA. *Id.*, 238 Cal. Rptr. at 204. The Liddingtons resisted arbitration. *Id.* at 1524, 238 Cal. Rptr. at 204. The trial court stayed arbitration pending litigation on the ground that California Code of Civil Procedure section 1281.2(c) gave the court discretion to impose a stay. *Id.* The California Court of Appeal reversed. *Id.* at 1529, 238 Cal. Rptr. at 207. Applying the holdings of the Supreme Court in *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), *Southland Corp. v. Keating*, 465 U.S. 1 (1984), *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985), and *Perry v. Thomas*, 482 U.S. 483 (1987), the California appellate court held that section 1281.2 was preempted by the USAA, because the California rule applied only to arbitration agreements and, therefore, should not be allowed under the USAA. *Liddington*, 192 Cal. App. 3d at 1525-28, 238 Cal. Rptr. at 205-07.

always free to determine what matters and contracts should be subject to arbitration; they may directly indicate in their arbitration agreement,<sup>270</sup> or they may agree that the issue of arbitrability be decided according to the law of a particular state.<sup>271</sup> The federal policy is that once the parties have agreed to arbitrate, they must live up to their agreement.<sup>272</sup> However, no federal law or policy forces parties to arbitrate certain issues once an arbitration agreement is enforced. To honor a choice-of-law clause on the issue of arbitrability effectively enhances faith in arbitration. On the other hand, since interpretation of arbitrability affects enforcement of federal arbitration rights,<sup>273</sup> the parties' intent to displace otherwise applicable federal interpretation rules must be clear.

Although the issue of division of functions between courts and arbitrators could affect the substantive issue of enforceability of arbitration agreements, parties can still agree on the matter of division of functions between the court and the arbitrators.<sup>274</sup> They can also agree that the matter be decided according to the law of a particular state. If parties have clearly and specifically indicated that the law of a particular state should govern issues in pre-award proceedings, including division of functions, the parties' clear intent and the choice-of-law clause should be given effect.<sup>275</sup>

For example, if the parties clearly agreed that New York arbitration

270. The USAA "does not prevent parties who do agree to arbitrate from excluding certain claims from the scope of their arbitration agreement." *Volt*, 109 S. Ct. at 1255.

271. For a case applying parties' choice-of-law clause to interpret the scope of arbitration agreements which were covered by section 2 of the USAA, see *Georgia Power Co. v. Cimarron Coal Corp.*, 526 F.2d 101 (6th Cir. 1975) (applying Georgia law), *cert. denied*, 425 U.S. 952 (1976).

272. *Perry*, 482 U.S. at 493 n.9.

273. See *supra* notes 202-08 and accompanying text.

274. 9 U.S.C. §§ 3-4 (1988). See also *supra* notes 181-95 and accompanying text. Even the *Prima Paint Corp.* Court and the Second Circuit in *In re Kinoshita & Co.* recognized that fraud in the inducement of a container contract is not for arbitrators to decide if the parties did not intend the issue to be arbitrated. *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 402 (1967); *In re Kinoshita & Co.*, 287 F.2d 951, 953 (2d Cir. 1961). The issue of parties' intent may be a matter of contention during litigation. Full discussion of the issue is beyond the scope of this Article. It suffices to note that the trend is towards liberal interpretation of the parties' intent in favor of arbitrability. See, e.g., *S.A. Mineracao Da Trindade-Samitri v. Utah Int'l, Inc.*, 745 F.2d 190, 195 (2d Cir. 1984) (unless parties have expressly excluded possibility of arbitration under particular circumstances, fraud-in-inducement claim is arbitrable).

275. *Volt* suggests that the parties are free to choose state arbitration rules and procedures applicable to pre-award state court proceedings even if the USAA would otherwise govern. 109 S. Ct. at 1255-56. In *Prima Paint Corp.*, the Supreme Court implied that the issue of division of functions between courts and arbitrators is an issue addressed by sections 3 and 4, but not section 2. 388 U.S. at 405. Therefore, like the issue of whether a state court should compel arbitration where a third, non-arbitrating party is involved, the division of functions

law would govern issues in pre-award proceedings, including division of functions, and under the New York arbitration statute the court is empowered to decide whether a claim subject to arbitration is barred by a statute of limitations, the statute of limitations issue should be decided by the court even though the underlying contract evidences a transaction involving commerce.<sup>276</sup> If the parties' choice-of-law clause is merely a general designation of which state's law is to apply, without specifying the application of state law to issues in pre-award judicial proceedings including division of functions, the clause should not be interpreted as intending to have state law apply to the issue of division of functions between the court and arbitrators. In sum, lacking a clearly expressed specific intent, the parties should be deemed to understand that federal law will govern the issue.<sup>277</sup>

## V. OTHER ISSUES IN PRE-AWARD PROCEEDINGS

### A. *Preliminary Injunctive Relief and Consolidation*

The USAA does not state whether a court has the power to order preliminary injunctive relief or whether it has the power to order non-consensual consolidation of arbitration proceedings.<sup>278</sup>

Federal district courts and courts of appeals are divided on the two issues.<sup>279</sup> State courts appear cautious in deciding whether to issue pre-

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between courts and arbitrators should be subject to the parties' express, unambiguous choice-of-law clause.

276. See *supra* notes 70-90 and accompanying text.

277. The contract in *Prima Paint Corp.* apparently did not have a choice-of-law clause although the lower federal courts assumed that but for the USAA, New York law might apply. 388 U.S. at 400 n.3. As Justice Black said in dissent, it was not clear that New York law would apply in the absence of the federal act. *Id.* at 411 n.4 (Black, J., dissenting). However, some courts have consequently denied application of state law where the choice-of-law clauses are unclear. See, e.g., *Sentry Sys., Inc. v. Guy*, 98 Nev. 507, 654 P.2d 1008 (1982) (applying federal separability approach despite contract providing that California law would govern).

278. The issue of judicial consolidation of arbitration proceedings arises where, in the absence of an agreement to consolidate, a party petitions the court to consolidate different arbitration proceedings in which that party is involved. See generally Stipanowich, *Arbitration and the Multiparty Dispute: The Search for Workable Solutions*, 72 IOWA L. REV. 473 (1987).

279. For an illustration of differences in federal cases as to the judicial power to issue preliminary injunctive relief pending arbitration, compare *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348 (7th Cir. 1983) (court could issue preliminary injunction), *cert. denied*, 464 U.S. 1070 (1984) with *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Hovey*, 726 F.2d 1286 (8th Cir. 1984) (court had power to issue preliminary injunction). However, a court generally has the power to issue preliminary injunctive relief where such a remedy was expressly agreed to by the parties. See, e.g., *RGI, Inc. v. Tucker & Assocs., Inc.*, 858 F.2d 227 (5th Cir. 1988). For an illustration of differences in federal cases as to the judicial power to order consolidation, compare *Compania Espanola de Petroleos v. Nereus Shipping, S.A.*, 527 F.2d 966 (2d Cir. 1975) (court had power to consolidate), *cert. denied*, 426 U.S. 936 (1976)

liminary injunctions where the arbitration agreements are governed by the USAA.<sup>280</sup> In two Texas cases, for instance, the same court held that in determining whether it had the power to issue preliminary injunctive relief, it had to look at federal law.<sup>281</sup> In both cases, the court interpreted federal arbitration law and policy as prohibiting a court from issuing a preliminary injunction.<sup>282</sup>

Contrary to what the Texas court held, reasons exist for supporting such a power. One important reason is that the issuance of preliminary injunctive relief can preserve the status quo and effect enforcement of the arbitrators' decisions.<sup>283</sup> Not surprisingly, some federal cases indeed support judicial power to issue preliminary injunctive relief.<sup>284</sup> A state court should be able to have the same power under its own law, even though the arbitration agreement in question falls under section 2.<sup>285</sup>

The same is also true of the judicial power to order non-consensual consolidation of arbitration proceedings—although such an order may interfere with the way arbitration would be conducted under the parties' agreements, consolidation may in some cases be necessary to prevent harsh results from separate arbitration proceedings.<sup>286</sup> For that reason,

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with *Weyerhaeuser Co. v. Western Seas Shipping Co.*, 568 F. Supp. 1220 (N.D. Cal. 1983) (court had no power to order non-consensual consolidation), *aff'd*, 743 F.2d 635 (9th Cir.), *cert. denied*, 469 U.S. 1061 (1984). It has been generally accepted that a court has power to order consolidation if the parties have agreed to it. *See, e.g.*, *Maxum Foundns., Inc. v. Salus Corp.*, 817 F.2d 1086 (4th Cir. 1987).

280. *Galtney v. Underwood Neuhaus & Co.*, 700 S.W.2d 602 (Tex. Ct. App. 1985); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum*, 666 S.W.2d 604 (Tex. Ct. App. 1984), *cert. denied*, 469 U.S. 1127 (1985).

281. *Galtney*, 700 S.W.2d at 604; *McCollum*, 666 S.W.2d at 608.

282. *Galtney*, 700 S.W.2d at 604; *McCollum*, 666 S.W.2d at 609.

283. *See, e.g.*, *Teradyne, Inc. v. Mostek Corp.*, 797 F.2d 43, 47-51 (1st Cir. 1986); *Merrill Lynch, Pierce, Fenner & Smith v. Bradley*, 756 F.2d 1048, 1052-54 (4th Cir. 1985); *Roso-Lino Bev. Distrib. v. Coca-Cola Bottling Co.*, 749 F.2d 124, 125 (2d Cir. 1984); *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348, 351 (7th Cir. 1983), *cert. denied*, 464 U.S. 1070 (1984). *See also* *PMS Distrib. Co. v. Huber & Suhner, A.G.*, 854 F.2d 355, 356-58 (9th Cir. 1988).

284. *See, e.g.*, *Teradyne, Inc.*, 797 F.2d at 47-51; *Bradley*, 756 F.2d at 1052-54; *Roso-Lino Bev.*, 749 F.2d at 125; *Sauer-Getriebe KG*, 715 F.2d at 351. *See also* *PMS Distrib.*, 854 F.2d at 356-58.

285. When state courts have issued preliminary injunctive relief, they have stated that such relief is consistent with the policy in favor of arbitration. *See, e.g.*, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. District Court*, 672 P.2d 1015, 1018 (Colo. 1983). Some state statutes authorize courts to issue preliminary injunctions pending arbitration. *See, e.g.*, GA. CODE ANN. § 9-9-4(e) (Supp. 1989); N.Y. CIV. PRAC. L. & R. 7503(c) (McKinney 1980).

286. One explanation for judicial willingness to order non-consensual consolidation is that courts wish to avoid conflicting arbitral decisions and inconsistent results. *See, e.g.*, *Compania Espanola de Petroleos*, 527 F.2d at 970. A court has only limited power to vacate or change awards after separate arbitrations. *See* *Consolidated Pac. Eng'g, Inc. v. Greater Anchorage Area Borough*, 563 P.2d 252, 256 (Alaska 1977) (Erwin, J., dissenting).



some federal courts support the judicial power to order non-consensual consolidation.<sup>287</sup> State courts should similarly be allowed to apply state rules to decide this issue, even where the agreement is governed by the USAA.<sup>288</sup>

Assessment of the benefits of judicial power to order preliminary injunctive relief or consolidation in light of the policy of enforcement of federal arbitration rights is essential. In general, the federal policy in favor of arbitration and enforcement of parties' agreements should not be equated with a hands-off approach to the arbitration right. To make arbitration a fair, just and effective method of dispute resolution, some judicial actions, such as orders granting injunctions, or consolidation, may still be necessary.<sup>289</sup> Where no clear federal rule exists on the matters, state rules that allow courts to take such actions should not be viewed as conflicting with the federal policy for enforcement of arbitration rights unless the state rules would unreasonably interfere with the parties' arbitration agreement.<sup>290</sup>

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287. See, e.g., *New England Energy, Inc. v. Keystone Shipping Co.*, 855 F.2d 1, 5-6 (1st Cir. 1988) (applying Massachusetts law), *cert. denied*, 109 S. Ct. 1526 (1989); *Compania Espanola*, 527 F.2d at 975.

288. One state court has refused to follow federal rules as to consolidation. See *Vigo S.S. Corp. v. Marship Corp.*, 26 N.Y.2d 157, 161-62, 257 N.E.2d 624, 626-27, 309 N.Y.S.2d 165, 169 (consolidation procedural in nature and its resolution not outcome determinative), *cert. denied sub nom. Frederick Snare Corp. v. Vigo S.S. Corp.*, 400 U.S. 819 (1970). Some state laws allow the court to order non-consensual consolidation. See, e.g., CAL. CIV. PROC. CODE § 1281.3 (West 1982); MASS. GEN. LAWS ANN., ch. 251, § 2(A) (West 1988). See also *Jefferson County v. Barton-Douglas Contractors*, 282 N.W.2d 155 (Iowa 1979); *Litton Bionetics, Inc. v. Glen Constr. Co.*, 292 Md. 34, 437 A.2d 208 (1981); *Grover-Diamond Assocs. v. American Arbitration Assoc.*, 297 Minn. 324, 211 N.W.2d 787 (1973); *Exber, Inc. v. Sletten Constr. Co.*, 92 Nev. 721, 558 P.2d 517 (1976); *County of Sullivan v. Edward L. Nezelek, Inc.*, 42 N.Y.2d 123, 128, 366 N.E.2d 72, 75, 397 N.Y.S.2d 371, 374 (1977); *Episcopal Hous. Corp. v. Federal Ins. Co.*, 273 S.C. 181, 255 S.E.2d 451 (1979).

289. See *New England Energy*, 855 F.2d at 6-7 (rejecting argument in favor of hands-off approach; holding that judicial consolidation is like judicial power to choose arbitrators and enforce arbitration subpoenas under sections 5 and 7 of USAA). In *Merrill, Lynch, Pierce, Fenner & Smith v. McCollum*, the United States Supreme Court declined to review a Texas Court of Appeals decision upholding the trial court's refusal to grant a preliminary injunction pending arbitration. 666 S.W.2d 604 (Tex. Ct. App. 1984), *cert. denied*, 469 U.S. 1127 (1985). The district court opinion suggests that the federal policy favoring arbitration does not mandate a particular result in such cases. *Id.* at 608-09.

290. Courts have not given adequate attention to the issue of what circumstances warrant injunctive or consolidation orders or whether an order is proper and reasonable in a given case. Discussions of those issues are beyond the scope of this Article. However, in determining whether preliminary injunctive relief or consolidation should be ordered, courts should not frustrate the parties' bargain or interfere with the domain reserved for arbitrators. See, e.g., *Klein Sleep Prods., Inc. v. Hillside Bedding Co.*, 563 F. Supp 904, 906 (S.D.N.Y. 1982) (judicial determination of preliminary injunctive relief should not invade province of arbitrator and undermine arbitration process); *Litton Bionetics, Inc.*, 292 Md. at 53, 437 A.2d at 218 (no

*B. Appellate Review Rules*

Prior to the November 1988 adoption of section 15 of the USAA concerning appeals,<sup>291</sup> federal statutes and case law failed to satisfactorily address appellate review of district court orders in pre-award proceedings.<sup>292</sup> Under the new section 15, the following pre-award district-court orders may be appealed:

- (1) [A]n order—
  - (A) refusing a stay of any action under section 3 of this title,
  - (B) denying a petition under section 4 of this title to order arbitration to proceed,
  - (C) denying an application under section 206 of this title to compel arbitration . . . ;
- (2) an interlocutory order granting, continuing, or modifying an injunction against an arbitration that is subject to this title; or
- (3) a final decision with respect to an arbitration that is subject to this title.<sup>293</sup>

This section forbids appeals of some interlocutory orders, providing that

[e]xcept as otherwise provided in section 1292(b) of title 28, an appeal may not be taken from an interlocutory order—

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consolidation should be ordered if it “deprives any objecting party of a contractual right under the arbitration agreement”).

291. Act of Nov. 19, 1988, Pub. L. No. 100-702 tit. x, § 1019(a), 102 Stat. 4670 (1988) (codified at 9 U.S.C. § 15 (1988)).

292. For many years the appealability of an order granting or denying a section 3 motion was controlled by the Enelow-Ettelson doctrine, under which a section 3 order—an interlocutory one—was appealable if the action stayed was legal, rather than equitable, in nature. *See, e.g., Hartford Software Fin. Sys. v. Florida Software Servs.*, 712 F.2d 724, 726-27 (1st Cir. 1983). The Supreme Court overruled the Enelow-Ettelson doctrine in *Gulfstream Aerospace Corp. v. Mayacamas Corp.*, 485 U.S. 270 (1988). After *Gulfstream*, whether a section 3 order was appealable depended on the “collateral order” rule and courts tended to dismiss appeals from section 3 orders under that rule. *See, e.g., McDonnell-Douglas Fin. Corp. v. Pennsylvania Power & Light Co.*, 849 F.2d 761, 764 (2d Cir. 1988) (dismissed appeal from order denying stay); *Commonwealth Ins. Co. v. Underwriters, Inc.*, 846 F.2d 196, 198 (3d Cir. 1988) (dismissed appeal from order granting stay). Although a section 4 order was generally considered a final judgment and therefore appealable, cases were divided as to whether a section 4 order made concurrently with a section 3 order was appealable. *Compare Langley v. Colonial Leasing Co.*, 707 F.2d 1 (1st Cir. 1983) (concurrent section 4 order treated as section 3 order) with *Administrative Mgt. Servs., Ltd. v. Royal Am. Managers, Inc.*, 854 F.2d 1272 (11th Cir. 1988) (order only appealable if order would decide all issues).

293. 9 U.S.C. § 15(a) (1988).

- (1) granting a stay of any action under section 3 of this title;
  - (2) directing arbitration to proceed under section 4 of this title;
  - (3) compelling arbitration under section 206 of this title;
- or
- (4) refusing to enjoin an arbitration that is subject to this title.<sup>294</sup>

Should these appeal rules apply to state court proceedings where the arbitration agreements are governed by the USAA?<sup>295</sup>

In the past, state courts appeared to be reluctant to apply federal appeal rules and practices, in part because state courts were not pleased with the condition of the federal appeal rules in arbitration cases, and in part because the appeal rules were procedural and therefore not binding on state courts.<sup>296</sup> State courts may resist application of the federal appeal provisions on the ground that the rules are merely procedural.<sup>297</sup> However, state courts may look to the federal appeal rules for guidance.

First, the new appeal rules in the USAA clearly reflect the policy favoring the use of arbitration.<sup>298</sup> The rules generally permit appeals from orders that prefer litigation to arbitration.<sup>299</sup> The rules also deny appealability of orders that favor the use of arbitration.<sup>300</sup> State courts would likely be impressed by these policy-oriented rules because of the strong federal interest in appellate review of pre-award orders. The clarity and certainty of the new rules governing appealability should make state courts more confident about ascertaining, and more willing to apply, the federal rules in this area.

Although uncertainty remains as to the applicability of sections 3

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294. *Id.* § 15(b).

295. The arbitration statutes in many states contain rules for appeals from pre-award orders, and these rules could differ significantly from the federal rules. For instance, section 19 of the Uniform Arbitration Act provides for appealability of certain pre-award orders, but unlike the new section 15(b) of the USAA, it does not expressly disallow any appeals from interlocutory orders. Compare UNIF. ARBITRATION ACT § 19, 7 U.L.A. 216-17 (1985) with 9 U.S.C. § 15(b) (1988).

296. See *Xaphes v. Mowry*, 478 A.2d 299, 301 (Me. 1984) (refusing to apply federal appeal rule because of anomaly of Enelow-Ettelson doctrine and procedural nature of rule); *McClellan v. Barrath Constr. Co.*, 725 S.W.2d 656, 658 (Mo. App. 1987) (procedural provisions of USAA are not binding on states provided state procedures do not defeat substantive rights granted under USAA).

297. See, e.g., *McClellan*, 725 S.W.2d at 658.

298. 9 U.S.C. § 15 (1988).

299. *Id.* § 15(a)(1)A-C.

300. *Id.* § 15(b)1-4.

and 4 to state court proceedings,<sup>301</sup> state cases almost unanimously have held that where the arbitration agreements are governed by the USAA, sections 3 and 4 apply to state courts.<sup>302</sup> The new appeal rules address actions taken pursuant to sections 3 and 4, thus, it can be argued that the appeal provisions are simply an extension of these provisions and should likewise apply to state courts. Despite the procedural characterization of appeal rules, the rules undeniably affect enforcement of arbitration rights. Even though state courts may not be bound to apply the federal appeal rules, they should as a matter of policy develop their appeal practice in line with the federal rules in order to effectively protect the federal arbitration right and avoid forum shopping.

## VI. SECTIONS 9, 10, 11 AND 12

Sections 9, 10, 11 and 12 of the USAA<sup>303</sup> address post-award judicial proceedings. Section 9 provides that the court shall confirm an award upon petition within a year after the award is made unless the award is vacated, modified or corrected.<sup>304</sup> Section 10 specifies a number of grounds on which an award can be vacated.<sup>305</sup> Section 11 provides

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301. The uncertainty results from the inconsistencies in United States Supreme Court cases. See *supra* note 11.

302. See, e.g., *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 67 Cal. App. 3d 19, 24-25, 136 Cal. Rptr. 378, 380-81 (1977); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Melamed*, 405 So. 2d 790, 793 (Fla. Dist. Ct. App. 1981); *GAF Corp. v. Werner*, 66 N.Y.2d 97, 104, 485 N.E.2d 977, 982, 495 N.Y.S.2d 312, 317 (1985), *cert. denied*, 475 U.S. 1083 (1986); *AAACon Auto Transp., Inc. v. Newman*, 77 Misc. 2d 1069, 1071, 356 N.Y.S.2d 171, 173-74 (1974); *Galtney v. Underwood Neuhaus & Co.*, 700 S.W.2d 602, 604 (Tex. Ct. App. 1985); *C.P. Assocs. v. Pickett*, 697 S.W.2d 828, 830-31 (Tex. Ct. App. 1985); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum*, 666 S.W.2d 604, 608-09 (Tex. Ct. App. 1984), *cert. denied*, 469 U.S. 1127 (1985).

303. 9 U.S.C. §§ 9-12 (1988).

304. *Id.* § 9. Section 9 provides in pertinent part:

If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration, and shall specify the court, then at any time within one year after the award is made any party to the arbitration may apply to the court so specified for an order confirming the award, and thereupon the court must grant such an order unless the award is vacated, modified, or corrected as prescribed in sections 10 and 11 of this title. If no court is specified in the agreement of the parties, then such application may be made to the United States court in and for the district within which such award was made . . . .

*Id.*

305. *Id.* § 10. Section 10 provides:

In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

- (a) Where the award was procured by corruption, fraud, or undue means.
- (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (c) Where the arbitrators were guilty of misconduct in refusing to postpone the

grounds for modification and correction of awards.<sup>306</sup> Section 12 provides that a motion to vacate, modify or correct an award must be made within three months after the award is made.<sup>307</sup>

These post-award rules and procedures mainly apply to federal court proceedings.<sup>308</sup> The question is whether and how they should apply to state court proceedings. None of these sections expressly provide that their applicability depends on the involvement of an arbitration agreement governed by section 2. If the application of these sections does not depend on the existence of a maritime transaction or a contract evidencing a transaction involving commerce, they are not part of the scheme for enforcement of the federal substantive law under section 2, and no reason would exist to apply these sections to state court proceedings.

There are, however, clear indications that the post-award rules and procedures under sections 9, 10, 11 and 12 were designed to apply to

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hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.

(d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

(e) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

*Id.*

306. *Id.* § 11. Section 11 reads:

In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—

(a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.

(b) Where the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the merits of the decision upon the matter submitted.

(c) Where the award is imperfect in matter of form not affecting the merits of the controversy. The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

*Id.*

307. *Id.* § 12. Section 12 provides in pertinent part: "[n]otice of a motion to vacate, modify, or correct an award must be served upon the adverse party or his attorney within three months after the award is filed or delivered . . ." *Id.*

308. Sections 9, 10 and 11, like sections 3 and 4, do not create federal question jurisdiction. *Dorn v. Dorn's Transp., Inc.*, 562 F. Supp. 822 (S.D.N.Y. 1983), *aff'd sub nom. Dorn's Transp., Inc. v. Teamsters Pension Trust Fund*, 787 F.2d 897 (3d Cir. 1986). Therefore, a federal district court must otherwise have subject matter jurisdiction in any post-award proceedings under the USAA. *See, e.g., id.* at 824-25. *See also generally* C. WRIGHT, A. MILLER & E. COOPER, *FEDERAL PRACTICE AND PROCEDURE* § 3569, at 171 (1984) (discussing language of section 9); Atwood, *supra* note 8, at 94-95 (discussing legislative history).

cases where the underlying transaction is maritime or the contract evidences a transaction involving commerce within the meaning of section 2.

#### A. Section 9

The stay provision under section 3 is logically linked to the confirmation proceedings under section 9. When an action involves an arbitration agreement, the court should stay pending arbitration under section 3; such a stay empowers the same court to have jurisdiction to confirm the forthcoming award under section 9.<sup>309</sup> Section 9 proceedings thus can be viewed as a continuation of the scheme of enforcement under section 3.<sup>310</sup> Moreover, if USAA post-award rules and proceedings do not apply of their own force but are applied only because the parties are in federal court solely on the basis of diversity, substantive provisions, such as those addressing the grounds for vacation, modification or correction of awards, become inapplicable under *Erie R.R. Co. v. Tompkins*.<sup>311</sup> It follows that USAA post-award rules and procedures, like USAA pre-award rules and procedures, are applicable to a maritime transaction or a contract evidencing a transaction involving interstate commerce only where federal question jurisdiction exists<sup>312</sup> pursuant to Congress' commerce power.<sup>313</sup> Finally, like the pre-award rules and procedures, post-award rules and procedures affect both the enforcement of section 2 and the policy favoring arbitration.<sup>314</sup> The section 2 arbitration right and the federal policy in favor of arbitration should apply in post-award proceed-

309. See, e.g., *T & R Enter. Inc. v. Continental Grain Co.*, 613 F.2d 1272, 1279 (5th Cir. 1980) (court power to enter judgment on arbitration award was outgrowth of original action).

310. The existence of an arbitration agreement governed by section 2 has been suggested to be one of the requirements for court jurisdiction to confirm awards under section 9. See *Duplan Corp. v. W.B. Davis Hosiery Mills, Inc.*, 442 F. Supp. 86, 89 (S.D.N.Y. 1977) (declining jurisdiction because of lack of valid arbitration agreement).

311. 304 U.S. 64 (1938). In that case, the Court held that where a federal court's jurisdiction was solely based on diversity of citizenship, the court is bound by state substantive law. *Id.* at 72-73.

312. See, e.g., *Monte v. Southern Del. County Auth.*, 321 F.2d 870, 871 (3d Cir. 1963) (in post-award proceedings, court must first decide whether contract evidenced transaction involving commerce in order for USAA to apply); *Tejas Dev. Co. v. McGough Bros.*, 165 F.2d 276, 278-79 (5th Cir. 1947) (USAA post-award rules and proceedings were not applicable because contract evidencing transaction did not involve maritime or commerce).

313. See *supra* notes 44-45 and accompanying text.

314. See *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1983) ("Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for resolution of claims which the contracting parties agreed to resolve by arbitration."). An award cannot be confirmed if the underlying arbitration agreement is not valid or enforceable. See, e.g., *Duplan Corp.*, 442 F. Supp. at 89.

ings through sections 9, 10, 11 and 12.<sup>315</sup> Presumably, sections 9, 10, 11 and 12 of the USAA enforcement scheme intend to promote the federal policy in favor of arbitration where the underlying contract evidences a transaction involving interstate commerce. Accordingly, these sections should also apply to state court proceedings.<sup>316</sup>

Under section 9, an award is presumed to be valid unless it is vacated.<sup>317</sup> The burden to vacate the award is on the party opposing its confirmation.<sup>318</sup> Confirmation rules and procedures clearly reflect the federal policy in favor of confirmation of arbitration awards and should be binding on a state court post-award proceeding where the underlying contract evidences a transaction involving commerce.<sup>319</sup> Section 9 has also been interpreted as preempting state law that contains a confirmation venue-limitation provision.<sup>320</sup>

Not all provisions under section 9 are applicable to state court proceedings. For instance, the "entry of judgment agreement rule"<sup>321</sup> addressing the issue of federal court jurisdiction does not appear to fall within the substantive portion of the USAA, nor support the federal pol-

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315. See *Willoughby Roofing & Supply Co. v. Kajima Int'l Inc.*, 776 F.2d 269, 270 (11th Cir. 1985) (in light of federal policy favoring arbitration, court should resolve all doubt in favor of arbitrator's award); *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 177 (2d Cir. 1984) (interpreting section 12 to enhance role of arbitration as mechanism for speedy dispute resolution); *Diapulse Corp. v. Cabra, Ltd.*, 626 F.2d 1108, 1110 (2d Cir. 1980) (interpreting section 11 in line with purposes of arbitration as relatively quick and inexpensive resolution of contract dispute); *Office of Supply v. New York Nav. Co.*, 469 F.2d 377, 379 (2d Cir. 1972) (interpreting section 10 to further objectives of arbitration); *Fairchild & Co. v. Richmond, F & P. R. Co.*, 516 F. Supp. 1305, 1310-16 (D.D.C. 1981) (interpreting and applying section 10 to enforce section 2 arbitration right).

316. Some state courts recognize that USAA post-award rules and procedures apply to state court proceedings. See *Hilton Constr. Co. v. Martin Mechanical Contractors, Inc.*, 251 Ga. 701, 703, 308 S.E.2d 830, 832 (1983); *Tampa Motel Mgmt. Co. v. Stratton of Florida, Inc.*, 186 Ga. App. 135, 138-39, 366 S.E.2d 804, 807 (1988); *Trident Tech. College v. Lucas & Stubbs, Ltd.*, 286 S.C. 98, 103-04, 333 S.E.2d 781, 785 (1985), *cert. denied*, 474 U.S. 1060 (1986). But see *Atlantic Painting & Contracting, Inc. v. Nashville Bridge Co.*, 670 S.W.2d 841, 846 (Ky. 1984).

317. 9 U.S.C. § 9 (1988).

318. *Id.* See also *Reed & Martin, Inc. v. Westinghouse Elec. Corp.*, 439 F.2d 1268, 1275 (2d Cir. 1971).

319. See *Trident Tech. College*, 286 S.C. at 111, 333 S.E.2d at 789.

320. See *Tampa Motel*, 186 Ga. App. at 139, 366 S.E.2d at 807 (court applied federal statute rather than Georgia venue statute to confirmation proceedings).

321. Under this rule, a court can confirm an award "[i]f the parties in their agreement have agreed that a judgment of the court shall be entered upon the award made pursuant to the arbitration . . . ." 9 U.S.C. § 9 (1988) (commonly referred to as "entry of judgment agreement rule"). Conversely, if the parties do not enter into such an agreement, a federal district court would decline to confirm the award. See *Varley v. Tarrytown Assoc., Inc.*, 477 F.2d 208, 210 (2d Cir. 1973).

icy in favor of arbitration.<sup>322</sup> Therefore, that portion of section 9 might not apply to state court proceedings.

### *B. Sections 10 and 11*

The rules and procedures contained in sections 10 and 11 provide for disturbance of arbitration awards,<sup>323</sup> in apparent contradiction to the policy favoring arbitration.<sup>324</sup> As a result, some courts seem uncertain whether such rules and procedures should apply to state courts.<sup>325</sup> This uncertainty is unfounded. The rules and procedures under sections 10 and 11 should apply to state court proceedings where the underlying contract evidences a transaction involving interstate commerce—the standard should be no different. The policy in favor of arbitration does not mean that post-award judicial proceedings simply “rubber stamp” the arbitrator’s decision. A court should have unrestricted authority to review the arbitrator’s decision<sup>326</sup> because federal policy does not favor confirmation of an award per se.<sup>327</sup> However, federal policy and interests do require that state courts be bound by the list of grounds in sections 10 and 11 on which awards can be disturbed.<sup>328</sup> Although the grounds under sections 10 and 11 of the USAA do not differ significantly from the grounds in many state arbitration laws,<sup>329</sup> federal courts have generally

322. The entry of judgment agreement rule has been criticized by federal courts. *Compania Chilena de Navegacion Interoceanica, S.A. v. Norton, Lilly & Co.*, 652 F. Supp. 1512, 1515 (S.D.N.Y. 1987) (“[T]he continued applicability of Varley as a limitation on federal jurisdiction to confirm arbitration awards is highly questionable.”); *Harris v. Brooklyn Dressing Corp.*, 560 F. Supp. 940, 941 (S.D.N.Y. 1983) (rule is “a dead letter”).

323. 9 U.S.C. §§ 10, 11 (1988).

324. *See Trident Tech. College*, 286 S.C. at 103, 333 S.E.2d at 785 (stating that in order to advance underlying policy in favor of arbitration, scope of judicial review is necessarily limited).

325. *See, e.g., Hilton Constr. Co.*, 251 Ga. at 703, 308 S.E.2d at 831-32. In *Hilton Constr. Co.*, the lower court held that state courts had no jurisdiction to vacate under section 10 because the section addresses only “the United States court.” The Supreme Court of Georgia did not decide this issue on appeal. *Id.* at 702, 308 S.E.2d at 831.

326. In commenting on the public policy in favor of arbitration in the New York’s first modern arbitration statute, Judge Cardozo said:

The declaration of such a policy does not call for a relaxation of restraints upon the conduct of the arbitrators in so far as those restraints have relation to the fundamentals of a trial and the primary conditions of notice and a hearing. Indeed, they are more important now than ever if arbitration is to attain the full measure of its possibilities as an instrument of justice.

*Stefano Berizzi Co. v. Krausz*, 239 N.Y. 315, 316, 146 N.E. 436, 437 (1925).

327. *See Commonwealth Coatings Corp. v. Continental Casualty Co.*, 393 U.S. 145, 150 (1968).

328. *See Trident Tech. College*, 286 S.C. at 111, 333 S.E.2d at 789.

329. The grounds for vacation, modification or correction under the Uniform Arbitration Act, for instance, are similar to sections 10 and 11 of the USAA. As one commentator has said, “[t]he grounds for judicial vacatur of an arbitration award are surprisingly uniform



interpreted these grounds to favor enforcement of arbitration awards more so than state courts have.<sup>330</sup> For instance, under federal law the claim of fraud in the inducement of a contract is arbitrable.<sup>331</sup> In Minnesota, however, the same claim is arbitrable only if the claimant seeks damages instead of rescission, and if the language of the arbitration agreement is particularly broad in scope.<sup>332</sup> Under this standard, a Minnesota court could set aside an arbitration award that failed to meet these requirements.<sup>333</sup>

Availability of punitive damages is another area where federal and state court interpretation of arbitration laws differs. The courts in some states prohibit arbitrators from awarding punitive damages,<sup>334</sup> whereas federal courts have not created such a prohibition.<sup>335</sup> Based upon the supremacy of federal law,<sup>336</sup> where federal and state laws conflict, federal rules and practices more favorable to the enforcement of arbitration awards should preempt state rules and practices.<sup>337</sup>

### C. Section 12

Under section 12, a motion for vacation, modification or correction must be served within three months after the award is filed or delivered.<sup>338</sup> Application of this time limit to state court proceedings has been opposed on the ground that section 12 is procedural in nature.<sup>339</sup> A careful examination of cases suggests that whether the three-month time limitation applies to state court proceedings depends on how this provision is interpreted in light of federal policy and interests.

One issue under section 12 is whether a party is allowed to raise a defense, based on sections 10 or 11, to a motion for confirmation after the three-month period has expired. For many years, federal courts held

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throughout the United States—more uniform, in fact, than any other aspect of arbitration law.” G. GOLDBERG, *A LAWYER’S GUIDE TO COMMERCIAL ARBITRATION* 62 (1983).

330. *Id.* at 67-68. *Cf.* *Freeman v. Duluth Clinic, Ltd.*, 334 N.W.2d 626 (Minn. 1983).

331. *See, e.g., Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 406-07 (1967).

332. *See Freeman*, 334 N.W.2d at 629 (award vacated because lower court had erred in letting arbitrator decide claim of fraudulent inducement).

333. *Id.*

334. *See, e.g., Garrity v. Lyle Stuart, Inc.*, 40 N.Y.2d 354, 353 N.E.2d 793, 386 N.Y.S.2d 831 (1976).

335. *See Bonar v. Dean Witter Reynolds, Inc.*, 835 F.2d 1378 (11th Cir. 1988).

336. U.S. CONST. art. VI, cl. 2.

337. *Costa & Head (Atrium), Ltd. v. Duncan, Inc.*, 486 So. 2d 1272, 1276 (Ala. 1986) (award of punitive damages confirmed applying federal law). *Cf. RPJ Energy Fund Mgmt. v. Collins*, 552 F. Supp 946 (D. Minn. 1982) (federal law applied to validity of award in fraudulent inducement claim; state law held irrelevant).

338. 9 U.S.C. § 12 (1988).

339. *Atlantic Painting & Contracting*, 670 S.W.2d at 846-47.

that the three-month time limitation under section 12 did not bar such a defense.<sup>340</sup> This position differed from that adopted by some state jurisdictions.<sup>341</sup> The federal position gave a dissatisfied party more time to challenge the award, and thereby delayed the finality of awards. State courts were unwilling to adopt the federal position in state proceedings.<sup>342</sup> However, the present federal position subjects a defense to a motion to confirm the three-month time limitation of section 12.<sup>343</sup> This position favors the finality of awards and reflects federal policy in favor of enforcement of awards.<sup>344</sup>

In summary, which limitation rule—federal or state—applies to state court proceedings should depend on which rule facilitates enforcement of arbitration awards. A state court may prefer the state limitation rule if that rule is more favorable to enforcement of awards.<sup>345</sup>

If the parties have chosen a particular state forum for enforcement of the award but have not specified that the state post-award rules and procedures will apply, the state court should still be bound by the federal post-award rules if the underlying contract evidences a transaction involving interstate commerce and the USAA is applicable.<sup>346</sup> A party's

340. See, e.g., *Riko Enter. v. Seattle Supersonics Corp.*, 357 F. Supp. 521, 523 (S.D.N.Y. 1973); *Moran v. Paine Webber*, 279 F. Supp. 573, 581 (W.D. Pa. 1967), *aff'd*, 389 F.2d 242 (3d Cir. 1968).

341. *State Farm Mut. Auto. Ins. Co. v. Cabs, Inc.*, 751 P.2d 61, 65-66 (Colo. 1988); *Mid-American Regional Bargaining Ass'n v. Modern Builders Indus. Concrete Corp.*, 101 Ill. App. 3d 83, 86, 427 N.E.2d 1011, 1013-14 (1981); *Board of Educ. v. Education Ass'n*, 286 Md. 358, 364-66, 408 A.2d 89, 92-93 (1979).

342. See *Kress Corp. v. Edward C. Levy Co.*, 102 Ill. App. 3d 264, 269, 430 N.E.2d 593, 595 (1981) (applying Illinois law).

343. See *Taylor v. Nelson*, 788 F.2d 220, 225 (4th Cir. 1986); *Florasynth, Inc. v. Pickholz*, 750 F.2d 171, 175 (2d Cir. 1984).

344. *Taylor*, 788 F.2d at 225; *Florasynth*, 750 F.2d at 175-77 (outcome determinative time limitation provision is susceptible to application by state courts.). See also *Tampa Motel*, 186 Ga. App. at 140, 366 S.E.2d at 808 (court relied on present federal interpretation of three-month time limitation under section 9).

345. See, e.g., *Downing v. Allstate Ins. Co.*, 124 Mich. App. 727, 732, 335 N.W.2d 139, 141 (applying 20-day time limitation on motion to vacate under Michigan law, instead of three-month limitation under federal law), *appeal denied, vacated in part*, 419 Mich. 932, 355 N.W.2d 111 (1983).

346. In *John Ashe Assocs., Inc. v. Envirogenics Co.*, the arbitration clause provided:

Any dispute arising under this order which is not disposed of by agreement between the parties shall be decided by arbitration in accordance with part 3 of Title 9 of the Code of Civil Procedure of the State of California. A judgment based on the award shall be entered in the Superior Court of the State of California in the county having jurisdiction thereof.

425 F. Supp. 238, 242 n.6 (E.D. Pa. 1977). The district court ruled that the agreement to the entry of judgment by a state court was enforceable. *Id.* at 243-44. However, the court was of the opinion that the relief under sections 10 and 11 for vacation and modification would still be available. *Id.* The court relied in part on its earlier decision in *Litton RCS, Inc. v. Turnpike*

reason for entering into a choice-of-forum agreement may be unrelated to that forum's law governing post-award proceedings. For example, the parties may have chosen a state forum because of convenience or because state proceedings may be speedier than federal proceedings. The parties may not have a particular preference for state post-award rules and procedures over federal post-award rules and procedures. In such cases, federal post-award rules should not be displaced by the parties' choice-of-state forum provision.

If, however, the parties have expressly agreed that the court in a particular state has exclusive jurisdiction for enforcement of awards and that the post-award rules and procedures in that state govern the judicial proceedings, the state court should apply state rules and procedures even if the underlying contract evidences a transaction involving interstate commerce. Although a choice-of-law clause cannot operate as displacing the federal law governing validity and enforceability of an arbitration agreement,<sup>347</sup> the law as chosen by the parties might still be applied to determine many issues in pre-award proceedings, as well as in post-award proceedings.<sup>348</sup>

Federal law and policy allow parties to agree on solutions to issues in post-award proceedings. For instance, under federal case law, the parties' agreement that the court can apply a review standard stricter than standards provided under the USAA is enforceable.<sup>349</sup> If parties have freedom through their agreement to decide matters in post-award proceedings, they should also be allowed, to an extent, to let those matters be governed by the law they choose. However, because of the importance of the USAA post-award rules and procedures in enforcement of federal arbitration rights, the parties' agreement as to the law applicable to post-award proceedings should be clear and unambiguous in order to displace the otherwise applicable federal post-award rules.

## VII. CONCLUSION

Whether and how federal arbitration law applies to state court proceedings should depend on consideration of two factors: (1) involvement of the federal policy favoring arbitration and enforcement of arbitration

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Comm'n, 376 F. Supp. 579, 585 (E.D. Pa. 1974), *aff'd*, 511 F.2d 1394 (3d Cir. 1975) (Pennsylvania Common Pleas Courts were proper forum for confirmation proceedings, but they were bound by federal substantive law). *John Ashe Assocs.*, 425 F. Supp. at 241.

347. *Perry v. Thomas*, 482 U.S. 483, 492-93 n.9 (1987).

348. *Volt Information Sciences, Inc. v. Board of Trustees*, 109 S. Ct. 1248, 1253-54 (1989).

349. *Fils et Cable d'Acier de lens v. Midland Metals Corp.*, 584 F. Supp. 240, 244 (S.D.N.Y. 1984).

rights created by federal law; and (2) the parties' intent as expressed in their choice-of-law agreement.

The enactment of the USAA demonstrates that Congress favors enforcement of arbitration and the development of federal arbitration law reflects a strong federal policy promoting the use of arbitration.<sup>350</sup> The policy favors enforcement of arbitration agreements and the resulting awards.<sup>351</sup> Generally, the USAA creates a federal arbitration right where the transaction is maritime or the contract evidences a transaction involving interstate commerce.<sup>352</sup> Once an arbitration agreement is found to fall within the USAA, the enforcement of arbitration rights is deemed to involve federal interests, regardless of whether the case is in federal or state court.<sup>353</sup>

Arbitration rights are based on an underlying contract. Honoring parties' agreements is one of the most important goals of the federal policy favoring arbitration.<sup>354</sup> Accordingly, if parties prefer application of the law of a particular state, their agreement should be honored. However, parties' choice-of-law agreements should be interpreted in accordance with federal policy and law.<sup>355</sup> An interpretation of a choice-of-law agreement which frustrates enforcement of an otherwise valid, enforceable and irrevocable arbitration right is unreasonable and inconsistent with federal policy.<sup>356</sup>

Federal rules of arbitration can be broken down into three categories, in terms of their applicability to state court proceedings. First, section 2 of the USAA creates federal substantive law governing the validity, enforceability and irrevocability of arbitration agreements where the transaction is maritime or the underlying contract evidences a transaction involving interstate commerce.<sup>357</sup> This section applies to state court proceedings.<sup>358</sup> The parties' choice-of-law provision cannot displace the application of federal substantive law or prevent its specific enforcement.<sup>359</sup>

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350. See *supra* notes 314-15 and accompanying text.

351. See *supra* notes 314-15 and accompanying text.

352. 9 U.S.C. § 2 (1988).

353. See *Volt*, 109 S. Ct. at 1254.

354. See *id.* at 1253-54.

355. See *Litton RCS, Inc. v. Pennsylvania Turnpike Comm'n*, 376 F. Supp. 579, 590 (E.D. Pa. 1974), *aff'd*, 511 F.2d 1394 (3d Cir. 1975).

356. *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 387 (2d Cir.) (Lumbard, C.J., concurring), *cert. denied*, 368 U.S. 817 (1961).

357. 9 U.S.C. § 2 (1988).

358. *Southland Corp.*, 465 U.S. at 12.

359. *Id.* at 11 ("We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under State law.").

Although section 2 does not preclude a role for state law in determining the validity and enforceability of arbitration agreements,<sup>360</sup> only generally recognized state contract rules apply.<sup>361</sup> Even so, those state rules cannot prevail if they directly conflict with federal law.<sup>362</sup> The definition of interstate commerce should be read broadly in order to bring as many contracts as possible within the ambit of the USAA. Bringing the maximum number of contracts within the USAA would further the worthy federal policies favoring arbitration and discouraging forum shopping. Therefore, courts must uniformly interpret and apply the contract rules in arbitration cases governed by section 2.

The second category is comprised of USAA rules which are part of the enforcement scheme of the federal substantive law governing arbitration rights and the federal policy favoring enforcement of arbitration agreements.<sup>363</sup> The rules address the scope of arbitration agreements,<sup>364</sup> the division of functions between courts and arbitrators,<sup>365</sup> bifurcated proceedings,<sup>366</sup> and matters in post-award proceedings,<sup>367</sup> such as standards of review and time limitations. Although some of these rules may be characterized as procedural, they should apply to state court actions because they determine the outcome of federally created arbitration rights.

However, important exceptions to the universal supremacy of federal law exist. Federal rules do not automatically preempt conflicting state rules. Preemption depends on whether any important federal policies or interests are served through its application. If state rules and procedures are equally or more effective than federal rules in promoting the enforcement of arbitration agreements or the resultant award, the state provisions might stand. Also, if the parties clearly and unambiguously intended that the arbitration rules of a particular state apply, those state rules should apply. Additionally, state courts may not be required to apply a federal procedural rule. However, if the rule could affect the outcome of arbitration rights, a state court should apply the federal rule.<sup>368</sup>

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360. See *supra* notes 91-95 and accompanying text.

361. *Southland Corp.*, 465 U.S. at 16 n.11.

362. U.S. CONST. art. VI, cl. 2. See *supra* notes 113-43 and accompanying text for discussions of the rules regarding contracts of adhesion and unconscionability.

363. 9 U.S.C. §§ 3-4, 9-12 (1988). See also *supra* notes 160-63 and accompanying text.

364. 9 U.S.C. §§ 3, 4 (1988). See also *supra* notes 202-08 and accompanying text.

365. 9 U.S.C. §§ 3, 4 (1988). See also *supra* notes 181-201 and accompanying text.

366. See also *supra* notes 218-22 and accompanying text.

367. 9 U.S.C. §§ 9-12 (1988). See also *supra* notes 303-49 and accompanying text.

368. See *supra* notes 291-302 and accompanying text for a discussion of appeal rules; see *supra* notes 338-44 and accompanying text for a discussion of section 12's time limitation.

Finally, in some areas, whether the federal rules apply or not is immaterial to promotion of the federal policy favoring enforcement of arbitration agreements or the resultant awards. Sometimes state rules are more favorable to enforcement of the federal arbitration rights than the relevant federal rules.<sup>369</sup> No reason exists for a state court to be bound by the federal rules in such a case. Also, state courts should not be required to apply federal rules where the federal rules are not clear and application of state rules, if reasonable, would not frustrate federal policy.<sup>370</sup>

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369. See *supra* notes 338-44 and accompanying text for a discussion of section 12's time limitation; see *supra* notes 223-26 and accompanying text for a discussion of venue provisions.

370. See *supra* note 290 and accompanying text.

