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THE FEDERAL ARBITRATION ACT'S INTERSTATE COMMERCE REQUIREMENT: WHAT'S LEFT FOR STATE ARBITRATION LAW?

Henry C. Strickland*

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The United States Congress enacted the Federal Arbitration Act\(^1\) ("FAA," "Act") in 1925, but the scope of its applicability has always been uncertain. The FAA made written arbitration agreements in maritime transactions and contracts "evidencing a transaction involving [interstate] commerce" enforceable.\(^2\) While Congress probably has the constitutional power under the commerce clause to require such enforcement of all commercial arbitration agreements in the United States, and to regulate the manner of their enforcement,\(^3\) it is not clear that Congress intended the FAA to reach that far.\(^4\) Such pervasive federal regulation, moreover, would displace a substantial body of state contract law.\(^5\) Consequently, courts continue to differ on when a transaction "involves" commerce such that the FAA applies.

The importance of determining the FAA's applicability has increased in recent years because judicial interpretations of the Act have dramatically expanded federal control over commercial arbitration agreements whenever they do "involve commerce." In addition to holding the FAA to be substantive federal law binding in state courts,\(^6\) recent United States Supreme Court decisions have relied on

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2. Id. § 2.
3. See infra notes 134-36 and accompanying text.
5. See infra part II, and notes 335-38 and accompanying text.
the FAA to articulate a federal common law of arbitration that replaces state law whenever the FAA is applicable. Whenever an arbitration agreement "involves [interstate] commerce," therefore, federal law now preempts state arbitration law and a significant portion of state contract law.

Despite the importance of determining whether an arbitration agreement "involves commerce" for purposes of the FAA, both the Supreme Court and commentators have remained surprisingly silent on the issue. The Supreme Court has never rendered a definitive interpretation of the "involving commerce" language, nor provided a standard for determining if a contract "involves" commerce. Lower federal courts and state courts, meanwhile, have reached no consensus on the issue. Some courts equate "involving" interstate commerce with "affecting" interstate commerce, while other courts search for a narrower standard.

Commentators have written extensively about the FAA and recent decisions applying it, but none focus on the interstate commerce issue. They analyze extensively the validity of the new federal common law of arbitration and the extent to which it displaces state arbitration and contract law when the FAA applies. They do not analyze, however, how a court decides whether a contract evidences a "transaction involving commerce" such that the FAA applies in the first place. Unless the contract involves interstate commerce, neither the FAA nor the federal common law of arbitration apply.

Litigation over the applicability of the FAA, meanwhile, appears likely to increase. Because of the recent expansion of the federal common law of arbitration that applies along with the FAA, differences between federal and state arbitration law have increased. Liti-

62-63 and accompanying text.

7. See infra notes 71-90 and accompanying text.


9. See, e.g., C. ALLEN FOSTER, THE LAW & PRACTICE OF COMMERCIAL ARBITRATION IN NORTH CAROLINA § 1:05 (1986) (discussing the commerce issue but only briefly); GABRIEL M. WILNER, DOMKE ON COMMERCIAL ARBITRATION §§ 4:05-4:06 (1991) (discussing the expansion of the FAA both in terms of the new federal common law of arbitration and the FAA's application in state courts, but containing very limited analysis of when a transaction "involves" commerce); Hirshman, supra note 4 (providing insightful in-depth analysis of the use of state law when the FAA applies, but does not analyze when the FAA applies in the first instance); Speidel, supra note 8, at 170 (noting most courts' "expansive reading" of the FAA's commerce requirement but noting that this reading is "not conclusive").
gants, therefore, will seek the application of whichever law is most favorable to their case. In addition, since state courts must now apply the FAA, they will have to determine the FAA's applicability to small claims, consumer transactions, and disputes between citizens of the same state—circumstances seldom faced by federal courts. "

This Article thus examines the issue of when a contract is one "involving commerce" under the FAA such that the contract is governed by federal law. Conversely, this Article seeks to identify commercial contracts that are not controlled by the FAA and federal law, if any exist. Part I of this Article lays the groundwork for this discussion by summarizing the history of American arbitration law and the FAA. Part II reviews the many differences and conflicts between federal and state arbitration law. Part III then examines and analyzes the case law that construes the FAA's "involving commerce" language. Part IV concludes that the case law on the issue creates sufficient doubt and unpredictability to spur litigation about the FAA's application, thereby frustrating the FAA's central purpose of providing expeditious enforcement of arbitration agreements. It then reviews and rejects possible judicial solutions to the problem. Finally, it suggests that a congressional amendment to the FAA is the best solution to assure attainment of the FAA's goals, and proper consideration of the interests and concerns embodied in state arbitration law.

I. A BRIEF HISTORY OF AMERICAN ARBITRATION LAW

A. Early Arbitration and the Common Law

Merchants and commercial interests have used arbitration\textsuperscript{11} to resolve disputes for centuries.\textsuperscript{12} Indeed, nearly all business disputes in England were decided by arbitration up to the time of Lord Mansfield.\textsuperscript{13}

\textsuperscript{10} Unlike most substantive federal statutes, the FAA creates no independent federal question jurisdiction. See Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983). Federal courts thus hear FAA cases only if there is diversity of citizenship among the parties or some independent grounds for federal question jurisdiction.

\textsuperscript{11} Although one can define arbitration in numerous ways, American common law decisions provide a useful definition for studying arbitration in the United States. "Arbitration is the submission of some disputed matter to selected persons and the substitution of their decision or award for the judgment of the established tribunals of justice." Sabra A. Jones, \textit{Historical Development of Commercial Arbitration in the United States}, 12 MINN. L. REV. 240, 241 (1928) (quoting Castle-Curtis Arbitration, 64 Conn. 501 (1894)).


\textsuperscript{13} \textit{Id.} at 239. For a thorough study of early arbitration, see JULIUS H. COHEN, COM-
Although the courts have been the primary tribunal for the resolution of business disputes since that time, many business interests prefer private arbitration. They thus seek to implement arbitration by agreement. They sometimes agree after a dispute arises to arbitrate the dispute. More frequently, they include arbitration clauses in commercial contracts under which they agree to arbitrate disputes that might later arise from the contractual relationship.

Despite the widespread use of arbitration and arbitration agreements among merchants and other business interests in both England and the United States, the common law in both countries was hostile to arbitration agreements.15 The courts usually enforced arbitration awards once they were rendered,16 but the courts refused to enforce prospective agreements to arbitrate.17 The result was that an agreement to arbitrate was revocable at the whim of any party until an arbitration award was actually rendered.18

B. The Statutory Response

Pressure from business interests eventually brought about legislation that reversed the common law and required courts to enforce some or all agreements to arbitrate.19 New York led the way in 1920 with a statute that declared arbitration agreements to “be valid, enforcible [sic] and irrevocable, save upon such grounds as exist at law or in equity for the revocation of any contract.”20 The New York statute was an immediate success,21 and other states soon

15. See Baum & Pressman, supra note 12, at 242.
17. See Baum & Pressman, supra note 12, at 240-42; Hirshman, supra note 4, at 1310 & n.27, and authorities cited therein.
18. See Paul L. Sayre, Development of Commercial Arbitration Law, 37 YALE L.J. 595, 598 (1924); Speidel, supra note 8, at 169 n.46; see also, e.g., Kinney v. Baltimore & O. Employees’ Relief Ass’n, 14 S.E. 8 (W. Va. 1891); Condon v. South Side R.R. Co., 55 Va. 302 (14 Gratt. 1858); Hirshman, supra note 4, at 1310-11 & n.28 and authorities cited therein.
adopted similar legislation.\textsuperscript{22}

In 1925, the United States Congress enacted what would prove to be the country’s most important legislation for commercial arbitration, the Federal Arbitration Act.\textsuperscript{23} The central substantive provision of the Act, section 2, provides:

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce\textsuperscript{24} 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.\textsuperscript{25}

The FAA also provides procedures for enforcing valid arbitration agreements. Section 3 provides for a stay of proceedings “in any of the courts of the United States” on an issue that is subject to a valid arbitration agreement.\textsuperscript{26} Section 4 provides procedures for obtaining a court order to compel a recalcitrant party to proceed with arbitration as agreed.\textsuperscript{27} The FAA further provides procedures for appointing arbitrators\textsuperscript{28} and issuing subpoenas to witnesses;\textsuperscript{29} and it provides procedures and grounds for judicial enforcement,\textsuperscript{30} modification,\textsuperscript{31} and annulment of arbitration awards.\textsuperscript{32}

\[\text{\textsuperscript{22}} \text{See Hirshman, supra note 4, at 1312 & n.33, and statutes cited therein.}\]
\[\text{\textsuperscript{23}} 9 U.S.C. §§ 1-14 (1988). The FAA is also referred to as the United States Arbitration Act. For a discussion of the legislative history of the FAA, see Atwood, supra note 8, at 73-79, 102-03.}\]
\[\text{\textsuperscript{24}} \text{The Act defines "commerce" as "commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation . . .." 9 U.S.C. § 1 (1988).}\]
\[\text{\textsuperscript{25}} 9 U.S.C. § 2 (1988). The Act excludes from its coverage, "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." Id. For additional discussion of this exception, see infra notes 260-61 and accompanying text.}\]
\[\text{\textsuperscript{26}} \text{Id. § 3.}\]
\[\text{\textsuperscript{27}} \text{Id. § 4.}\]
\[\text{\textsuperscript{28}} \text{Id. § 5.}\]
\[\text{\textsuperscript{29}} \text{Id. § 7.}\]
\[\text{\textsuperscript{30}} \text{Id. § 9.}\]
\[\text{\textsuperscript{31}} \text{Id. § 11.}\]
\[\text{\textsuperscript{32}} \text{Id. § 10.}\]
C. Erie and the FAA

Although the significance of the FAA at the date of its enactment depended on the scope of its applicability, the Act was ambiguous on that point. Section 2 of the Act made enforceable only those arbitration agreements that related to maritime transactions and contracts involving interstate commerce. The Act did not specify, however, whether it applied to cases in state court as well as federal court. Nor did it specify whether it applied to cases in federal court on diversity of citizenship as well as federal question jurisdiction.

These questions, however, do not appear to have been controversial ones in the decade following the FAA's enactment, at least not with respect to the FAA's central provisions making arbitration agreements valid and enforceable. Courts and commentators concluded, almost unanimously, that the Act applied in all federal cases, including those in federal court on diversity jurisdiction.33 Few if any commentators, meanwhile, thought that state courts were obligated to apply the Act.34


34. See Baum & Pressman, supra note 12, at 428, 430-31, 459-60 (noting that "[t]he entire history and tenor of the . . . statute does not purport to extend its teeth to state
The Supreme Court's 1938 decision in *Erie Railroad Co. v. Tompkins*, however, forced a reexamination of the FAA's scope and the authority under which Congress enacted it. *Erie* ended the power of federal courts to make substantive rules of decision in diversity cases, and cast doubt on Congress' power to do so. If the FAA were deemed to regulate substantive contract rights, therefore, *Erie* arguably precluded its application in diversity cases. *Erie* thus threatened to gut the FAA of its effectiveness. If the FAA did not apply in state courts, and under *Erie*, could not apply in diversity cases in federal courts, the Act was all but meaningless.

The courts struggled for decades to determine the scope of the FAA's applicability and the impact of *Erie*. Under *Erie*, the scope of the FAA's applicability depended on the constitutional authority under which Congress enacted the statute. If Congress, relying on its Article III power over practice in the federal courts, sought to provide either a rule of procedure or a substantive rule of decision applicable only in the federal courts, then the FAA applied only in federal court. The constitutionality of applying such a rule in diversity cases—although likely under later cases—was uncertain in the decades following *Erie*. If, on the other hand, the FAA was a substantive measure enacted pursuant to Congress' power to regulate interstate commerce, then the Act likely applied in all state and federal cases. Since Congress passed the FAA a decade before *Erie*

35. 304 U.S. 64 (1938).
38. See Bernhardt v. Polygraphic Co. of Am., 350 U.S. 198, 208 (1956) (Frankfurter, J., concurring) ("[I]t would raise a serious question of constitutional law whether Congress could subject to arbitration litigation in the federal courts which is there solely because it is 'between Citizens of different States' in disregard of the law of the State in which a federal court is sitting." (citation omitted)).
39. For further analysis of the possible implications of *Erie* for the FAA, see Hirshman, supra note 4, at 1313-24.
40. See supra note 34 and accompanying text.
was decided, moreover, Congress did not specify the constitutional
source of its authority to enact the FAA.\textsuperscript{41} Consequently, more
than forty years passed before the Supreme Court resolved these issues.

The United States Supreme Court first confronted these issues in
\textit{Bernhardt v. Polygraphic Co. of America, Inc.}\textsuperscript{42} That case arose
from an employment contract in which the parties agreed to arbitrate
"any differences, claim or matter in dispute arising between them out
of this agreement or connected herewith . . . ."\textsuperscript{43} After Polygraphic
discharged Bernhardt, Bernhardt filed a lawsuit alleging that Poly-
graphic had breached its employment contract. Polygraphic sought to
stay the action pending arbitration.

The district court and the court of appeals struggled to analyze
the arbitration issue under \textit{Erie} and reached different conclusions. The
district court said that, under \textit{Erie} and \textit{Guaranty Trust Co. of New
York v. York},\textsuperscript{44} a federal court sitting in diversity must reach the
same result as a court of the state in which it sits.\textsuperscript{45} Since Vermont
courts would apply Vermont common law to deny the stay,\textsuperscript{46} a fed-
eral court must do the same, the FAA notwithstanding. The district
court thus applied Vermont law and denied Polygraphic's motion to
stay the action pending arbitration.\textsuperscript{47} The Second Circuit Court of
Appeals reversed.\textsuperscript{48} It held that "a stay, pursuant to Section 3 of the
[FAA] is not 'substantive' within the meaning of \textit{Erie}"\textsuperscript{49} and thus
should apply in diversity cases even in the face of contrary state law.\textsuperscript{50}

\begin{itemize}
\item \textsuperscript{41} See Hirshman, supra note 4, at 1314-15 & nn.52-53. "Little emerges from the
legislative history other than unhappiness with prior law." \textit{Id.} at 1315.
\item \textsuperscript{42} 122 F. Supp. 733 (D. Vt. 1954), rev'd, 218 F.2d 948 (2d Cir. 1955), rev'd, 350
U.S. 198 (1956).
\item \textsuperscript{43} Bernhardt, 218 F.2d at 949. For additional details about the contract and discussion
of the interstate commerce issue, see infra notes 147-50 and accompanying text.
\item \textsuperscript{44} 326 U.S. 99 (1945).
\item \textsuperscript{45} Bernhardt, 122 F. Supp. 733.
\item \textsuperscript{46} "The common law rule [in Vermont] is that an agreement to submit an issue to
arbitration is not binding and is revocable at any time before an award is actually made by
arbitrators." \textit{Id.} at 734-35 (citing Mead v. Owen, 74 A. 1058 (Vt. 1910)).
\item \textsuperscript{47} \textit{Id.} at 735.
\item \textsuperscript{48} Bernhardt, 218 F.2d 948.
\item \textsuperscript{49} \textit{Id.} at 951. The Second Circuit relied on Murray Oil Products Co. v. Mitsui & Co.,
146 F.2d 381, 383 (2d Cir. 1944), in which Judge Learned Hand wrote, "Arbitration is
merely a form of trial, to be adopted in the action itself, in place of the trial at common
law: it is like a reference to a master, or an 'advisory trial' under [the] Federal Rules of
Civil Procedure." \textit{Id.}
\item \textsuperscript{50} The Second Circuit stated:
Section 3 applies whether or not the agreement is of a kind covered by Sec. 2,
i.e., for purposes of Sec. 3, the agreement need not involve a maritime transaction

\end{itemize}
The Supreme Court interpreted the FAA in such a way as to avoid deciding the difficult issues surrounding the application of Erie to the FAA. The Court ruled that section 3 of the FAA, which concerns stays pending arbitration, applies only to arbitration agreements governed by section 2, agreements in maritime transactions, and transactions in interstate commerce. Since the contract before the Court did not involve a maritime transaction nor interstate commerce, the FAA was inapplicable by its own terms. The Court interpreted the statute this way expressly to avoid deciding whether application of the FAA in a diversity case was unconstitutional under Erie.

The Court next confronted the application of Erie to the FAA in Prima Paint Corp. v. Flood & Conklin Manufacturing Co. That case arose from a contract under which Prima Paint purchased Flood & Conklin's ("F&C") paint business. In connection with the purchase, the parties entered a consulting agreement under which F&C agreed to advise and assist Prima Paint in servicing customer accounts and in moving manufacturing operations from New Jersey to Maryland. The consulting agreement contained a provision requiring arbitration of "[a]ny controversy or claim arising out of or relating to [the] or interstate or foreign commerce. The power to enact Sec. 3 derives from Article III, Section 2 of the Constitution.

Bernhardt, 218 F.2d at 951.

51. Bernhardt v. Polygraphic Co. of Am., 350 U.S. 198, 200-01 (1956); see also infra notes 147-50 and accompanying text.

52. The Court stated:

If respondent's contention [that § 3 applies in a diversity case in the absence of a maritime transaction or a transaction involving interstate commerce] is correct, a constitutional question might be presented. Erie R. Co. v. Tompkins indicated that Congress does not have the constitutional authority to make the law that is applicable to controversies in diversity of citizenship cases . . . . [The Court has not previously considered] whether arbitration touched on substantive rights, which Erie R. Co. v. Tompkins held were governed by local law, or was a mere form of procedure within the power of the federal courts or Congress to prescribe. Our view, as will be developed, is that § 3, so read, would invade the local law field. We therefore read § 3 narrowly to avoid that issue.

Bernhardt, 350 U.S. at 202 (citation omitted). The Court went on to conclude that federal courts could not enforce arbitration agreements as a matter of federal common law in diversity cases. Noting that the enforcement of a contract is a state-created right, the Court held that a "federal court enforcing a state-created right in a diversity case . . . may not 'substantially affect the enforcement of the right as given by the State.'" Id. at 203 (quoting Guaranty Trust Co. of N.Y. v. York, 326 U.S. 99, 109 (1945)). Concluding that arbitration "substantially affects the cause of action created by the State," the Court held that state law must apply, at least in the absence of an applicable federal statute. Id.


54. Id. at 397, 401.
Agreement. When a dispute later arose concerning performance of the consulting agreement and an allegation that the contract had been fraudulently induced, Prima Paint filed an action in court. F&C responded by filing a motion to stay the action pending arbitration. The district court stayed the action, and the Second Circuit affirmed.

The Supreme Court affirmed the stay. It first held that the contract fell within the coverage of the FAA because it involved interstate commerce within the meaning of the statute. Having found that the terms of the FAA covered Prima Paint's contract, the Court had to decide whether the Act could be constitutionally applied under *Erie* in the face of contrary state law. Relying on legislative history, the Court decided that Congress had enacted the FAA pursuant to its Article I power over interstate commerce and admiralty—not its Article III power over the federal courts. The Court thus concluded that the case and indeed the FAA did not raise the issue of whether Congress could prescribe substantive rules of decision for cases simply on the basis of their being in federal court. "Rather," the Court said, "the question is whether Congress may prescribe how federal courts are to conduct themselves with respect to subject matter [such as interstate commerce] over which Congress plainly has power to legislate. The answer to that can only be in the affirmative." Prima Paint thus laid to rest any doubt about the FAA's applicability in federal court—even in diversity cases—by holding that the FAA was enacted as a substantive regulation of interstate commerce.

D. The FAA in State Courts

The logical implication of that holding was that the FAA also applied in state courts, and indeed many state courts began applying the FAA after the *Prima Paint* decision. Other state courts,
however, refused to apply the FAA, ruling that the holding in Prima Paint was limited to federal diversity cases.62

Finally in 1984, nearly sixty years after Congress enacted the FAA, the Supreme Court resolved these issues. It held in Southland Corp. v. Keating63 that state courts must apply the central provisions of the FAA.64 Citing Prima Paint and Moses H. Cone Memorial Hospital v. Mercury Construction Corp.,65 the Court reaffirmed its view that the FAA "creates a body of federal substantive law" based on Congress's power to regulate interstate commerce.66 When Congress exercises its authority to regulate commerce, the Court said, "it normally creates rules that are enforceable in state as well as federal courts."67 Admitting that the FAA's legislative history on the issue is ambiguous, the Court nonetheless determined that Congress intended the central provisions68 of the FAA to apply in state courts.69

Prima Paint and Southland thus federalized the law of arbitration by establishing the FAA as the generally applicable substantive law of arbitration in the United States. The scope of the FAA's applicability now depends entirely on the terms of the FAA itself. If the FAA by

the forum shopping that would ensue if a different rule prevailed in state and federal courts."  
Id. at 1326. For a sampling of the cases reaching these conclusions, see id. at 1326 nn.122-24.

62. Id. at 1326-27 & n.125, and cases cited therein.
64. Id. at 10-16.
65. 460 U.S. 1 (1983). Relying on Prima Paint's characterization of the FAA as a substantive regulation of interstate commerce, the Court stated in Moses H. Cone that the FAA governs the issue of arbitrability "in either state or federal court." Id. at 24. Like Prima Paint, however, Moses H. Cone was a federal diversity case so the Court's statement regarding application of the FAA in state courts still was technically dicta. Some state courts thus continued to refuse to apply the FAA. See Ex parte Alabama Oxygen Co., Inc., 433 So. 2d 1158, 1161-67 (Ala. 1983).
67. Southland, 465 U.S. at 12 (quoting Prima Paint, 388 U.S. at 420 (Black, J., dissenting)).
68. The Court expressly held that only § 2 of the Act, which makes arbitration agreements valid, enforceable contracts, is binding on state courts. "In holding that the Arbitration Act pre-empts 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. Section 4, for example, provides that the Federal Rules of Civil Procedure apply in proceedings to compel arbitration. The Federal Rules do not apply in such state-court proceedings." Id. at 16 n.10.
69. For persuasive arguments that the FAA's legislative history evidences congressional intent to apply the FAA only in federal courts, see id. at 21-36 (O'Connor, J., dissenting). For analysis of both the majority and the dissenting opinions on this point, see Hirshman, supra note 4, at 1343-46. For additional analysis of the legislative history, see Atwood, supra note 8, at 73-79.
its terms applies to an agreement to arbitrate, then it preempts conflicting state law.\textsuperscript{70}

\textbf{E. The Expanding Federal Common Law of Arbitration}

Even after determining that the FAA governs a particular arbitration agreement, courts must decide a variety of issues not directly addressed by the Act. Arbitration agreements, after all, are simply contracts, and the substantive portion of the FAA on its face does little more than require these contracts to be enforced as all other contracts. Attempts to enforce or to circumvent arbitration agreements, therefore, raise a host of contract issues regardless of the applicability of the FAA. If the agreement is governed by the FAA, courts must decide whether state law should govern these issues or whether the FAA requires the fashioning of a federal common law of arbitration to govern these issues. Increasingly, the Supreme Court has fashioned its own federal common law based on either the language of the FAA or the policies implicit in the FAA.\textsuperscript{71} This common law preempts inconsistent state law whenever the FAA applies.

The Supreme Court first joined this trend in \textit{Prima Paint}. After finding the FAA applicable in that case,\textsuperscript{72} the Court relied on the statute's language to adopt the doctrine of separability despite possible conflict with state law. Some state courts and some lower federal courts had held that claims of fraud in the inducement must be decided by a court rather than an arbitrator, despite the existence of an arbitration clause. If the contract containing the arbitration clause was fraudulently induced, these courts reasoned, then the entire contract—including the agreement to arbitrate—was void. The defrauded party should not be compelled to arbitrate, they said, because that party did not really agree to arbitrate. Relying on language in the FAA, however, the Supreme Court held that the arbitration agreement should be treated separate from the contract containing it.\textsuperscript{73} If a claim of fraud is addressed to the arbitration provision specifically, the Court said, then the arbitration agreement is potentially void and that claim of fraud must be decided by the court before the court can

\textsuperscript{70} One exception to this rule is state laws enacted for the purpose of regulating the business of insurance. \textit{See infra} notes 300-24 and accompanying text (discussing the impact of the McCarran-Ferguson Act on the FAA).

\textsuperscript{71} For analysis and criticism of this expanding federal common law of arbitration, see generally \textit{Atwood}, \textit{supra} note 8; \textit{Hirsbman}, \textit{supra} note 4.

\textsuperscript{72} \textit{See infra} notes 153-57 and accompanying text.

\textsuperscript{73} \textit{See Prima Paint}, 388 U.S. at 402-04.
order arbitration. If, on the other hand, a claim of fraud is addressed to the contract as a whole, then the arbitration provision must be enforced under the FAA, and the arbitrator must decide the fraud claim.74

The Court substantially expanded this federal common law and its displacement of state law in a series of cases in the 1980s.75 One of the most important of these cases was Southland Corp. v. Keating.76 That case arose from a franchise contract that contained an arbitration provision. The franchisees filed an action in state court alleging fraud, breach of contract, and violation of the California Franchise Investment Law.77 The California Supreme Court held that all of the claims had to be submitted to arbitration except for the statutory claim.78 The California court construed the Franchise Investment Law to require claims made under it to be asserted in court rather than in arbitration.79

The United States Supreme Court reversed, holding that the FAA preempted the state court’s interpretation of the California Franchise Investment Law. State law, the Court decided, cannot prevent arbitra-

74. Id.
75. See Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213 (1985); Southland Corp. v. Keating, 465 U.S. 1 (1984); Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 (1983). For a thorough discussion of these cases and the Court’s dramatic expansion of the FAA in the early 1980s, see Hirshman, supra note 4. In the later 1980s and into the 1990s, the Court further held that virtually all federal statutory claims are arbitrable under the FAA unless Congress expressly forbids their arbitration. See Rodriguez de Quijas v. Shearson/American Express, Inc., 490 U.S. 477 (1989) (reversing 36-year-old precedent by holding that agreements to arbitrate claims arising under the Securities Act of 1933 must be enforced under the FAA); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (holding that claims arising under the Securities Exchange Act of 1934 are arbitrable); Mitsubishi Motors Corp. v. Solet Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) (holding that claims arising under the Sherman Act are arbitrable, at least when they relate to an international transaction).
77. The California statute provided: “Any person who offers or sells, a franchise in violation of [the substantive provisions of this Act] shall be liable to the franchisee or subfranchisor, who may sue for damages caused thereby . . . .” CAL. CORP. CODE § 31300 (West 1992).
79. The 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 . . . is void.” CAL. CORP. CODE § 31512 (West 1992). The California Supreme Court construed that provision to require judicial resolution of claims made pursuant to the statute despite the existence of an otherwise valid arbitration agreement. Keating, 645 P.2d at 1198-1200.
tion of a claim that is subject to an arbitration agreement governed by the FAA—even if the claim is created by state statute. Therefore, as Professor Hirshman has written,

[T]he preemptive effect of the FAA after Southland is not confined to state law based on historic, across-the-board hostility to arbitration: it displaces all state law limiting arbitration regardless of the underlying policy. Second, defenses directed to the formation of the arbitration agreement are treated after Southland in the same way as other grounds for revocation under section 2. Accordingly, state-law restrictions on contracting for arbitration are no more immune to the impact of the FAA than restrictions on enforcement of the arbitration agreement . . . .

The expansion of the federal common law of arbitration is even more dramatic in Moses H. Cone Memorial Hospital v. Mercury Construction Corp. That case arose from a construction contract that contained an arbitration clause. The contractor, Mercury Construction ("Mercury") believed that the Hospital, the owner of the project, was liable under the contract for various delay costs. The Hospital filed a declaratory judgment action in state court seeking a declaration (1) that Mercury "had lost any right to arbitration under the contract due to waiver, laches, estoppel, and failure to make a timely demand for arbitration"; and (2) that the Hospital was not liable to Mercury for the alleged delay costs. Mercury responded by filing an action in federal district court seeking to enforce the arbitration agreement pursuant to the FAA. The federal district court stayed the action pending resolution of the Hospital's state declaratory judgment action.

The Supreme Court held that the stay was erroneous. One of the factors on which the Court based its decision was the role federal law played in the decision on the merits. "Federal law in the terms of the Arbitration Act," the Court said, "governs [the issue of arbitrability] in either state or federal court." Even though the FAA does not address issues of timeliness, waiver, and laches, the Court indicated federal law governs even those issues. The Court stated:

81. Hirshman, supra note 4, at 1350.
83. Id. at 7.
84. Id.
85. Id. at 23-26.
86. Id. at 24.
The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.87

Moses H. Cone thus confirmed two principles:

First, the FAA embodies a federal policy favoring arbitration that is not confined to the express language of the Act. Second, federal courts may decide issues not expressly covered by the FAA by crafting a federal common law rule even if the otherwise applicable state law does not discriminate against arbitration.88

Although the continued role of state law in FAA cases is not yet clear, these cases make it apparent that the role of state law and policy is extremely limited. Southland indicates that "state law will provide [at most] neutral rules of contract formation and enforcement addressed . . . to the arbitration clause."89 Moses H. Cone indicates that even these neutral rules of contract law may be displaced by federal rules deemed more favorable to the enforcement of arbitration agreements.90

II. CURRENT CONFLICTS BETWEEN STATE AND FEDERAL ARBITRATION LAW

As a result of the Supreme Court's expansion of the FAA, the determination of whether a particular arbitration agreement falls within the terms of the FAA has grown increasingly important. Based on the authority suggested in Southland and Moses H. Cone, federal courts have articulated federal rules of contract and arbitration law on a wide array of issues. The result is a significant body of federal arbitration law—statutory and decisional—that is in some instances significantly different from state arbitration and contract law. Consequently, while an increasing number of states have passed modern arbitration statutes that adopt the FAA's underlying policy of promoting and enforcing arbitration agreements,91 federal and state law

87. Id at 24-25.
88. Hirshman, supra note 4, at 1347.
89. Id. at 1378.
90. See id.
91. See WILNER, supra note 9, at 28 & app. I.
have diverged on a variety of more specific issues. An exhaustive list of these differences and the possible differences that may arise in the future is beyond the scope of this Article. A sampling of these conflicts, however, demonstrates both the wide array of issues on which the new federal arbitration law differs from state law and the significance these differences could have on the outcome of attempts to enforce or avoid agreements to arbitrate.

The most obvious conflict between federal and state arbitration law arises in those states that still deem arbitration agreements unenforceable as a matter of public policy. Although nearly all states now accept and promote arbitration in some or most contract disputes, three states still embrace the common law hostility toward arbitration and will enforce arbitration agreements only if the FAA applies. In those states, the determination of whether the FAA applies determines outright the enforceability of any arbitration agreement.

Many other states, while accepting and enforcing arbitration agreements generally, specifically preclude enforcement of arbitration agreements in certain types of contracts. The Georgia Arbitration Code enacted in 1988, for example, liberally provides for the enforcement of "[a] written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit any

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92. See id. at 28. For a periodically updated list of the states that enforce arbitration agreements under state law, see Foster, supra note 9, at 5 n.5. For a periodically updated chart summarizing state arbitration statutes, see Wilner, supra note 9, at app. I.

93. At present, it appears that only Alabama, Mississippi, and Nebraska continue to hold arbitration agreements to be generally unenforceable absent application of the FAA. Alabama adheres to the old common law rule that all pre-dispute arbitration agreements are void as against public policy. See Ala. Code § 8-1-41(3) (1984) (providing that an arbitration agreement cannot be specifically enforced); Ex parte Clements, 587 So. 2d 317, 319 (Ala. 1991) ("[U]nless the FAA is applicable, pre-dispute arbitration agreements are void in Alabama as against public policy."). Mississippi also takes that position, see McClendon v. Shutt, 115 So. 2d 740 (Miss. 1959), except for disputes arising from construction contracts, see Miss. Code Ann. § 11-15-101 (Supp. 1992) (providing for enforcement of arbitration agreements in contracts "for the planning, design, engineering, construction, erection, repair or alteration of any building, structure, fixture, road, highway, [or] utility" and in supply contracts relating to those contracts). Although Nebraska adopted the Uniform Arbitration Act, see Neb. Rev. Stat. §§ 25-2601 to 25-2622 (1989), the Nebraska Supreme Court held that the act violated the Nebraska Constitution, see State v. Nebraska Ass'n of Pub. Employees, 477 N.W.2d 577 (Neb. 1991) (holding the Nebraska Uniform Arbitration Act violates the Nebraska Constitution to the extent that it requires enforcement of agreements to arbitrate future disputes); John M. Gradwohl, Arbitrability in Nebraska, 70 Neb. L. Rev. 381, 408-11 (1991).

94. See Clements, 587 So. 2d at 319.

Yet the Georgia statute excludes from its coverage arbitration agreements relating to contracts of insurance, loan agreements and consumer financing agreements involving $25,000.00 or less, contracts for the purchase of consumer goods, contracts involving consumer transactions, and agreements to arbitrate future tort claims arising out of personal injury or wrongful death. These and other exceptions are common in state arbitration statutes. Arbitration agreements subject to these exclusions are unenforceable unless they fall within the coverage of the FAA.

96. Id. § 9-9-3.
97. Id. § 9-9-2(e)(3), (5), (6), (7), & (10). Section 9-9-2 also excludes agreements relating to arbitration of medical malpractice claims, which are regulated by a separate, specialized statute. Id. § 9-9-2(o)(1); see also id. §§ 9-9-60 to 9-9-84 (providing procedures for arbitration of medical malpractice claims). It also requires that arbitration provisions in certain types of contracts must be separately initialed at the time of the contract’s execution in order to be enforceable. See id. § 9-9-2(e)(8) (sales agreements or loan agreements for the purchase or financing of residential real estate between parties other than real estate brokers or agents); Id. § 9-9-2(e)(9) (“contracts relating to terms and conditions of employment”).
98. See ARIZ. REV. STAT. ANN. § 12-1517 (1982) (providing for enforcement of arbitration agreements except for “arbitration agreements between employers and employees or their respective representatives”); ARK. CODE ANN. § 16-108-201 (Michie 1987) (excluding “person- al injury or tort matters, employer-employee disputes,” and claims by “any insured or beneficiary under any insurance policy or annuity contract”); IND. CODE ANN. § 34-4-2-1(b) (West 1983) (excluding “all consumer leases, sales, and loan contracts, as . . . defined in the Uniform Consumer Credit Code”); IOWA CODE ANN. § 679A.1(2)(a) & (b) (West 1987) (excluding contracts of adhesion, contracts between employers and employees, and some tort claims); KAN. STAT. ANN. § 5-401 (1986 Supp.) (excluding contracts of insurance, contracts between employers and employees, and contracts providing for arbitration of tort claims); KY. REV. STAT. ANN. § 417.050 (Michie/Bobbs-Merrill 1992) (excluding insurance contracts and arbitration agreements between employers and employees); LA. REV. STAT. ANN. § 9:4216 (West 1991) (excluding “contracts of employment of labor”); MD. CODE ANN., CTS. & JUD. PROC. § 3-206(b) (1989) (excluding agreements between employers and employees); MO. STAT. ANN. § 435.350 (Vernon 1992) (excluding arbitration agreements in contracts of insurance and contracts of adhesion); MONT. CODE ANN. § 27-5-114 (1991) (excluding agreements to arbitrate disputes arising after the arbitration agreement is made when the dispute relates to: (i) claims arising from personal injury; (ii) contracts by individuals for the acquisition of property, services, or credit where the total consideration furnished by the individual is $5,000 or less; (iii) agreements concerning insurance policies or annuity contracts other than those between insurance companies; and (iv) claims for workers’ compensation); NEB. REV. STAT. § 25-2602 (1989) (excluding adhesion contracts, claims arising out of personal injury, and claims for workers compensation); OHIO REV. CODE ANN. § 2711.01 (Anderson 1992) (excluding certain disputes concerning title to land); S.C. CODE ANN. § 15-48-10 (Law. Co-op. 1976 & Supp. 1991) (excluding workers compensation claims, certain claims arising from lawyer-client and doctor-patient relationships, personal injury claims, and claims under any insurance policy or annuity contract).
agreement.  

Even when states provide for the enforcement of arbitration agreements, details of state law often conflict with federal law. One such area of conflict concerns the formation of a valid agreement or contract to arbitrate. Unlike the FAA, "[a] number of states impose special requirements on the formation of arbitration agreements—presumably to guard against 'surprise' and to insure that consent to arbitration has been knowing and informed." These include requirements that arbitration provisions include certain language, that they appear in a certain size of type, that they be separately initialed, and even that they be signed by both the parties and the parties' attorneys. Arbitration agreements that do not

100. See, e.g., Securities Indus. Ass'n v. Connolly, 883 F.2d 1114, 1124 (1st Cir. 1989) (holding that in contracts involving interstate commerce, the FAA preempts state law providing that arbitration agreements in contracts of adhesion are unenforceable), cert. denied, 495 U.S. 956 (1990); Webb, 800 F.2d at 806-07 (holding that in a transaction involving interstate commerce, the FAA preempts a state law provision that arbitration agreements in contracts of adhesion are unenforceable).


102. See Vt. STAT. ANN. tit. 12, § 5652(b) (1991) (enforcing arbitration provision only if it contains a prominently displayed notice in the form prescribed by the statute); see also R.I. GEN. LAWS § 10-3-3 (1985 & Supp. 1992) (enforcing arbitration provisions in insurance contracts only if the provision is placed immediately above the parties' signatures); S.C. CODE ANN. § 15-48-10 (Law. Co-op. 1976 & Supp. 1991) (enforcing certain arbitration agreements only if the arbitration provision appears prominently on the first page of the contract).


104. See IOWA CODE ANN. § 679A.1 (West 1987) (enforcing agreements to arbitrate tort claims only if contained in a separate writing executed by the parties); TENN. CODE ANN. § 29-5-302 (1992) (enforcing arbitration agreements relating to farm property and residential property only if the arbitration provision is separately signed by the parties); VT. STAT. ANN. tit. 12, § 5652(b) (1991) (enforcing arbitration agreements only if the contract is accompanied by a separate acknowledgment or the contract contains a prominently displayed acknowledgment on the first page).

105. See TEX. REV. CIV. STAT. ANN. art. 224(b) & (c) (West 1993). These subsections exclude from the Texas Uniform Arbitration Act:

(b) any contract for the acquisition by an individual person or persons . . . of real or personal property, or services, or money or credit where the total consideration therefor to be paid or furnished by the individual is $50,000 or less, unless said individual and the other party or parties agree in writing to submit to arbitration and such written agreement is signed by the parties to such agreement and their attorneys;

(c) any claim for personal injury except upon the advice of counsel to both parties as evidenced by a written agreement signed by counsel to both parties.
comply with these requirements are unenforceable.\textsuperscript{106} If they fall within the FAA's coverage, however, then the FAA preempts these state law requirements and compels enforcement of the arbitration agreements.\textsuperscript{107}

Another difference between state and federal arbitration law relating to the formation of a valid arbitration agreement arises from the "battle of the forms" problem. In the arbitration context, this problem most commonly arises when a merchant makes an offer on a form that does not contain an arbitration provision, and the offeree accepts the offer or confirms acceptance using a form that does contain an arbitration provision.\textsuperscript{108} This exchange of inconsistent forms is governed by section 2-207 of the Uniform Commercial Code, which provides that the additional terms in the acceptance or confirmation become part of the contract unless they materially alter it.\textsuperscript{109} Some state courts have held that the addition of an arbitration provision is a "per se material alteration" of the contract regardless of the

\textsuperscript{106} See, e.g., Donahue v. Assoc. Indem. Corp., 227 A.2d 187 (R.I. 1967) (voiding an arbitration provision in an insurance contract because it was not located immediately above the testimonium clause as required by Rhode Island law, R.I. GEN. LAWS § 10-3-2 (1956 version)); Withers-Busby Group v. Surety Indem., Inc., 538 S.W.2d 198 (Tex. Civ. App. 1976) (holding that an arbitration provision was unenforceable because it was not signed by the parties' attorneys as required by TEX. REV. CIV. STAT. ANN. art. 224 (West 1973)); Ioder Bldg. Corp. v. Lewis, 569 A.2d 471 (Vt. 1989) (holding that an arbitration provision that was not in bold face or underlined as required by Vt. CODE § 5652(b) was unenforceable).

\textsuperscript{107} See, e.g., Securities Indus. Ass'n v. Connolly, 883 P.2d 1114 (1st Cir. 1989) (holding that the FAA preempts the state requirement that arbitration clauses in pre-dispute arbitration agreements between broker dealers and their customers be conspicuously brought to the attention of customers and explained in writing regarding their legal effect), cert. denied, 495 U.S. 956 (1990); Webb v. R. Rowland & Co., 800 F.2d 803, 806 (8th Cir. 1986) (holding that the FAA preempts the state statutory requirement that all arbitration provisions be accompanied by a notice, in ten point capital letters and that the contract contains a binding arbitration provision); Collins Radio Co. v. Ex-Cell-O Corp., 467 F.2d 995 (8th Cir. 1972) (holding that the FAA preempts the state statutory requirement that an arbitration agreement be signed by the parties' attorneys); Bunge Corp. v. Perryville Feed & Produce, Inc., 685 S.W.2d 837 (Mo. 1985) (holding that when it applies, the FAA preempts a state statute requiring inclusion of a special notice that the contract contains an arbitration provision); Godwin v. Stanley Smith & Sons, 386 S.E.2d 464, 467 (S.C. Ct. App. 1989) (holding that the arbitration provision was enforceable under the FAA even though it was not printed in the type prescribed by S.C. CODE ANN. § 15-48-10(a) (Law. Co-op. 1976)); Withers-Busby Group, 538 S.W.2d 198 (holding that the arbitration provision was unenforceable because it was not signed by the parties' attorneys as required by TEX. REV. CIV. STAT. ANN. art. 224 (Vernon 1973)).

\textsuperscript{108} See Hirshman, supra note 4, at 1357. For a survey of cases addressing this problem, see id. at 1357-60 nn.331-48.

factual context and thus does not become part of the contract. The "per se material alteration" rule, however, conflicts with the FAA and the new federal common law of arbitration, because it treats arbitration provisions less favorably than other contract provisions that might be added in confirmation forms. If the FAA applies, therefore, the FAA will likely preempt the state rule and will require a more neutral application of section 2-207.

Another conflict relating to the formation of a valid arbitration agreement arises when a party claims that a contract containing an arbitration provision was fraudulently induced. As discussed above, the United States Supreme Court held in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.* that an arbitration provision is deemed separate from the larger contract that contains it. Consequently, the Court held that the agreement to arbitrate is not void even if the container contract was fraudulently induced. Under the FAA, therefore, a claim of fraud in the inducement must be submitted to arbitration unless the alleged fraud was directed specifically to the arbitration provision. Some states, however, reject this doctrine of separability. These states hold that a fraudulently induced contract

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110. See e.g., *Supak & Sons Mfg. v. Pervel Indus.*, 593 F.2d 135, 136 (4th Cir. 1979) (holding that the addition of an arbitration provision is a per se material alteration under either New York or North Carolina law); *Marlene Indus. v. Carnac Textiles, Inc.*, 380 N.E.2d 239 (N.Y. 1978).


> Massachusetts could . . . pass legislation declaring all contracts of adhesion presumptively unenforceable . . . . Such a rule would apply to arbitration contracts, among others. But Massachusetts may not say (judicially, legislatively, or in a regulatory mode) that "adhesion contracts are especially bad when arbitration is included, so we will therefore ban, or place gyves and shackles upon, only those adhesive contracts which contain arbitration clauses." That kind of value judgment is foreclosed precisely because the FAA ordains that the state’s appulse toward arbitration agreements must be the same as its approach to contracts generally.

*Id.* (citation omitted).

112. See *id.* But see *Supak & Sons*, 593 F.2d at 136-37 (the FAA does not displace state law rulings that arbitration provisions are per se material for purposes of U.C.C. § 2-207).

113. Parties claiming fraud argue that the entire contract—including the agreement to arbitrate—is void as a result of the fraud. Since the arbitration agreement is void, they argue, their claim of fraud must be decided by the court. It would be unfair, they argue, to require the fraud claim to be decided by an arbitrator when the agreement to submit the matter to the arbitrator was void on account of fraud.


115. See *George Engine Co. v. Southern Shipbuilding Corp.*, 350 So. 2d 881, 884-86 (La. 1977); *Thayer v. American Fin. Advisors, Inc.* 322 N.W.2d 599, 602-03 (Minn. 1982);
is voidable in its entirety—including any arbitration provision.\textsuperscript{116} Under the law of those states, therefore, any party claiming that a contract was fraudulently induced may have that claim decided in court rather than arbitration.\textsuperscript{117} If the FAA applies, however, it would require the same claim to be submitted to arbitration.

Even if state and federal law agree that a valid arbitration agreement exists, federal law still may differ from state law in the standards to be applied in interpreting an arbitration agreement and the scope of the parties' agreement. Although standards of contract interpretation would appear to be a matter of general and neutral state contract law that would be applicable even under the FAA, federal courts frequently hold that "federal law governs the question of whether the parties have agreed to arbitrate."\textsuperscript{118} The Supreme Court stated in \textit{Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.}:\textsuperscript{119}

\begin{quote}
[T]he first task of a court asked to compel arbitration of a dispute is to determine whether the parties agreed to arbitrate that dispute. The court is to make this determination by applying the "federal substantive law of arbitrability, applicable to any arbitration agreement within the coverage of the [Federal Arbitration] Act." And that body of law counsels "that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration . . . . The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of [some] defense to arbitrability."\textsuperscript{120}
\end{quote}

This federal presumption of arbitrability may be subtly different from

\textsuperscript{116} See, e.g., George Engine Co., 350 So. 2d at 885-86.


\textsuperscript{118} In re Hart Ski Mfg. Co., 711 F.2d 845, 846 (8th Cir. 1983).

\textsuperscript{119} 473 U.S. 614 (1985).

\textsuperscript{120} Id. at 626 (quoting Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983) (citations omitted)).
state law standards of contract interpretation.

Federal law also differs from that of some states in the remedies available in arbitration. Some states prohibit arbitrators from awarding punitive damages and will not enforce arbitration awards that include punitive damages. Federal law contains no such prohibition. In transactions governed by the FAA, federal law will likely preempt state law prohibitions on the award of coercive sanctions in arbitration.

Federal law also differs from state law in the availability of defenses to arbitration and the standards governing those defenses. These differences are evident in the courts' treatment of claims that a party has waived its right to compel arbitration. Under both state and federal law, some level of participation in court proceedings will result in a ruling that a party waived its right to arbitration. Some state courts hold that a party waives the right to arbitrate an issue


122. See Raytheon Co. v. Automated Business Sys., Inc., 882 F.2d 6, 9-12 (1st Cir. 1989); Bonar v. Dean Witter Reynolds, Inc., 835 F.2d 1378, 1386-87 (11th Cir. 1988); Willoughby Roofing & Supply Co. v. Kajima Int'l, Inc., 598 F. Supp. 353, 360 (N.D. Ala. 1984), aff'd, 776 F.2d 269, 270 (11th Cir. 1985); Hirshman, supra note 4, at 1361-63; cf. Mitsubishi Motors Corp., 473 U.S. at 635-36 (upholding arbitration as an appropriate forum for the award of treble damages pursuant to the Sherman Act in an international transaction).

123. See Hirshman, supra note 4, at 1361-63; accord Bonar, 835 F.2d at 1387 (holding that choice of law provision does not deprive arbitrators of their power to award punitive damages); Willoughby Roofing & Supply Co., 598 F. Supp. at 358-59. Professor Hirshman states:

Section 2 of the FAA . . . guarantees the parties' right to bargain for an arbitration forum . . . . [T]he policy underlying New York's attempt to retain a public monopoly on the use of coercive sanctions—the superiority of court adjudication—is identical to the policy underlying the old common-law prohibition on arbitration ousting the courts of their jurisdiction.

Hirshman, supra note 4, at 1361. It is such hostility toward arbitration that the FAA sought to end. Id.

As Professor Hirshman notes, the dispute over an arbitrator's award of punitive damages usually arises only after arbitration is completed and the parties seek enforcement or review of the award. She notes, however, that § 10 of the FAA limits the judicial review of awards and that these "limits on judicial review in section 10 should generally preclude application of the New York rule." Id. at 1362.

when that party’s participation in a lawsuit “manifests an affirmative acceptance of the judicial forum.” These courts focus on the actions of the party alleged to have waived the right to arbitrate. Based on his or her own actions a party in those states may waive the right to arbitrate, even if that party’s actions are not prejudicial to the party opposing arbitration. Courts applying the FAA, meanwhile, must take a different approach. “Under the Federal policy favoring arbitration, a party does not automatically waive arbitration merely by engaging in pleading and discovery activities. More is required than action inconsistent with the arbitration provision; prejudice to the party opposing arbitration must also be shown.” The determination of whether the FAA governs an arbitration agreement, therefore, dramatically affects claims that a party has waived its contractual right to arbitration.

Another potential conflict between federal and state arbitration law, relates to the application of statutes of limitation to claims asserted in arbitration. Given the federal policy favoring arbitration, federal courts applying the FAA have held that absent contractual intent to the contrary, issues relating to timeliness, statutes of limita-

125. DeSapio, 321 N.E.2d at 772.
126. See id.
127. See MURRAY ET AL., supra note 101, at 567.
128. David v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 440 N.W.2d 269, 274 (N.D. 1989) (citations omitted), quoted in WILNER, supra note 9, at § 19:01; see also Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983) (“The Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration [when] the problem at hand is ... an allegation of waiver [or] delay.”); Fraser, 817 F.2d at 252 (holding that a finding of prejudice is required before a party may be deemed to have waived its right to invoke the FAA); Maxum Foundations, Inc. v. Salus Corp., 779 F.2d 974, 981 (4th Cir. 1985) (“A litigant may waive its right to invoke the Federal Arbitration Act by so substantially utilizing the litigation machinery that to subsequently permit arbitration would prejudice the party opposing the stay.”); MURRAY ET AL., supra note 101, at 567. Professors Murray, Rau, and Sherman state in their text:

Given the “strong federal policy favoring enforcement of arbitration agreements between knowledgeable business people,” a finding of waiver is not favored in federal court; the party asserting it bears a heavy burden of proof.

Federal courts therefore tend to ask whether one of the parties will have been “prejudiced” if his adversary is permitted to take part in litigation and then later demand arbitration ....

Without such a finding of “prejudice,” the fact that a party has delayed in calling for arbitration will not be enough to cause a waiver to his right to arbitrate.

tion, and laches should be addressed to and decided by the arbitrator—not a court. The arbitrator then has substantial discretion to rule on such claims as he or she sees fit, and the arbitrator's ruling is effectively unreviewable. New York, meanwhile, has a statute that permits a party to apply to the court to assert the statute of limitations as a bar to arbitration. Consequently, determining whether the FAA or state law governs the arbitration agreement again has a substantial impact on the parties’ right and obligation to submit their dispute to arbitration.

Finally, federal and state law may differ about the standard of review courts should apply to arbitration awards. The Second Circuit summarized such a conflict with Pennsylvania law as follows:

Despite limited review of the merits, federal courts have permitted reversal where an arbitrator “manifest[s] an infidelity” to her obligation to interpret the contract, . . . ignores a plain and unambiguous provision of the contract, . . . or even strongly relies on an unambiguous and undisputed mistake of fact . . . . In contrast, under Pennsylvania “common law” arbitration, which applies to arbitration arrangements not explicitly invoking the provisions of the Pennsylvania Arbitration Act . . . , an arbitrator’s error . . . is unreviewable on appeal even if it “has the effect of varying the terms of the contract.”

This discussion of the differences between state and federal arbitration law is not exhaustive. Many more differences—both large and small—exist, and the differences vary from state to state. This summary of some of the key differences simply indicates the importance of determining whether state arbitration law or the FAA and accompanying federal common law apply to a given arbitration agreement.

130. See WILNER, supra note 9, § 19:06.
III. THE FAA'S "INVOLVING COMMERCE" REQUIREMENT

Given the immense differences between federal and state arbitration law, the determination of which law governs the enforcement of an arbitration agreement can be critical. The choice between federal and state law can have substantial—even determinative—impact on the enforceability of an arbitration agreement or award, and even on the outcome of a case.

As discussed above, the terms of the FAA itself now govern this choice of law. For most commercial arbitration agreements, the choice hinges on the FAA's commerce requirement. If an arbitration agreement concerns a transaction involving interstate commerce, then the FAA and accompanying federal common law control; if the contract does not involve interstate commerce, then state law controls.

134. See supra notes 53-70 and accompanying text.
135. 9 U.S.C. § 2 (1988). The FAA applies to written arbitration agreements "in any maritime transaction or . . . a transaction involving commerce" but the Act's application to maritime transactions is less problematic than its application to commercial transactions. Id. The FAA provides a more detailed definition of "maritime transactions." It states, "'Maritime transactions,' as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs of vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced with admiralty jurisdiction . . . ." Id. § 1 (compare the Act's definition of "commerce," infra note 136).

In addition, the federal courts have greater authority over admiralty and maritime matters than they do over general commercial disputes. The Supreme Court has long construed the "provision of Article III, section 2 of the Constitution extending the judicial power to 'all Cases of admiralty and maritime Jurisdiction' . . . to vest the federal courts with authority to create substantive law." MARTIN H. REDISH, FEDERAL JURISDICTION: TENSIONS IN THE ALLOCATION OF JUDICIAL POWER 138 (2d ed. 1990). Federal district courts also have exclusive original jurisdiction over admiralty and maritime cases. 28 U.S.C. § 1333 (1988). In light of the states' reduced authority to articulate substantive law in these areas, conflicts between the FAA and state statutes and policies would seem less important.


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 . . . .


Section 1 of the FAA excludes certain contracts from the Act's coverage, but this exclusion has been interpreted to apply to relatively few cases. It provides that the FAA shall not apply to "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." Id. The courts have construed that exclusion very narrowly. They typically hold that only employees involved in the actual movement of goods in interstate commerce are covered by the exclusion. See Erving v.
Applying the FAA's commerce requirement is a matter of congressional intent. Congress has the constitutional power to regulate any activity or transaction that "affects interstate commerce." Applying this standard, the Supreme Court has held that even "intrastate activities of a very small scale could be federally regulated if they might affect commerce when combined with similar small-scale activities." Consequently, Congress has the power to regulate and make enforceable any arbitration agreement that affects interstate commerce. Given the courts' broad interpretation of "affecting" interstate commerce, Congress likely has the power to regulate and make enforceable all commercial arbitration agreements and perhaps all arbitration agreements of any kind.

In determining the scope of the FAA's applicability, therefore, the question is how much of its constitutional power Congress sought to exercise when it enacted the FAA. When Congress passes legislation intended to reach everything within its constitutional commerce power, the legislation usually states expressly that it covers all subject activities or transactions that "affect" interstate commerce. Yet Congress did not use that language in the FAA. The FAA applies to all transactions that "involve" commerce. In applying the FAA, therefore, courts must decide whether Congress intended the FAA to regulate all arbitration agreements within its commerce power (which likely includes all commercial arbitration agreements) or just some portion of those agreements. If it sought to regulate less than all agreements within its commerce power, then the courts must further decide how to determine what part.

Despite the importance of determining when a transaction is one "involving commerce" for purposes of the FAA, surprisingly little

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Virginia Squires Basketball Club, 468 F.2d 1064, 1069 (2d Cir. 1972); Dickstein v. duPont, 443 F.2d 783, 785 (1st Cir. 1971); Jeffrey W. Stempel, Reconsidering the Employment Contract Exclusion in Section 1 of the Federal Arbitration Act: Correcting the Judiciary's Failure of Statutory Vision, 2 J. Disp. Resol. 259, 263-70 (1991) (criticizing the courts' interpretation of the exclusion in § 1 as being unduly narrow).


138. NOWAK ET AL., supra note 137, at 153 (citing Wickard v. Filburn, 317 U.S. 111 (1942)).


attention has been given to the issue. Although the Supreme Court has addressed the issue, it has done so on a case-by-case basis. The Court has offered little in the way of a test or standard to be applied in other cases.\textsuperscript{142} Lower federal courts and state courts have confronted the issue many times, but they use a variety of approaches and standards. They typically make a narrow, fact-based determination of the commerce issue without delineating the standard used.\textsuperscript{143} The courts sometimes do not even consider the issue, applying federal or state law with little consideration of the possible applicability of the other.\textsuperscript{144} Perhaps more surprising, commentators have all but ignored the issue.\textsuperscript{145} This part of this Article, therefore, collects and analyzes the cases—state and federal—that address the FAA’s interstate commerce requirement.

\section{A. Supreme Court Cases}

The Supreme Court’s treatment of the FAA’s interstate commerce issue is sparse. The issue has never been the central issue before the Court. Rather, the Court has addressed the Act’s commerce requirement in passing to reach\textsuperscript{146} or to avoid\textsuperscript{147} other issues concerning the FAA. Indeed, the Court has addressed the commerce issue directly only twice.\textsuperscript{148} In each instance, the Court made a relatively narrow fact-based determination that the transaction in question did or did not involve interstate commerce.

The Supreme Court’s first case to directly address the interstate commerce issue was \textit{Bernhardt v. Polygraphic Co. of America}.\textsuperscript{149}

\begin{enumerate}
\item See infra part III.A.; see also Speidel, supra note 8, at 170.
\item See infra part III.C.
\item See, e.g., Hoffman v. Fidelity & Deposit Co., 734 F. Supp. 192 (D.N.J. 1990) (applying the FAA to a construction contract without considering the possible application of state law); Chrysler Corp. v. Maiocco, 552 A.2d 1207 (Conn. 1989) (deciding whether arbitrator could award attorney fees in lemon law case); Bill Butler Assoc. v. New England Sav. Bank, 611 A.2d 463 (Conn. Super. Ct. 1991) (holding that claims under the Connecticut Unfair Trade Practices Act are not arbitrable, without mentioning the FAA); A.C. Beals Co. v. Rhode Island Hosp., 292 A.2d 865 (R.I. 1972) (applying state law to an arbitration arising from a contract under which a seller manufactured boilers in Massachusetts and delivered them to a buyer in Rhode Island).
\item See supra note 8 and accompanying text.
\item See Prima Paint Corp. v. Flood & Conklin Mfg. Co., 388 U.S. 395 (1967) (discussed infra notes 153-57 and accompanying text); see also cases cited infra note 162.
\item Search of WESTLAW, SCT and SCT-OLD files (August 13, 1992).
\item 350 U.S. 198 (1956).
\end{enumerate}
FEDERAL ARBITRATION ACT

That case arose from an employment contract under which Polygraphic, a New York corporation, employed Bernhardt as the superintendent of its plant in Vermont.\footnote{150} The parties entered the contract in New York while Bernhardt was a New York resident. Some time after Bernhardt moved to Vermont to perform his duties under the contract, Polygraphic discharged him. Bernhardt then filed an action in a Vermont state court alleging that Polygraphic breached the employment contract. Polygraphic removed the case to federal district court on the basis of diversity of citizenship and sought to stay the action pending arbitration. The district court held the \textit{FAA} applicable and the court of appeals held it inapplicable, both on the basis of \textit{Erie Railroad Co. v. Tompkins}.\footnote{151}

The Supreme Court avoided the difficult \textit{Erie} issue by deciding that the \textit{FAA} did not apply because the contract involved neither a maritime transaction nor interstate commerce. The totality of the Court's brief treatment of the determinative commerce issue is as follows:

No maritime transaction is involved here. Nor does this contract evidence "a transaction involving commerce" within the meaning of § 2 of the Act. There is no showing that petitioner while performing his duties under the employment contract was working "in" commerce, was producing goods for commerce, or was engaging in activity that affected commerce, within the meaning of our decisions.\footnote{152}

The Court ignored the fact that the contract clearly contemplated Bernhardt's moving from New York to Vermont to perform his duties under the contract.

The Court's only other real discussion of the \textit{FAA}'s interstate commerce requirement was in \textit{Prima Paint Corp. v. Flood & Conklin Manufacturing Co.} \footnote{153} That case arose from a contract under which Prima Paint purchased Flood & Conklin's ("F&C") paint business. In connection with the purchase, the parties entered a consulting agreement under which F&C agreed to advise and assist Prima Paint in servicing customer accounts, and moving manufacturing operations

\footnote{150. Bernhardt v. Polygraphic Co. of Am., 218 F.2d 948, 949 (2d Cir. 1955), \textit{rev'd}, 350 U.S. 198 (1956).}
\footnote{151. 304 U.S. 64 (1938); \textit{see also supra} notes 43-50 and accompanying text.}
\footnote{152. Bernhardt, 350 U.S. at 200-01.}
\footnote{153. 388 U.S. 395 (1967).}
from New Jersey to Maryland. The consulting agreement contained an arbitration clause, which Prima Paint alleged to be unenforceable.

The Supreme Court held that the consulting agreement involved interstate commerce under the FAA. Perhaps because a contract for assistance in moving the operations of a multistate business from one state to another involves interstate commerce under any but the most restrictive definition, the Court again offered little discussion of the issue. In addition to rejecting the dissent’s argument that the FAA applies only to “contracts between merchants for the interstate shipment of goods,” the Court simply stated:

Prima Paint acquired a New Jersey paint business serving at least 175 wholesale clients in a number of States, and secured F&C’s assistance in arranging the transfer of manufacturing and selling operations from New Jersey to Maryland. The consulting agreement was inextricably tied to this interstate transfer and to the continuing operations of an interstate manufacturing and wholesaling business. There could not be a clearer case of a contract evidencing a transaction in interstate commerce.

The Court’s brief statements in Prima Paint and Bernhardt provide little direction for future cases. The Court held in Prima Paint that the FAA’s application is not limited to contracts between merchants for the physical interstate shipment of goods, but otherwise the Court’s ruling was a purely fact-specific finding that the contract in that case involved interstate commerce. The Court’s statement in Bernhardt indicated in dicta that the commerce requirement would have been satisfied if the defendant had proven that Bernhardt “was working ‘in’ commerce, was producing goods for commerce, or was engaging in activity that affected commerce.” Although the Court’s statement indicates a fairly broad interpretation of interstate commerce, the Court apparently was not ready to give the commerce issue the same broad interpretation and perfunctory treatment it re-

154. Id. at 397, 401.
155. The Supreme Court and the Second Circuit briefly discussed the existence of interstate commerce, but neither said that the parties contested the issue. The district court did not mention the interstate commerce issue. Prima Paint Corp. v. Flood & Conklin Mfg. Co., 262 F. Supp. 605 (S.D.N.Y. 1966).
157. Id. at 401 (citations omitted).
158. Bernhardt, 350 U.S. at 200-01 (quoted supra text accompanying note 152).
ceives in other contexts. Reluctant to permit the inference of interstate activity from the contract itself, the Court apparently required proof of interstate commerce. The contract, after all, contemplated that Bernhardt would move from New York to Vermont to perform his duties under the contract, and he did so. His employer, Polygraphic, was a New York corporation and operated a plant in Vermont.

Despite their lack of guidance, these two brief statements are the Supreme Court's most in-depth treatments of the commerce issue. In its numerous other FAA cases, the Court (and presumably the parties) simply assumed the applicability of the FAA, perhaps because the involvement of interstate commerce was irrefutable. The Court's other cases that mention the issue contain scarcely more than one sentence on the subject. The Supreme Court thus has not deter-

159. For a discussion of the Court's treatment of other legislation enacted pursuant to Congress' commerce power, see NOWAK ET AL., supra note 137, §§ 4.9, 4.10.

Chief Justice Earl Warren later stated that the issue was still open whether a construction contract between a New York general contractor and a Georgia subcontractor for work on a Georgia construction project requiring interstate movement of materials and personnel involved commerce for purposes of the FAA. See Moseley v. Electronic & Missile Facilities, Inc., 374 U.S. 167, 173 (1963) (Warren, J., concurring); see also Electronic & Missile Facilities, Inc. v. United States, 306 F.2d 554, 555 (5th Cir. 1962).


163. In Volt Info. Sciences, the Court simply noted that "[i]t is undisputed that this contract falls within the coverage of the FAA, since it involves interstate commerce." 489 U.S. at 476. The Court mentioned the commerce issue in Moses H. Cone in a footnote, but only to summarize the North Carolina courts' changing treatment of the issue. Moses H. Cone, 460 U.S. at 27 n.36. In Scherk, the Court summarily stated that the FAA clearly applied because "the transaction in this case constitutes 'commerce with foreign nations.'" 417 U.S. at 511 n.5.

In a concurrence in Moseley v. Electronic & Missile Facilities, Inc., 374 U.S. 167
minded whether the FAA’s commerce requirement includes all transactions within the reach of Congress’s commerce power, nor has it articulated a definitive test or standard to be applied in determining whether a transaction involves commerce for purposes of the FAA. The Court’s only definitive ruling on the issue is that application of the FAA is not limited to “contracts between merchants for the inter-state shipment of goods.”

B. Standards for Determining Involvement in Interstate Commerce

In the absence of a definitive Supreme Court ruling on the issue, lower federal courts and state courts have addressed the FAA’s interstate commerce requirement in different ways. Like the Supreme Court, these courts often make a fact-based ruling on the issue without providing any discernible standard. Several federal courts of appeal and state courts, however, have sought to articulate generally applicable standards for determining whether a transaction involves interstate commerce for purposes of the FAA. This section summarizes these standards.

1. An Expansive Interpretation of the FAA:
   Does the Contract Affect Interstate Commerce?

Several courts have interpreted the FAA’s commerce language broadly “to be coextensive with congressional power to regulate under the Commerce Clause.” Those courts thus apply the FAA to all transactions that “affect” interstate commerce. Since this standard

(1963), Chief Justice Warren pointed out that the Court’s decision left open the issue of whether “a construction project, like the one in this case, [is] one ‘involving commerce’ within the restricted scope of the Arbitration Act.” Id. at 173 (Warren, J., concurring). The contract disputed in Moseley was one between a New York general contractor and a Georgia subcontractor for heating and plumbing work on a missile site construction project in Georgia, and the project “required substantial interstate movement of materials and personnel.” Electronic & Missile Facilities, Inc. v. Moseley, 306 F.2d 554, 555 (5th Cir. 1962), rev’d on other grounds, 374 U.S. 167 (1963). On those facts, the Fifth Circuit held that the contract involved interstate commerce. Id. For additional discussion of the interstate commerce requirement in the context of construction contracts, see infra notes 244-58 and accompanying text.

165. See authorities cited and discussed infra part III.C.
166. Foster v. Turley, 808 F.2d 38, 40 (10th Cir. 1986).
167. See, e.g., Snyder v. Smith, 736 F.2d 409, 418 (7th Cir.), cert. denied, 469 U.S. 1037 (1984) (“Under the commerce clause, Congress may reach activities ‘affecting’ interstate commerce.”); Kodak Mining Co. v. Carrs Fork Corp., 669 S.W.2d 917, 920 (Ky. 1984) (relying on Federal Mine Safety and Health Act cases to hold that all mining activity is
goes to the limits of Congress' constitutional power, it obviously is the broadest standard applied to the FAA interstate commerce requirement.

The Seventh Circuit's opinion in *Snyder v. Smith* \(^{168}\) contains perhaps the most extensive and most often cited discussion justifying use of the "affecting interstate commerce" standard in FAA cases. The court first ruled that the FAA "does not limit a court to considering only those transactions expressly authorized on the face of the contract in determining whether the FAA applies." \(^{169}\) The Seventh Circuit noted that in *Prima Paint* the Supreme Court relied on affidavits and related contracts to determine that the transaction involved commerce. \(^{170}\) The Seventh Circuit went on to conclude that prior Supreme Court decisions and the "strong federal policy favoring arbitration" demand that the FAA's commerce requirement "be construed broadly." \(^{171}\) It particularly focused on *Southland Corp. v. Keating*, \(^{172}\) in which the Supreme Court held that the FAA's commerce language demonstrated Congress' reliance on its commerce power in enacting the FAA. \(^{173}\) Since the commerce language was an invocation of Congress' commerce powers, the Seventh Circuit said, "Congress intended the FAA to apply to all contracts that it constitutionally could regulate." \(^{174}\) The Seventh Circuit then pulled back.
from making such a holding, however, noting that the transaction before it involved commerce without such a broad interpretation of the FAA’s applicability.\textsuperscript{175}

2. A Subjective Standard: Did the Parties Contemplate Substantial Interstate Activity?

A number of courts have concluded that Congress did not intend for the FAA to extend to all transactions Congress could constitutionally regulate.\textsuperscript{176} Consequently, those courts conclude, the standard for applying the FAA “is not the ‘regulating standard’ of ‘affecting interstate commerce.’”\textsuperscript{177} If the FAA does not exercise the full reach of Congress’ commerce power and does not apply to all transactions affecting commerce, of course, courts must decide how far it reaches; they must develop a standard for determining which contracts and transactions fall within its control.

Many courts follow the thoughtful concurring opinion of Judge Lumbard in \textit{Metro Industrial Painting Corp. v. Terminal Construction Co.}\textsuperscript{178} That case arose from a construction dispute. A Connecticut corporation and a New Jersey corporation entered a joint venture in order to obtain a contract to construct a housing project at a United States Air Force Base in Florida.\textsuperscript{179} The joint venture entered a sub-contract with Metro Industrial Painting, a New York corporation, to perform painting work at the Florida construction site. The subcontract contained an arbitration provision. When a dispute arose concerning Metro Industrial’s performance and its right to receive alleged delay damages, Metro Industrial sought to have the dispute arbitrated.\textsuperscript{180}

The trial court entered an order compelling arbitration, and the joint venture appealed, arguing among other things that the FAA did

\textsuperscript{175} See id.
\textsuperscript{177} \textit{Warren}, 548 So. 2d at 160.
\textsuperscript{178} 287 F.2d 382, 385-88 (2d Cir.) (Lumbard, J., concurring), \textit{cert denied}, 368 U.S. 817 (1961).
\textsuperscript{179} Id. at 383.
\textsuperscript{180} Id. at 384.
not apply because the transaction did not involve interstate commerce. The Second Circuit affirmed. It found that the transaction involved interstate commerce regardless of what standard applied, because of the transaction's many interstate elements.\(^{181}\)

Judge Lumbard concurred in the court's decision but wrote a separate opinion to address "the significant question as to the scope of federal law and its effect on state courts."\(^{182}\) Under the Second Circuit's earlier conclusion (later adopted by the Supreme Court)\(^{183}\) that the FAA was an exercise of Congress's commerce power,\(^{184}\) he noted that the FAA is applicable in state courts as well as federal courts.\(^{185}\) He also noted the Second Circuit's ruling (later adopted by the Supreme Court)\(^{186}\) that the FAA "empowered the courts to develop a substantive body of federal law with regard to the interpretation and construction of [arbitration] clauses."\(^{187}\) These rulings had the combined impact, he suggested, of displacing a substantial body of state contract and arbitration law.\(^{188}\) "It is most important, therefore," Judge Lumbard said, "to define precisely what the limits of the federal law are."\(^{189}\) In the context of this case, he continued, the issue is "whether . . . the contract to paint buildings in Florida was one 'evidencing a transaction involving commerce.'"\(^{190}\)

To address this issue, Judge Lumbard considered Congress' purpose in enacting the FAA, the extent to which Congress intended the FAA to reach, and the extent to which Congress intended to supersede state law. He found that:

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181. Id. The court noted that:

[Twenty per cent of Metro's work force at the Florida site, as well as a substantial number of supervisory personnel, were transported from New York City to Florida; and materials used by Metro's employees were purchased from other states, as were materials used by other subcontractors, many of whom were also from out of state.

182. Id. at 385 (Lumbard, J., concurring).


185. Metro Indus., 287 F.2d at 386 (Lumbard, J., concurring).

186. See supra notes 71-90 and accompanying text.

187. Metro Indus., 287 F.2d at 386.

188. See id.

189. Id.

190. Id.
The legislative history of the [FAA] reveals little awareness on the part of Congress that state law might be affected.\textsuperscript{191} Having no clear mandate from Congress as to the extent to which state statutes and decisions are to be superseded, we must be cautious in construing the act lest we excessively encroach on the powers which Congressional policy, if not the Constitution, would reserve to the states . . . .\textsuperscript{192}

In enacting the [FAA], unlike various other statutes invoking the interstate commerce power, Congress was not seeking to regulate and control activity affecting commerce, but was providing for those engaged in interstate transactions an expeditious extra-judicial process for settling disputes. The [FAA] may be avoided entirely by those engaged in interstate traffic if they merely refrain from including any arbitration provisions in their contracts. The Congressional intent was not, therefore, to impose an adjudicative system on those who wished none nor was the intent to affect all contracts possessing certain interstate elements; the purpose of the act was to assure those who desired arbitration and whose contracts related to interstate commerce that their expectations would not be undermined by federal judges, or, since the clarification in Lawrence,\textsuperscript{193} by state courts or legislatures.

The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties \textit{did} cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they \textit{contemplated} substantial interstate activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract, and if it, on its face, evidences interstate traffic, . . . the contract should come within section 2 [of the FAA]. In addition, evidence as to how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated.\textsuperscript{194}

\textsuperscript{191} For a study of the FAA's legislative history that supports this conclusion, see Atwood, \textit{supra} note 8.


\textsuperscript{193} \textit{See} Robert Lawrence Co. v. Devonshire Fabrics, Inc., 271 F.2d 402 (2d Cir. 1959) (holding that the FAA was an exercise of Congress's commerce power and, consequently, is applicable in state courts as well as federal courts), \textit{cert. granted}, 362 U.S. 909, and \textit{cert. dismissed}, 364 U.S. 801 (1960).

\textsuperscript{194} \textit{Metro Indus.}, 287 F.2d at 386-87 (citations omitted) (footnotes added).
Judge Lumbard further noted:

The fact that it is necessary for one party to cross state lines in order to fulfill obligations arising out of the contract should not by itself bring the arbitration clause within the reach of the federal statute. The [FAA] should apply only when the parties know or have reason to believe that the performance of the contract will require substantial interstate movement.195

Applying this new standard to the case before him, Judge Lumbard found it “reasonably clear that the parties anticipated substantial interstate traffic.”196

A number of courts use Judge Lumbard’s test. The supreme courts of North Carolina197 and Alabama198 expressly adopted Judge Lumbard’s standard and routinely apply it in FAA cases. Several other courts quote Judge Lumbard’s opinion at length and expressly follow his analysis.199 Still other courts use the language of Judge Lumbard’s “contemplating” commerce standard.200

195. Id. at 388 (citations omitted).
196. Id.
198. See Ex parte Clements, 587 So. 2d 317, 319 (Ala. 1991); Ex parte Warren, 548 So. 2d 157, 159-60 (Ala.), cert. denied, 493 U.S. 998 (1989). In three cases decided in 1992, however, the Alabama Supreme Court adopted its own “slightest nexus with interstate commerce” standard. See infra note 205.
200. See Varley v. Tarrytown Assoc., Inc., 477 F.2d 208, 209 (2d Cir. 1973) (applying the FAA because the contract “contemplated that Varley would act as a textile consultant throughout the United States and preliminary discussions evidenced the clear expectation that Varley would evaluate plants and fabrics manufactured throughout the country”); Singer Co. v. Tappan Co., 403 F. Supp. 322, 323 n.1 (D.N.J. 1975), aff’d, 544 F.2d 513 (3d Cir. 1976); O’Meara v. Texas Gas Transmission Corp., 230 F. Supp. 788, 790-91 (N.D. Ill. 1964); University Casework Sys., Inc. v. Bahre, 362 N.E.2d 155, 162 (Ind. Ct. App. 1977) (examining “both the position of the parties at the time the contract was executed and their conduct subsequent to the contracts formation in determining whether the parties to the contract therein contemplated a transaction which would involve interstate commerce”); Pathman Constr. Co. v. Knox County Hosp. Ass’n, 326 N.E.2d 844, 852 (Ind. Ct. App. 1975); Deep South Oil Co. v. Texas Gas Corp., 328 S.W.2d 897, 905-06 (Tex. Civ. App. 1959) (holding that the FAA is inapplicable to a contract for the sale of natural gas because the parties at
As one might expect, courts applying Judge Lumbard’s test are less likely to find involvement in interstate commerce than courts applying the “affecting” commerce standard. This author has found no cases applying the “affecting” commerce standard that have found a contract not to involve interstate commerce. Several cases exist, meanwhile, in which courts applied Judge Lumbard’s standard and found the contract not to involve interstate commerce.\(^{201}\)

3. Other Standards and Factors

The broad “affecting” commerce standard and Judge Lumbard’s subjective standard are the only tests widely quoted or used repeatedly. Several cases, however, address the FAA’s commerce requirement in such a way that one can discern a standard, or at least par-

the time they entered the contract did not contemplate that the gas would be resold in interstate commerce.

Some courts, while conceding that the parties’ expectations are relevant to deciding whether a contract involves interstate commerce, hold that their actual performance must be considered as well. See C.P. Robinson Constr. Co. v. National Corp. for Hous. Partnerships, 375 F. Supp. 446, 450 (M.D.N.C. 1974) (stating that the “subjective intent of the parties is not controlling in determining if the agreement objectively evidences a transaction involving commerce, but it is illuminating as to how the parties interpreted their own contract”); University Casework Sys., 362 N.E.2d 155.

201. See Clements, 587 So. 2d at 319; Warren, 548 So. 2d at 159-60; Action CATV, 508 So. 2d at 1276 (stating that even though the plaintiff managed a Florida cable system from Massachusetts, the FAA did not apply to a contract for the construction and management of the system because the original parties to the contract did not contemplate interstate activity); Riverfront Properties, 460 So. 2d at 953-54; Paramore, 316 S.E.2d at 92 (in which the parties did not contemplate substantial interstate activity in, and the FAA did not apply to, a contract for the lease of a tractor already present at the defendant’s North Carolina dealership, even though lease payments were to be made to Montana).

In the following cases, courts applied Judge Lumbard’s standard and found that the contract did involve interstate commerce: O’Meara, 230 F. Supp. at 790-91 (holding that the FAA applied to the contract for sale of natural gas where the buyer operated an interstate pipeline system and the seller obtained federal regulatory permission to sell natural gas for resale in interstate commerce); R.J. Palmer Constr. Co., 642 P.2d at 130 (holding that the FAA applied to construction contract because parties contemplated the use of redwood siding which had to be shipped from outside Kansas, and the parties knew the building would be used to house and sell musical instruments that moved in interstate commerce); Burke County Pub. Schs. Bd. of Ed., 279 S.E.2d at 822-23 (applying the FAA to a contract for architectural services relating to the construction of a school in North Carolina, because the principal architect worked and resided in Indiana, most of the architectural work was done in Indiana, the architect made periodic visits to the construction site in North Carolina, the structural engineering design work was done by a firm in Michigan, and the architect dealt with and specified materials manufactured by suppliers all over the country); Cohoon, 298 S.E.2d at 730-31 (where the parties contemplated substantial interstate activity in, and FAA applied to, a partnership agreement between citizens of both North and South Carolina relating to land development in both states).
ticular factors that the court found determinative.

As noted above, the Alabama Supreme Court at various times has used a standard under which it applies the FAA if the arbitration agreement has "the slightest nexus" with interstate commerce. The court articulated this test in *Ex parte Costa & Head (Atrium), Ltd.*, decided in 1986. The court then apparently abandoned the test for six years, choosing instead to apply Judge Lumbard's test. The Alabama court has now revived its "slightest nexus" test, having applied it in its last three cases on the issue.

The effect of Alabama's "slightest nexus" standard is uncertain, but it is probably narrower than the "affecting commerce" standard, and broader than Judge Lumbard's test that the Alabama courts applied earlier. Of the four cases in which the court applied the test, the court found that three of the contracts in question involved interstate commerce. Each of those three cases concerned a construction contract which required the use of materials shipped, or personnel, from other states. In the fourth case, however, the court found that a lease of surface mining rights did not involve interstate commerce even though it involved residents of different states and required lease payments to be mailed across state lines.

In *Downing v. Allstate Insurance Co.*, the Michigan Court of Appeals seemed to use a less expansive interpretation of "involving commerce," but one that still focuses on objective events of the transaction. Specifically, the court looked at the location of events relevant to the transaction to determine if they occurred in more than one state. The court held that the contract in this case, an automobile insurance policy issued by a national insurance company, did not

202. See *Warren*, 548 So. 2d at 162 (Maddox, J., dissenting); *Ex parte Costa & Head (Atrium), Ltd.*, 486 So. 2d 1272, 1275 (Ala. 1986). The Alabama court has since rejected this approach and embraced Judge Lumbard's approach of determining whether the parties "contemplated substantial interstate activity." See supra notes 175-98 and accompanying text.

203. 486 So. 2d 1272, 1275 (Ala. 1986).

204. See *Clements*, 587 So. 2d at 319; *Warren*, 548 So. 2d at 159-60. The "slightest nexus" standard was used during this time in at least one dissenting opinion. See id. at 162 (Maddox, J., dissenting).


206. See *Ex parte Brice Bldg.*, 607 So. 2d at 133; *Maxus*, 598 So. 2d at 1379; *Costa & Head*, 486 So. 2d at 1275.

207. See *A.J. Taft Coal Co.*, 602 So. 2d at 397.

evidence a transaction involving interstate commerce. "Every event relevant to this case," the court found, "took place in Michigan. Thus, . . . the federal act does not apply to plaintiff's contract."

This contract likely would be deemed to involve interstate commerce under either the "affecting commerce" standard or Judge Lumbard's subjective standard, because the insurance policy likely covered the insured and his car not only in Michigan but in any state to which they travelled.

4. Burdens of Proof

Whether a transaction is one that involves interstate commerce is a question of fact. Whatever test courts apply in determining whether a transaction involves commerce, they must decide who has the burden of raising and proving the issue. Can a party rely on mere allegations of interstate commerce if the party opposing application of the FAA presents no evidence on the issue, or must a party always present evidence of interstate commerce to invoke the Act? If the parties present conflicting evidence regarding the interstate and intrastate nature of the transaction, who has the ultimate burden of persuasion on the issue? Although the handful of reported cases that address these issues do not provide definitive answers, close analysis of the opinions indicate some consensus on the burden of proof issues.

In *Maxum Foundations, Inc. v. Salus Corp.*, the Court of Appeals for the Fourth Circuit rendered the most decisive opinion on the issue. The court stated:

[The plaintiff] essentially argues that in order for the Federal Arbitration Act to apply, the party invoking the Act must put forth specific evidence documenting the interstate aspect of the transaction. The statute does not impose such a burden, however. The Federal Act applies to arbitration agreements in contracts "evidencing a transaction involving [interstate] commerce," but does not require proof by affidavit or other specific evidence of the nexus to interstate commerce. Where, as here, the party seeking arbitration alleges that the transaction is within the scope of the Act, and

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209. *Id.* at 141.


211. 779 F.2d 974 (4th Cir. 1985).

212. In its memorandum supporting its motion to stay the action pending arbitration, the defendant asserted that "both parties to the subcontract are incorporated in different jurisdic-
the party opposing application of the Act does not come forward with evidence to rebut jurisdiction under the federal statute, we do not read into the Act a requirement of further proof by the party invoking the federal law.\textsuperscript{213}

In the Fourth Circuit, therefore, the mere allegation of involvement in interstate commerce is sufficient unless evidence is presented to rebut that allegation. The Fourth Circuit clearly puts the burden of going forward with the evidence on the party opposing application of the FAA.\textsuperscript{214}

In apparent contrast to \textit{Maxum Foundations}, several appellate decisions have refused to apply the FAA because involvement in interstate commerce was not sufficiently proven.\textsuperscript{215} Those cases are frequently cited for the proposition that a party invoking the FAA must present evidence of interstate commerce.\textsuperscript{216} \textit{Merritt-Chapman \\& Scott Corp. v. Pennsylvania Turnpike Commission\textsuperscript{217}} is one of the most frequently cited of these cases. The plaintiff in \textit{Merritt-Chapman} filed an action seeking damages. The defendant sought to stay the action pending arbitration pursuant to a contractual arbitration provision. The trial court stayed the action and the plaintiff appealed. The Third Circuit refused to apply the FAA, stating:

The . . . allegations of the complaint . . . make no reference to commerce. Defendant's motion to dismiss . . . [does not] make any claim that the contract between the parties constituted a transaction involving commerce. However much we may speculate on what may have been the nature of the performance required by the con-

\textsuperscript{213} Id. (citation omitted) (quoting 9 U.S.C. § 2).

\textsuperscript{214} For a similar approach, see Kirschner v. West Co., 247 F. Supp. 550, 552 (E.D. Pa.) (where the court takes judicial notice that a transaction in coatings to be used in the pharmaceutical industry involves commerce under the FAA where that finding is supported by the pleadings), \textit{aff'd}, 353 F.2d 537 (3d Cir. 1965), \textit{cert. denied}, 383 U.S. 945 (1966).


\textsuperscript{216} \textit{See} E.C. Ernst, Inc. v. Manhattan Constr. Co. of Tex., 551 F.2d 1026, 1040 n.36 (5th Cir. 1977), \textit{cert. denied}, 434 U.S. 1067 (1978); \textit{accord} \textit{FOSTER}, \textit{supra} note 9, § 1.05, at 10.

\textsuperscript{217} 387 F.2d 768 (3d Cir. 1967).
tract, it is impossible for us to determine on appeal whether the United States Arbitration Act applies.  

Another leading case that follows Merritt-Chapman is Gavlik Construction Co. v. H.F. Campbell. The district court in Gavlik stayed the action pending arbitration and the plaintiff appealed. On appeal, the plaintiff argued that the FAA did not apply because the defendant did not "sustain its burden of establishing that the subcontracts evidence 'a transaction involving commerce.'" The Third Circuit ruled as follows:

The district court made no findings as to whether the Gavlik subcontracts evidence a "transaction involving commerce," the predicate for applying the United States Arbitration Act. Hence, it could not, and therefore did not, determine the applicability of that statute. The absence of these findings precludes our consideration of the applicability of the act.

The court noted that it could remand the case for a finding on the issue, but decided that remand was unnecessary. It held that the district court had inherent power to stay the action even if the FAA did not apply.

Although these and similar opinions seem to put the burden of proving interstate commerce on the party invoking the FAA, careful reading of the opinions indicate that they are not contrary to Maxum Foundations. Despite their strong rhetoric about the importance of factual proof they do not really address the burden of proof issue. Rather, they hold that appellate courts cannot apply the FAA on appeal absent a finding of fact by the trial court or something in the record indicating that the transaction at issue involved interstate commerce. In Merritt-Chapman, the opinion indicates that there was not so much as an allegation of interstate commerce at the trial level,

218. Id. at 772; see also Bucks County Bar Ass'n v. Data-Matic Sys. Co., No. CIV.A.85-7017, 1985 WL 5013, at *6 n.4 (E.D. Pa. Dec. 30, 1985) (holding the FAA inapplicable to a contract to provide computer hardware and software because "there are no allegations evidencing a transaction involving commerce. Both parties are alleged to be citizens of Pennsylvania and no reference is made to commerce").
219. 526 F.2d 777 (3d Cir. 1975).
220. Id. at 784.
221. Id.
222. Id.
much less evidence of interstate commerce. The court’s reference to allegations in the pleadings suggests that unrebutted allegations might be sufficient to justify application of the FAA. In Gavlik, it is not clear whether anyone alleged interstate commerce;\textsuperscript{224} again, therefore, the court might have applied the FAA if confronted with unrebutted allegations of interstate commerce. These cases thus stand for the proposition that the party invoking the FAA has the burden of pleading interstate commerce, but they do not necessarily address the burden of production of evidence or the burden of persuasion.\textsuperscript{225}

Even Higley South, Inc. v. Park Shore Development Co.,\textsuperscript{226} the opinion with perhaps the strongest rhetoric about the need for proof, appears to follow this assessment. Rather than a dispute over arbitrability, Higley South arose from a declaratory judgment action in which Higley South sought a judgment that several arbitrable disputes involving several parties should be consolidated into one arbitration proceeding. In order to rule on the consolidation issue, the court had to determine whether Florida law or the FAA applied. The Florida Court of Appeals ruled that it could not apply the FAA to the case. The court stated:

[T]here is nothing before us permitting the finding that interstate commerce is either affected or involved. We . . . reject the notion that we should find such commerce contact from the nature and magnitude of the construction undertaken by [the plaintiff]. Common knowledge or surmise cannot substitute for proof or, as in this case, a pleading alleging the presence of interstate commerce.\textsuperscript{227}
Although the court in this passage emphasizes the importance of factual evidence, the decision does not necessarily put the burden of production on the party invoking the FAA. The last phrase in the quotation suggests that an unrebutted allegation of interstate commerce might suffice.

Taken together, these cases clearly indicate that the party invoking the FAA has the burden of pleading interstate commerce. Except for Maxum Foundations, however, none of the cases provide any real authority on burdens of production and persuasion at the trial level. Indeed, close reading of the opinions indicates that these courts might agree with the Maxum Foundations holding that once the party invoking the FAA alleges interstate commerce, the burden of contradicting that allegation shifts to the party opposing application of the FAA to present evidence or at least arguments that the transaction does not involve interstate commerce. None of the cases address the ultimate burden of persuasion once the issue of interstate commerce is joined. Some cases suggest the necessity of trial court findings concerning interstate commerce to support application of the FAA on appeal, but other courts have expressly rejected even that requirement. The prudent course for the party seeking application of the
FAA, of course, is to allege interstate commerce, introduce evidence to support the allegation, and secure a factual determination by the trial court that the transaction involved interstate commerce.\textsuperscript{231}

\section*{C. Applicability of the FAA to Particular Types of Contracts}

As noted above, most cases do not apply a generally applicable test or standard in determining whether a contract or transaction "involves" commerce for purposes of the FAA. Rather, most courts simply review the interstate elements of each transaction and conclude that it does or does not involve interstate commerce. These courts frequently rely on previous cases that concern similar contracts or facts. This section of the Article thus reviews the courts' rulings on the FAA's commerce requirement in several frequently encountered categories of contracts.

1. Contracts for the Sale or Lease of Goods

The contracts that most clearly fall within the FAA's commerce requirement are contracts for the interstate sale of goods. Application of the FAA to even these contracts, however, must be analyzed to determine just what interstate elements must exist for the transaction to be deemed one "involving" interstate commerce.

The transactions that most clearly involve interstate commerce are sales contracts between residents of different states, requiring the physical movement of goods from one state to another.\textsuperscript{232} These

\textsuperscript{231} See \textit{Foster}, supra note 9, § 1.05, at 10-11.

\textsuperscript{232} See \textit{Genesco, Inc. v. T. Kalduchi & Co.}, 815 F.2d 840 (2d Cir. 1987) (applying the FAA to a contract under which an American manufacturer agreed to buy textiles from a Japanese manufacturer); Municipal Energy Agency of Miss. v. Big Rivers Elec. Corp., 804 F.2d 338, 340, 342 (5th Cir. 1986) (holding that the FAA applies to a contract for a Mississippi agency to buy electricity from a corporation in Kentucky); Island Creek Coal Sales Co. v. City of Gainesville, 764 F.2d 437 (6th Cir.) (per parties' agreement, applied the FAA to an agreement for Florida City to buy coal to be extracted in Kentucky), \textit{cert. denied}, 474 U.S. 948 (1985); \textit{Wick v. Atlantic Marine, Inc.}, 605 F.2d 166, 168 n.4 (5th Cir. 1979) (applying the FAA to a contract between Alaska residents and a Florida corporation for the construction of a boat in Florida for sale to Alaskans for use in Alaska); \textit{Medical Dev. Corp. v. Indus. Molding Corp.}, 479 F.2d 345, 346-47 (10th Cir. 1973) (applying the FAA to a contract under which a California corporation agreed to sell goods to a Utah corporation, F.O.B. Los Angeles); \textit{Robert Lawrence Co. v. Devonshire Fabrics, Inc.}, 271 F.2d 402, 409 (2d Cir. 1959) (applying the FAA to a purchase of wool by a corporation in Massachusetts from a corporation in New York); \textit{Kentucky River Mills v. Jackson}, 206 F.2d 111, 117-18 (6th Cir.) (applying the FAA to a contract under which a Kentucky mill purchased textile...
transactions "involve" interstate commerce under any standard,\(^\text{233}\) regardless of whether the sale is between merchants\(^\text{234}\) or to a consumer.\(^\text{235}\) Sales contracts between citizens of the same state also "involve" interstate commerce when performance of the contract requires goods to be shipped across state lines.\(^\text{236}\)


\(^{233}\) *Cf. Warrior Basin Gas Co.*, 512 So. 2d at 1365, 1369 (applying Judge Lumbard's test to find that a contract between an in-state natural gas supplier and an out-of-state natural gas purchaser involved interstate commerce).

\(^{234}\) See cases cited *supra* note 232.

\(^{235}\) See *Wick*, 605 F.2d at 169 n.4.

\(^{236}\) See Missouri *ex rel.* St. Joseph Light & Power Co. v. Donelson, 631 S.W.2d 887,
Sales contracts in which an in-state seller delivers goods within the state to an out-of-state buyer presents a closer question. A number of courts have said that a contract does not "involve" interstate commerce just because it is between citizens of different states. Nonetheless, most courts have held that such transactions "involve" interstate commerce, at least when the seller anticipates that the buyer will place the goods in interstate commerce. Likewise, one court held this type of local sale to "involve" interstate commerce because completion of the transaction required one of the parties to move personnel and payments across state lines.

The involvement of interstate commerce is even less clear when the buyer is a consumer and the goods are already in the buyer's state prior to the transaction. Since most goods, or at least their component parts, usually travel in interstate commerce, one could legitimately interpret even these intrastate consumer transactions to involve interstate commerce. A California resident's purchase of a car from a California retailer could be deemed to "involve" interstate commerce, for example, because the retailer previously purchased the car from a Michigan manufacturer. In addition, given the mobile nature and purpose of a car, one might assume that the buyer will use the car in interstate commerce. Certainly, such consumer transactions "affect" commerce and thus are governed by the FAA if the broad "affecting"

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890 (Mo. Ct. App. 1982) (holding that a sales contract between two Missouri corporations requiring shipment of coal from seller's Iowa facility to buyer's Missouri facility involved interstate commerce).


238. See O'Meara v. Texas Gas Transmission Corp., 230 F. Supp. 788, 790-91 (N.D. Ill. 1964) (holding that a contract for the sale of natural gas from the plaintiff's Louisiana well to be delivered to defendant's Louisiana processing plant "involved" commerce since plaintiff sought and received from the Federal Power Commission a certificate giving the plaintiff permission to sell natural gas to defendant for resale in interstate commerce); McEntire v. Monarch Feed Mills, Inc., 631 S.W.2d 307, 308-09 (Ark. 1982) (holding that a contract by an Arkansas resident to sell and deliver grain to a Missouri corporation's Arkansas plant "involved" interstate commerce since the buyer had plants in both Arkansas and Missouri and was in the business of buying and selling grain in both states). But see Deep South Oil Co. of Tex. v. Texas Gas Corp., 328 S.W.2d 897, 905-06 (Tex. Civ. App. 1959) (holding that a contract by a Texas gas supplier to sell gas to a buyer that processes the gas in the same county did not "involve" interstate commerce despite the buyer's subsequent sale of the gas in interstate commerce).

239. See Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp., 797 F.2d 238, 243 (5th Cir. 1986) (holding that a contract between citizens of different states for the intrastate sale of natural gas "involved" interstate commerce since the contract necessitated "interstate travel of both personnel and payments").
commerce standard is applied. Nonetheless, the essential transaction between the parties to a consumer sale takes place entirely in one state. If the courts use a narrower interpretation of “involving” commerce, therefore, the FAA likely would not apply to these transactions.

Only a handful of reported cases address the applicability of the FAA to such intrastate consumer transactions, but each held the FAA inapplicable. Two cases have held that:

[T]he sale in Alabama of an automobile manufactured outside of Alabama to an Alabama resident who is buying it as a consumer and not for commercial purposes, is not a contract involving “interstate commerce,” as that term is used in the FAA, where the seller has its only place of business in Alabama . . . and all obligations arising out of the contract are to be performed in Alabama.

Similarly, the North Carolina Court of Appeals held that the FAA did not apply to a North Carolina resident’s lease of a tractor already located at a North Carolina dealership. The court held that the FAA did not apply even though the lessor was a Minnesota corporation and payments were made to Minnesota, with the North Carolina dealer acting only as leasing agent. Significantly, all three of these cases were decided by courts that apply Judge Lumbard’s “involving commerce” test under which courts inquire whether the parties contemplated substantial interstate activity.

2. Construction Contracts

Like intrastate consumer transactions, construction contracts appear at first to be essentially local in nature, and many parties to

240. Cf. Wickard v. Filburn, 317 U.S. 111, 127-28 (1942) (holding that a farmer’s action of growing wheat for consumption on his own farm affects interstate commerce and thus is subject to congressional regulation).

241. Ex parte Williams, 555 So. 2d 146, 148 (Ala. 1989); see also Ex parte Warren, 548 So. 2d 157, 159-60 ( Ala.), cert. denied, 493 U.S. 998 (1989).


243. See Warren, 548 So. 2d at 159-60; Paramore, 316 S.E.2d at 92; see also supra notes 175-201.

244. See Bryant-Durham Elec. Co. v. Durham County Hosp. Corp., 256 S.E.2d 529, 532 (N.C. Ct. App. 1979) ("The construction of the Durham County General Hospital was not an act in interstate commerce and we hold the [FAA] does not apply."). But see Burke County Pub. Sch. Bd. of Educ. v. Shaver Partnership, 279 S.E.2d 816, 818-19, 821-24 & n.12 (N.C. 1981) (applying the FAA to a contract for architectural services, suggesting that the North Carolina Court of Appeals’ interpretation of “involving” commerce was too restrictive and that construction contracts may involve commerce).
construction contracts have argued on that basis that, the FAA does not apply to construction contracts.\(^{245}\) One contractor argued, for example, that its contract was "one for construction in a single county in Kentucky and that the transaction should be characterized as 'construction not commerce.'"\(^{246}\)

Yet despite this appearance, a great many cases apply the FAA to construction contracts because the contractor or the owner resides in a state other than the state where the construction takes place.\(^{247}\) Many of these cases also rely on the fact that materials used on the project come from another state or other contractors or workers on the project come from another state.\(^{248}\) A number of cases even apply

\(^{245}\) See, e.g., Monte v. Southern Del. County Auth., 321 F.2d 870, 871-72 (3d Cir. 1963).

\(^{246}\) Fite & Warmath Constr. Co. v. MYS Corp., 559 S.W.2d 729, 734 (Ky. 1977).


the FAA to construction contracts in which the owner, the contractor, and the construction site are all in the same state. These cases find that the contract "involves" interstate commerce because the project uses materials, workers, or subcontractors from other states.249 A few cases even rely partly on the fact that the completed building will be used in commerce or to facilitate commerce.250

Only a handful of cases have held the FAA inapplicable to a construction project because it did not "involve" interstate commerce,251 and those cases have questionable precedential value. The


250. See R.J. Palmer Constr. Co., 642 P.2d at 130 (noting that "the building presumably was to be used to house and sell musical instruments and related items that would be moved in interstate commerce").

North Carolina Court of Appeals held that "[t]he construction of the Durham County General Hospital was not an act in interstate commerce and . . . [the FAA] does not apply." A later decision by the North Carolina Supreme Court, however, likely has overruled that case.

Likewise, the Alabama Supreme Court refused to apply the FAA to a construction contract in its initial opinion in *H.L. Fuller Construction Co. v. Industrial Development Board*. The court stated:

[W]e conclude that the transaction in dispute did not involve interstate commerce, as contemplated by the FAA. Our conclusion is predicated on the following facts: (1) All of the parties to the controversy are Alabama corporations; (2) the contract was to be executed solely within the State of Alabama; and (3) all obligations arising out of the contract were to be performed solely within the State of Alabama.

The court withdrew that opinion, however, after granting the parties' petition for rehearing. On rehearing, the court applied the FAA, but only because both parties agreed throughout the litigation that it applied. Recent decisions of the Alabama Supreme Court suggest that it has joined the consensus reached by other courts that nearly all construction contracts "involve" interstate commerce and are subject to the FAA.

Co. v. Basic Constr. Co., 586 F. Supp. 964, 966 (M.D.N.C. 1982) (applying the FAA to a contract between a Virginia contractor and a North Carolina electrical subcontractor for work on a North Carolina project for which materials were ordered from out of state); Warren Bros. Co. v. Community Bldg. Corp., 386 F. Supp. 656, 664-65 (M.D.N.C. 1974) (holding that the North Carolina construction by a Georgia contractor involved commerce under the FAA because workers, materials, and surety bonds for the project came from other states).


253. *See Burke County Pub. Sch. Bd. of Educ. v. Shaver Partnership*, 279 S.E.2d 816, 818-19, 821-23 & n.12 (N.C. 1981) (applying the FAA to a contract for architectural services, suggested that the North Carolina Court of Appeals' interpretation of "involving" commerce was too restrictive and that construction contracts may involve commerce).


255. 1991 WL 170853, at *2 (this initial opinion was replaced by 590 So. 2d 218 (Ala. 1991)).

256. *H.L. Fuller Constr.*, 590 So. 2d at 219.

257. Id. at 221.

258. *See Ex parte Brice Bldg. Co.*, 607 So. 2d 132 (Ala. 1992) (holding that a construction contract involved commerce because out-of-state materials and an out-of-state subcontractor were used on the project); *Maxus, Inc. v. Sciacca*, 598 So. 2d 1376, 1379 (Ala. 1992) (holding that a contract for the construction of a house involved commerce because materials were shipped from other states; the mail system was used to send payments interstate; and the national banking system was used for holding, investing, and dispersing escrow funds).
3. Employment and Personal Service Contracts

Application of the FAA to employment contracts and personal service contracts has proven over the years to be more complicated than its application to other contracts. First, early cases held that the FAA did not apply to certain personal service contracts because they did not "involve" commerce.259 In addition, the FAA expressly excludes certain employment contracts from its coverage.260 Although the early case law and the exclusion in § 1 of the FAA stood as potential barriers to the application of the FAA to employment contracts, courts now apply the FAA to employment contracts almost as they would any other contract.

The early cases held that the FAA did not apply to certain personal service contracts, particularly contracts for the services of entertainers, because they did not "involve" commerce.261 In one of the most famous cases to take this position, Conley v. San Carlo Opera Co.,262 the Second Circuit held that a contract for the services of an opera singer did not "involve" commerce within the meaning of the FAA, even though the contract required the singer to travel and perform in several states.263 Another court held that a minor league baseball manager's contract did not "involve" commerce even though it required him to travel to several states.264

Recent cases have rejected those decisions, except perhaps as applied to baseball.265 In Erving v. Virginia Squires Basketball Club,266 for example, the Second Circuit expressly criticized its earlier decision in Conley. The court noted that Conley was based on early Supreme Court rulings that baseball is not "commerce" and thus not subject to federal regulation under Congress' commerce pow-

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262. 163 F.2d 310 (2d Cir. 1947).

263. See id.


266. 468 F.2d 1064 (2d Cir. 1972).
er.267 Later Supreme Court cases, the Second Circuit noted, have held those rulings to be "an aberration confined to baseball."268 The Second Circuit thus held that a contract to play professional basketball throughout the country "involved" interstate commerce within the meaning of the FAA.269

Even if an employment contract involves interstate commerce, the FAA still may not be applicable. Section 1 of the FAA specifically excludes from the Act's coverage "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."270 A broad interpretation of this exclusion could exclude nearly all employment contracts from the FAA's coverage. The courts have consistently construed this provision, however, to exclude from the FAA only employment contracts of workers engaged in the actual movement of goods across state lines or work closely related to that movement.271

Except for workers involved in actual interstate transportation, therefore, the FAA applies to employment contracts to the same extent as it applies to any other contract.272 Numerous cases apply the FAA to employment contracts under which the employee's duties directly involve interstate commerce.273 Courts have applied the

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268. Erving, 468 F.2d at 1069 (citing Flood v. Kuhn, 407 U.S. 258, 282 (1972)).
269. Id. at 1068-69.
271. See, e.g., Dickstein v. duPont, 443 F.2d 783, 785 (1st Cir. 1971) ("Courts have generally limited this exception to employees . . . involved in, or closely related to, the actual movement of goods in interstate commerce."); Signal-Stat Corp. v. United Elec. Radio & Mach. Workers Local 475, 235 F.2d 298, 301-03 (2d Cir. 1956), cert. denied, 354 U.S. 911 (1957); Tenney Eng'g Inc. v. United Elec. Radio & Mach. Workers Local 437, 207 F.2d 450, 452-53 (3d Cir. 1953) (holding that the exclusion applies only to those "classes of workers engaged directly in commerce, that is, only those other classes of workers who are actually engaged in the movement of interstate or foreign commerce or in work so closely related thereto as to be in practical effect part of it"); Home v. New England Patriots Football Club, Inc., 489 F. Supp. 465, 469 (D. Mass. 1980); Donmoor, Inc. v. Sturtevant, 449 So. 2d 869, 870-72 (Fla. Dist. Ct. App. 1984). For analysis of this exclusion and criticism of the courts' narrow interpretation of it, see Stempel, supra note 136.
272. See, e.g., Dickstein, 443 F.2d at 785 (holding that "the creation of an employment relationship which involves commerce is a sufficient 'transaction' to fall within section 2 of the [FAA]").
273. See Corion Corp. v. Chen, No. CIV.A. 91-11792-Y, 1991 WL 280288, at *3-4 (D. Mass. Dec. 27, 1991) (applying the FAA to an employment contract between a manufacturing manager, who resided and worked in Connecticut, and his employer, a Massachusetts corporation based in Massachusetts, partly because the employee was engaged in interstate com-
FAA regularly to employment contracts of sales representatives that require the employee to travel and make sales calls in several states,\textsuperscript{274} and to other employment contracts that require the employee to travel across state lines.\textsuperscript{275} Likewise, innumerable cases apply the FAA to employment contracts between stock brokers and securities traders and their employers.\textsuperscript{276}
At least one court has indicated that an employment contract "involves" commerce if the employer carries on interstate business operations.277 Applying the "affecting" commerce standard, the court in GAF Corp. v. Werner278 held that the FAA was applicable to a contract between GAF and the former chairman of its board of directors.279 The scope of GAF's precedential value, however, is perhaps limited, because the duties of the "employee" in that case actually touched every aspect of the company's extensive international operation. There are no reported cases addressing the application of the FAA to lower level employees who work locally for interstate companies.

In Ex parte Clements,280 a case in which the employer's interstate activities were less apparent than in GAF Corp., a different court found that the employment contract of a company vice president did not "involve" interstate commerce.281 That case concerned a stock purchase agreement. The contract provided that Communications Resources, Inc. would employ Clements as vice president and that Clements would not compete with Communications Resources within the states of Alabama, Florida, or Louisiana.282 Communications Resources sought to compel arbitration of an ensuing dispute pursuant to the FAA. The Alabama Supreme Court held that the FAA did not apply. It said:

The fact that the covenant not to compete extended to Florida

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277. See GAF Corp. v. Werner, 484 N.Y.S.2d 12, 15 (App. Div.), rev'd on other grounds, 495 N.Y.S.2d 312 (N.Y. 1985), cert. denied, 475 U.S. 1083 (1986); see also Zell v. Jacoby-Bender, Inc., 542 F.2d 34, 37 (7th Cir. 1976) (noting the interstate and international nature of the employer's business in determining that the FAA applied to the employment contract of a sales representative required to travel a nine state area).


279. Id. at 13, 15.


281. Id. at 319.

282. Id. at 318.
and Louisiana, standing alone, does not provide a sufficient nexus with interstate commerce activity. Based on the facts before us, we are compelled to conclude that the evidence in the record is not sufficient to support a finding that the agreement has a sufficient nexus with interstate commerce activity to bring the agreement within the coverage of the FAA.⁴³

4. Service Contracts

The early hesitancy of the courts to apply the FAA to personal service contracts did not stop them from applying it to other types of service contracts.⁴⁴ Courts thus regularly apply the FAA to contracts under which a business agrees to provide services in another state.⁴⁵ They also apply the FAA when the services themselves di-

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²⁸³ See Communications Resources v. Clements, 677 F.2d 318, 319 (5th Cir. 1982) (holding that it was not necessary to consider the personal jurisdiction of the defendant because the company engaged in the sale of telecommunications equipment throughout Alabama, Florida, Louisiana, and other states).

²⁸⁴ See Parsons & Whittemore, Inc. v. Rederiaktiebolaget Nordstjerman, 145 N.Y.S.2d 466, 467-68 (App. Div. 1955) (applying the FAA to a contract between a wood pulp exporter and steamship lines under which the exporter agreed to use the steamship lines exclusively in exchange for lower rates).

²⁸⁵ See Wasyl, Inc. v. First Boston Corp., 813 F.2d 1579, 1581 (9th Cir. 1987) (applying the FAA to a contract for the bank's valuation of assets located throughout the country); McGuire, Cornwell & Blakey v. Grider, 765 F. Supp. 1048, 1050 (D. Colo. 1991) (applying the FAA to an agreement between attorney and client under which they agreed to arbitrate fee disputes and claims regarding the law firm's handling of the client's matter, where it was "uncontested that the fee arrangements evidence[d] a transaction involving interstate commerce"); Realco Enterprises, Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 738 F. Supp. 515, 517 (S.D. Ga. 1990) (holding that it was sufficient to bring the agreement within the coverage of the FAA); LeJacq Publishing, Inc. v. American Soc'y of Contemporary Medicine, Surgery, and Ophthalmology, No. 88 Civ. 7242 (MUL), 1989 WL 37673, at *2 (S.D.N.Y. April 11, 1989) (applying the FAA to a contract under which a New York corporation agrees to use a printing company to publish and distribute journals for an Illinois society); Ashi Int'l, Inc. v. N.L. Indus., Inc., No. CIV.A.H-85-5775, 1987 WL 14365, at *1-2 (S.D. Tex. June 15, 1987) (holding that a contract under which plaintiff agreed to act as a Texas corporation's sales representative in India involved commerce under the FAA); Block 175 Corp. v. Falmont Hotel Mgmt. Co., 648 F. Supp. 450, 451 (D. Colo. 1986) (applying the FAA to a contract under which a Delaware corporation agrees to manage a Colorado hotel); URS Co.-Kansas City v. Titus County Hosp. Dist., 604 F. Supp. 423, 424 n.2 (W.D. Mo. 1985) (holding that a contract for architectural services between a Missouri architectural firm and a Texas hospital district relating to a hospital in Texas involved commerce under the FAA); First Citizens Mun. Corp. v. Fershing Div. of Donaldson, Luften & Jenrette Sec. Corp., 546 F. Supp. 884, 887 (N.D. Ga. 1982) (holding that a contract under which a Delaware corporation provides services to a Georgia broker-dealer in connection with the sale of municipal securities involves commerce under the FAA); Hartford Fin. Sys., Inc. v. Florida Software Serv., Inc., 550 F. Supp. 1079, 1082 (D. Me. 1982) (holding that it is undisputed...
that a contract under which a Connecticut partnership made up of Connecticut and Maryland corporations agreed to provide data processing services to a Maine corporation involved commerce under the FAA), appeal dismissed, 712 F.2d 724 (1st Cir. 1983); Wydel Assoc. v. Thermasol, Ltd., 452 F. Supp. 739, 742 (W.D. Tex. 1978) (relating to a contract between Texas and New York companies for the installation and maintenance of steam bath units); Bartell Media Corp. v. Fawcett Printing Corp., 342 F. Supp. 196, 198 (S.D.N.Y. 1972) (holding that a contract under which a Kentucky corporation printed magazine for a New York publisher involved commerce under the FAA); Aacon Auto Transp., Inc. v. Newman, 356 N.Y.S.2d 171, 172-73 (Sup. Ct. 1974) (applying the FAA to a contract to transport an automobile from the owner's home in Illinois to California); Burke County Pub. Sch. Bd. of Edu. v. Shaver Partnership, 279 S.E.2d 816, 818-19, 821-24 & n.12 (N.C. 1981) (applying the FAA to a contract whereby an architectural firm with its main office in Indiana agreed to provide architectural services in the construction of schools in North Carolina, where the principal architect resides in Indiana, most of the architectural work is done in Indiana, and engineers and materials from other states are used in the construction project); see also Ex parte Shamrock Food Serv., Inc., 514 So. 2d 921, 921 (Ala. 1987) (holding without explanation that a contract between a food service company and a college involves interstate commerce); Atlantic Painting & Contracting, Inc. v. Nashville Bridge Co., 670 S.W.2d 841, 844 (Ky. 1984) (applying the FAA to a contract to paint a bridge spanning across the Ohio River between Kentucky and Illinois). But see Action CATV, Inc. v. Wildwood Partners, Ltd., 508 So. 2d 1274, 1276 (Fla. Dist. Ct. App. 1987) (holding that the FAA does not apply to a contract between a New Jersey partnership and a Connecticut corporation under which the Connecticut corporation manages a cable television system in Florida for the partnership, because the Connecticut corporation was an assignee—not the original contracting party, and the original contract did not contemplate substantial interstate activity).

286. See Block 175 Corp., 648 F. Supp. at 451 (holding the FAA applicable to a contract to manage a hotel partly because the "hotel business is designed to accommodate interstate travellers"); Litton RCS, Inc. v. Pennsylvania Turnpike Comm'n, 376 F. Supp. 579, 585-87 (E.D. Pa. 1974) (involving a contract to develop and install toll collection equipment for the Pennsylvania turnpike), aff'd, 511 F.2d 1594 (3d Cir. 1975); Zenol, Inc. v. Carblox, Ltd., 334 F. Supp. 866, 867 (W.D. Pa. 1971) (involving a contract to act as an agent for an English manufacturer to sell its products in the United States), aff'd 474 F.2d 1398 (3d Cir. 1973); Saucy Susan Prod., Inc. v. Allied Old English, Inc., 200 F. Supp. 724, 726-27 (S.D.N.Y. 1961) (applying the FAA to a contract under which a New York corporation manufactured products for a New Jersey corporation under the latter's trademark and the products were sold in interstate commerce); Parsons & Whittmore, Inc. v. Rederikstiebolaget Nordstjerman, 141 F. Supp. 220, 224 (S.D.N.Y. 1956) (holding that a rate agreement between an American corporation and a Swedish steamship involved commerce under the FAA); Newman, 356 N.Y.S.2d at 172 (applying the FAA to a contract to transport automobile from the owner's home in Illinois to California); see also Miller v. Aacon Auto Transp., Inc., 434 F. Supp. 40, 41-43 (S.D. Fla. 1977) (holding the FAA applicable to a contract for interstate transport of an automobile but also holding the arbitration clause to be void because it was unconscionable and violated 49 U.S.C. § 20(11)-316(b) (the Interstate Commerce Act)), aff'd, 614 F.2d 292 (5th Cir.), cert. denied, 449 U.S. 918 (1980).

287. See RPJ Energy Fund Management, Inc. v. Collins, 552 F. Supp. 946, 949 (D. Minn. 1982) (the FAA applies to a contract between a Minnesota corporation and a Kentucky citizen under which the Kentucky citizen agrees to drill and operate oil and gas wells in Kentucky, where the operation required the purchase of drilling equipment outside the state and the Minnesota corporation sent personnel to Kentucky to assist in the operation).
Numerous cases, for example, apply the FAA to stockbrokers' customer agreements and other such contracts for services relating to the purchase and sale of securities on national and international exchanges.288

Significantly, the only reported cases that apply the FAA to service contracts entered by a consumer are those in which the ser-

vice relates to interstate commerce. Many of the cases applying the FAA to stockbrokers’ customer agreements involve individual investors. Likewise, at least one court has applied the FAA to a contract to transport an individual’s automobile from one state to another. No reported cases, however, address the applicability of the FAA to a contract between a business in one state to provide a local service for a consumer in another state. Such a contract appears likely to “involve” interstate commerce for purposes of the FAA, however, unless the personnel, equipment, and supplies needed to provide the service are already in the consumer’s state.

5. Business Relationship Contracts: Partnerships, Joint Ventures, and Franchise Contracts

A number of cases apply the FAA to contracts that establish ongoing business relationships. Partnership agreements, for example, “involve” commerce within the meaning of the FAA when the partners reside in different states and the partnership does business in more than one state. A partnership agreement between residents


290. See Newman, 356 N.Y.S.2d at 172 (applying the FAA to a contract for the transport of an automobile from the owner’s home in Illinois to California).

291. See Hoffelder v. Zinzow, No. 90 C 5450, 1991 WL 104178, at *2 (N.D. Ill. June 12, 1991) (applying the FAA to a partnership agreement to develop land where partners reside in Wisconsin and land is located in Illinois); Com-Tech Assocs. v. Computer Assocs. Int’l, Inc., 753 F. Supp. 1078, 1084 (E.D.N.Y. 1990) (applying the FAA to a partnership agreement to develop and market a computer tape system for IBM computers); Cohoon v. Ziman, 298 S.E.2d 729, 731 (N.C. Ct. App. 1983) (applying the FAA to a partnership agreement between a resident of North Carolina and a resident of South Carolina, where the partnership was formed as a real estate business and owned land in both North and South Carolina, the partnership agreement was signed in South Carolina, the partnership’s principal office was to be in North Carolina, all partnership funds were to be deposited in North Carolina banks, the partners traveled outside their home states on partnership business, and the partnership employed a North Carolina contractor to build one of its South Carolina shopping centers); see also Foster v. Turley, 808 F.2d 38, 40 (10th Cir. 1986) (applying the FAA to a contract for the sale, by a New Mexico resident to an Oregon resident, of an undivided one-half interest in mining claims on property in New Mexico, where the contract not only provided for interstate payments between the parties but also the development and operation of the mines and the distribution of the proceeds); Weatherly Cellaphonics Partners v. Hueber, 726 F. Supp. 319, 323 (D.D.C. 1989) (determining that when a federal agency held a lottery to distribute cellular phone markets, agreement among numerous participants in the lottery to buy and sell interests in “winning” entries involved interstate commerce); Lawn v. Franklin, 328 F. Supp. 791, 794-95 & n.2 (S.D.N.Y. 1971) (holding that a contract under which Texas residents and a New Jersey resident terminated numerous joint interstate business enterprises involved commerce under the FAA). But see Wald v. Tauber, No. CV-86-3104,
of the same state “involves” commerce when the partnership is formed to engage in activities in another state. The same rules apply to joint ventures.

Likewise, a number of cases apply the FAA to franchise contracts:

1987 WL 19425, at *2 (E.D.N.Y. Oct. 23, 1987) (holding that a partnership agreement between citizens of different states which is restricted to real estate activities in New York does not involve interstate commerce).

292. See Snyder v. Smith, 736 F.2d 409, 412, 418 (7th Cir.) (applying the FAA to a partnership agreement where the partners are both residents of Illinois, the partnership is managed from Illinois, and the partnership does its banking in Illinois; but the partnership’s business is limited to “the ownership of certain property located in . . . Texas, and to any property purchased by the partnership within one mile of that property”), cert. denied, 469 U.S. 1037 (1984); Seltzer v. Klein, No. CIV. A. 88-6737, 1989 WL 41288, at *3 (E.D. Pa. April 20, 1989) (involving a partnership to develop, construct, and manage a condominium project).

293. See Pioneer Properties, Inc. v. Martin, 557 F. Supp. 1354, 1364 (D. Kan. 1983) (applying the FAA to contracts under which a resident of Kansas purchased interests in joint ventures to develop residential real estate in Canada: “Certainly the use of plaintiff’s money to develop and manage Canadian real estate is a transaction involving commerce for purposes of . . . the [FAA]”); Masthead Mac Drilling Corp. v. Fleck, 549 F. Supp. 854, 855 (S.D.N.Y. 1982) (holding that a joint venture formed to drill for oil in Texas involved interstate commerce because some matters addressed in the agreement such as money-raising functions were to be performed in other states); Woodward Pipeline, Inc. v. Reliance Pipeline Co., 776 S.W.2d 241, 245 (Tex. Ct. App. 1989) (holding without explanation that the joint venture agreement involved interstate commerce). But see Withers-Busby Group v. Surety Indus., Inc., 538 S.W.2d 198, 199 (Tex. Civ. App. 1976) (affirming the trial court’s decision not to apply the FAA to an “Agreement to Form a Joint Venture” signed before the drafting of an actual joint venture agreement despite testimony that the parties contemplated “extensive business in the future on a nationwide scale”).

distributorship agreements,\textsuperscript{295} and agency agreements\textsuperscript{296} between entities in different states. The decision of the Washington Supreme Court in \textit{Allison v. Medicab International, Inc.}\textsuperscript{297} is typical. The plaintiff in \textit{Allison} entered a franchise agreement under which he expected to establish a business to provide transportation for the physically handicapped.\textsuperscript{298} The court held that the FAA applied to the franchise contract because "[t]he transaction involved a New York corporation and a Washington resident. Franchise payments were

to a New York franchise contract to establish "Jerry Lewis Cinemas" in designated territories in Georgia); Scanlon v. P&J Enters., Inc., 451 N.W.2d 616, 617 (Mich. App. 1990) ("Because the transfer of marketing expertise from Tennessee to Michigan through the franchise agreement is a transaction in or affecting interstate commerce, the [FAA] governs."); Downey v. Christensen, 825 P.2d 557, 559 (Mont. 1992); Sentry Sys., Inc. v. Guy, 654 P.2d 1008, 1008-09 & n.1 (Nev. 1982) (applying the FAA because a franchise agreement on its face "contemplates an on-going relationship conducting business across state lines," with a Nevada franchisee agreeing to operate a business in Nevada and pay royalties in exchange for a California corporation's agreeing to provide training, equipment, follow-up assistance, and use of its trademark); Cooper v. Computer Credit Sys., Inc., 336 N.Y.S.2d 380, 381 (App. Div. 1972) (applying the FAA to a contract between a Georgia franchisor and a New York franchisee); Allison v. Medicab Int'l, Inc., 597 P.2d 380, 382-83 (Wash. 1979); Pinkis v. Network Cinema Corp., 512 P.2d 751, 754 (Wash. Ct. App. 1973) (applying the FAA to a franchise contract under which a Delaware corporation agreed to provide a Washington franchisee with advice, training, educational materials, promotional assistance, advertising, and films).


\textsuperscript{297} 597 P.2d 380 (Wash. 1979) (en banc).

\textsuperscript{298} Id. at 380-81.
made in New York; supplies were purchased in New York for use in
the state of Washington; and performance of the agreement involved
considerable interstate travel by both parties to the contract. 299

Nearly all the reported cases, therefore, apply the FAA to con-
tracts establishing ongoing business relationships. Significantly, all of
these contracts involve either parties from different states or parties in
one state undertaking business ventures in another state. No reported
case applies the FAA to a partnership, joint venture, or franchise
agreement under which parties from the same state agree to do busi-
ness in the same state. Such a contract clearly would be subject to
the FAA if the “affecting interstate commerce” standard is used, but
the FAA might not apply if a narrower standard is used.

6. Insurance Contracts

Application of the FAA to insurance contracts is more problem-
atic than its application to other types of contracts, because it in-
volves the added consideration of the McCarran-Ferguson Act.300
The McCarran-Ferguson Act sought to perpetuate state regulation of
the insurance industry free from the impact of certain generally appli-
cable federal laws.301 To that end, it provided that: “No Act of
Congress shall be construed to invalidate, impair, or supersede any
law enacted by any State for the purpose of regulating the business
of insurance . . . unless such Act specifically relates to the business
of insurance.” 302 Even if an insurance contract involves interstate

299. Id. at 382.
301. Id. See Stephen Lamson, The Impact of the Federal Arbitration Act and the
McCarran-Ferguson Act on Uninsured Motorist Arbitration, 19 CONN. L. REV. 241, 264
(1987). The McCarran-Ferguson Act was largely a response to United States v. South-Eastern
Underwriters Ass'n, 322 U.S. 533 (1944). See id. Supreme Court cases in the nineteenth
century held in other contexts that “insurance was not commerce, interstate or otherwise.” Id.
at 256 (citing New York Life Ins. Co. v. Deer Lodge County, 231 U.S. 495, 510 (1913);
Hooper v. California, 155 U.S. 648, 654-55 (1895); Paul v. Virginia, 75 U.S. (8 Wall.) 168,
183 (1868)). It was thus unclear for many years whether Congress had the power to regulate
the insurance industry under its commerce power. In South-Eastern Underwriters, however,
the “Court, in broad language, rejected any idea that the business of insurance was not com-
merce.” Id. at 257. South-Eastern Underwriters thus cleared the way for application of the
FAA and other federal statutes to the insurance industry. See, e.g., Hart v. Orion Ins. Co.,
453 F.2d 1358, 1360 (10th Cir. 1971). But see Booth v. Seaboard Fire & Marine Ins. Co.,
285 F. Supp. 920, 925 (D. Neb. 1968) (holding that the South-Eastern Underwriters case
does not hold that individual insurance contracts are commerce), modified, 431 F.2d 212 (8th
Cir. 1970). Congress responded with the McCarran-Ferguson Act to limit the applicability of
federal statutes to the insurance industry. Lamson, supra, at 264.
commerce, therefore, the McCarran-Ferguson Act can preclude applica-
tion of the FAA.

Under the McCarran-Ferguson Act, the FAA applies to insurance
contracts only if its application will not impair state laws enacted to
regulate the business of insurance.\(^3\)\(^0\) Agreements by insurance com-
panies to arbitrate disputes—especially agreements with customers to
arbitrate disputes relating to insurance coverage—probably constitute
"the business of insurance" within the meaning of the McCarran-
Ferguson Act.\(^3\)\(^0\) Consequentiy, the applicability of the FAA to in-
surance contracts will depend on relevant state law "regulating the
business of insurance" and the extent to which the FAA impairs such
laws.\(^3\)\(^0\)

State insurance laws that specifically regulate arbitration agree-
ments in insurance contracts and arbitration of insurance disputes\(^3\)\(^0\)6
supersede the FAA regardless of whether they are generally consistent
or inconsistent with it.\(^3\)\(^0\)7 Likewise, state laws that specifically re-
quire judicial determination of certain disputes relating to insurance
companies preclude arbitration of those disputes under the FAA.\(^3\)\(^0\)8

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303. See id; Lamson, supra note 301, at 264. Professor Lamson summarizes the operation
of the McCarran-Ferguson Act as follows:

In order to establish that an activity is exempt from a particular federal law [under
that Act], one must demonstrate three things: (1) that the federal law in question
does not specifically relate to the business of insurance; (2) that the activity in
question is the "business of insurance"; and (3) that application of federal law
would invalidate, impair or supersede state regulation of the activity.

Id. at 264-65. The FAA clearly does not specifically regulate the business of insurance. The
Impact of the McCarran-Ferguson Act on the FAA thus depends on the latter two issues. See id.
at 265.

304. See Lamson, supra note 301, at 264-70. Professor Lamson notes that "no cases . . .
hold that arbitration of claims is or is not the business of insurance." Id. at 265. He further
points out that a series of Supreme Court cases has narrowed the meaning of "business of
insurance" as used in the McCarran-Ferguson Act. Id. at 265-70 (discussing the cases). He
nonetheless concludes that "contractual arbitration of insurance claims indeed appears to be
the 'business of insurance.'" Id. at 270.

305. See id. at 270 & nn.147-48.

306. For a sampling of state arbitration laws relating to insurance contracts, see infra
notes 311-12. For a comprehensive review of state statutory treatment of arbitration provisions
in insurance contracts, see Lamson, supra note 301, at 248-51.

307. See Nationwide Mut. Ins. Co. v. Patterson, CIV. A. No. 89-8796, 1991 WL 96677,
at *2-3 (E.D. Pa. May 28, 1991), aff'd, 953 F.2d 44 (3d Cir. 1991); Lamson, supra note
301, at 271-72 and authorities cited therein.

308. See Washburn v. Corcoran, 643 F. Supp. 554, 556 (S.D.N.Y 1986) (holding that a
statute granting exclusive jurisdiction over the liquidation of insurance companies to the New
York Supreme Court is a law regulating the business of insurance and the McCarran-
Ferguson Act precludes application of the FAA to remove claims involving insolvent insurers
from that court); In re Union Indem. Ins. Co., 521 N.Y.S.2d 617, 619-21 (Sup. Ct. 1987)
The extent to which general state arbitration laws supersede the FAA under the McCarran-Ferguson Act depends on the language and specificity of the state laws. General state arbitration laws that do not mention insurance contracts specifically were not "enacted . . . for the purpose of regulating the business of insurance," and consequently, they do not supersede the FAA even if they conflict with it.

A number of state arbitration laws do address insurance contracts specifically. Frequently, however, these statutes simply exempt insurance contracts from the operation of the larger state arbitration statute which makes arbitration agreements generally enforceable. (holding that a statute which sets forth procedures for liquidation and dissolution of insurance companies and which gives liquidation court exclusive jurisdiction of all claims involving the insolvent insurer is a "state law regulating the business of insurance" under the McCarran-Ferguson Act, and thus precludes application of the FAA to enforce arbitration agreements against the insolvent insurer).

310. See Hart v. Orion Ins. Co., 453 F.2d 1358, 1360 (10th Cir. 1971); Hamilton Life Ins. Co. v. Republic Nat'l Life Ins. Co., 408 F.2d 606, 611 (2d Cir. 1969) (applying the FAA because "[i]t is quite plain that arbitration statutes, including those of Texas and New York, are not statutes regulating the business of insurance, but statutes regulating the method of handling contract disputes generally"). Even state arbitration statutes that preclude arbitration of personal injury claims or preclude enforcement of arbitration provisions in adhesion contracts do not specifically regulate insurance, and thus probably do not prevent application of the FAA to insurance contracts. See Lamson, supra note 301, at 274-75. For a review of the exceptions contained in state arbitration statutes, see supra note 98.
311. See, e.g., CAL. INS. CODE § 11580.2(f) (West 1972) (requiring the inclusion of an arbitration provision in uninsured motorist policies); CONN. GEN. STAT. § 38a-336(c) (1992) (providing for arbitration of insurance coverage disputes); ILL. REV. STAT. ch. 73, ¶ 755a(1) (Supp. 1992) (requiring inclusion of arbitration provision in uninsured motorist coverage); KY. REV. STAT. ANN. § 304.20-050 (Michie/Bobbs-Merrill 1988) (requiring that agreements to arbitrate future disputes contained in automobile insurance policy not be binding on named insured or any person claiming under him); MASS. GEN. L. ch. 175, § 111(D) (1987) (requiring inclusion of arbitration provision in uninsured motorist coverage); OR. REV. STAT. § 742.504(1)(a) (1991) (requiring inclusion of arbitration provision in uninsured motorist coverage); VA. CODE ANN. § 38.2-2206H (Michie 1990) (prohibiting provisions that require the insured to arbitrate uninsured motorist claims). For a comprehensive review of state statutory treatment of arbitration provisions in insurance contracts, see Lamson, supra note 301, at 248-51.
312. See ARK. CODE ANN. § 16-108-201 (Michie 1987) (excluding claims by "any insured or beneficiary under any insurance policy or annuity contract"); GA. CODE ANN. § 9-9-2 (6) (Cum. Supp. 1991) (excluding arbitration agreements relating to contracts of insurance); KAN. STAT. ANN. § 5-401(b)(1) (Supp. 1982) (excluding contracts of insurance); KY. REV. STAT. ANN. § 417.050(2) (Michie/Bobbs-Merrill 1992) (excluding insurance contracts); MO. REV. STAT. § 435.350 (1992) (excluding enforcement of agreements to arbitrate future disputes contained in insurance contracts); MONT. CODE ANN. § 27-5-114 (1979) (excluding enforcement of agreements to arbitrate future disputes contained in insurance contracts); NEB. REV. STAT. § 25-2602 (1989) (excluding enforcement of agreements to arbitrate future disputes contained in adhesion contracts such as insurance contracts); R.I. GEN. LAWS § 10-3-
This exemption from the operation of a generally applicable state statute is scant basis on which to characterize the provision as a law regulating the business of insurance. It does not regulate insurance arbitration so much as leave it unregulated. Nonetheless, since state arbitration statutes usually were passed to reverse common law refusal to enforce arbitration agreements,

an explicit exclusion of insurance contracts from the effect of such statutes indicates a legislative determination that such agreements are unenforceable as a matter of public policy. Thus, it is reasonable to conclude that such a statute constitutes state regulation of the business of insurance which . . . would be . . . impaired . . . by application of the [FAA].

No reported cases, however, have addressed the effect of such statutes on the application of the FAA.

If state insurance laws do not preclude application of the FAA under the McCarran-Ferguson Act, of course, the FAA still applies to insurance contracts only if they “involve” interstate commerce. Cases applying the FAA’s interstate commerce requirement to insurance contracts are few. Several cases apply the FAA to reinsurance contracts between insurance companies. Most of these cases concern agreements between companies in different states, and the courts thus

2 (1985) (enforcing arbitration agreements in insurance contracts against the insured only if the arbitration provision is placed immediately above the testimonium clause or the parties’ signatures); S.C. CODE ANN. § 15-48-10 (Law. Co-op. 1978) (excluding “any insured . . . under any insurance policy” from coverage of arbitration statute).

313. Lamson, supra note 301, at 273-74.

314. See Mutual Reinsurance Bureau v. Great Plains Mut. Ins. Co., Inc., 750 F. Supp. 455, 459-60 (D. Kan. 1990) (defendant argued that the FAA was inapplicable under the McCarran-Ferguson Act because Kansas excluded contracts of insurance from its arbitration statute; after reviewing cases addressing the interplay between the McCarran-Ferguson Act and the FAA, the court avoided the issue by holding that the exclusion in the Kansas arbitration statute did not apply to a reinsurance agreement), rev’d, 969 F.2d 931 (10th Cir.), cert. denied, 113 S. Ct. 604 (1992).

find interstate commerce on that basis.\textsuperscript{316} Some courts also rely on
the fact that some of the insurance policies underlying the reinsurance
agreement were negotiated in more than one state.\textsuperscript{317} Two courts
even suggest that "the fact that the agreement involved insurance may
be enough to establish the interstate commerce connection."\textsuperscript{318}

Cases addressing the application of the FAA to individual insurance
contracts, meanwhile, conflict. Several cases apply the FAA to
individual insurance contracts in which an insurance company issued
a policy to a resident of another state.\textsuperscript{319} One case,\textsuperscript{320} Downing \textit{v.}
\textit{Allstate Insurance Co.},\textsuperscript{321} held the FAA inapplicable to an automo-
bile insurance contract and the arbitration proceedings instituted to
settle a claim on it. Without saying specifically whether the policy
was issued in the insured's home state, the court in \textit{Downing} stated
that the FAA applies only to contracts "evidencing a transaction in-
volving [interstate] commerce." The contract involved in this case
does not evidence such a transaction. Every event relevant to this
case took place in Michigan.\textsuperscript{322}

No reported cases address the applicability of the FAA to indi-
vidual "insurance contract[s] issued to a resident of the same state in
which the insurance company has its principal place of business."\textsuperscript{323}

\begin{itemize}
\item 316. \textit{See Mutual Reinsurance Bureau}, 750 F. Supp. at 462-63; Colonial Penn Ins. Co. \textit{v.}
(S.D.N.Y. 1968), aff'd, 408 F.2d 606 (2d Cir. 1969).

at 55.

\item 318. \textit{Mutual Reinsurance Bureau}, 750 F. Supp. at 462-63; see also \textit{Ainsworth}, 634 F. Supp.
at 55.

\item 319. \textit{See Miller v. National Fidelity Life Ins. Co.}, 588 F.2d 185 (5th Cir. 1979); Hart \textit{v.}
Orion Ins. Co., 453 F.2d 1358, 1360 (10th Cir. 1971) (applying the FAA to an occupational
disability insurance policy where the insured applied for the insurance in Montana, the insurer
accepted the policy in Illinois, and the insurer delivered the policy to the insured in Mont-
1976) (applying the FAA to a contract to insure business assets in Chile without discussing
the commerce issue); Lamson, \textit{supra} note 301, at 260-61; see also \textit{Nationwide Mut. Ins. Co.}
(describing that an automobile insurance contract between a Pennsylvania resident and an Ohio
insurer involved commerce under the FAA, but pursuant to the McCarran-Ferguson Act, the
FAA did not apply), aff'd, 953 F.2d 44 (3d Cir. 1991).

1984).

\item 321. \textit{Id.} at 141 (alteration in original) (citing 9 U.S.C. § 2).

\item 322. Lamson, \textit{supra} note 301, at 261.
\end{itemize}
Again, the FAA likely applies to such contracts if the broad "affecting" commerce standard applies in FAA cases, but its applicability is less certain if narrower standards apply.

7. Contracts for the Sale or Lease of Land, Interests in Land, and Fixtures

The sale of land or an interest in land would seem to be an essentially local transaction, especially when all parties to the transfer reside in the state where the land is located. Such transactions in land presumably "affect" interstate commerce, but reasonable arguments can be made that they do not "involve" interstate commerce if narrower interpretations are applied. Cases addressing the applicability of the FAA to land transactions are rare, and the few cases that address the issue conflict.

Several courts have held that transactions conveying interests in land do not involve commerce under the FAA. Even when the transaction contains some interstate elements, several courts still have held the FAA inapplicable. One court, for example, held that a contract granting an easement to a pipeline company did not involve interstate commerce. Another held that a surface mining lease between citizens of different states which required interstate lease payments did not involve interstate commerce.

In Riverfront Properties, Ltd. v. Max Factor III, the court held that the FAA did not apply to an agreement between joint owners of property to use the property as security for a loan. The proper-

323. See id. at 261-62.
324. Automobile insurance contracts and other types of insurance that provide coverage even when the insured person or property is in another state might "involve" commerce under any standard.
325. See Riess v. Murchison, 329 F.2d 635, 644 (9th Cir. 1964) (holding that a contract for the sale of land does not involve commerce under FAA), cert. denied, 383 U.S. 946 (1966). But see Berhorst v. J.L. Mason of Mo., Inc., 764 S.W.2d 659, 661 (Mo. Ct. App. 1988) (applying that FAA where one of the parties initially argued that the FAA did not apply to the sale of a house, but where the parties later agreed that the contract involved commerce and that the FAA applied).
ty in that case was located in Florida, and the contract was between the owners, who resided in California. The agreement provided that the land in question would be used to secure a four million dollar loan from a bank in Florida. It further provided that the loan proceeds would be disbursed in California, and it required that payments on the loan be made to the Florida bank. The court nonetheless concluded that the agreement, as distinguished from the loan transaction with the bank, did “not contemplate substantial interstate activity.”

While it recognized that the agreement contemplated some interstate activity, it said that the “agreement, considered in its entirety, does not evince the degree of interstate activity necessary to invoke the [FAA].”

Other cases, meanwhile, have applied the FAA to a variety of transactions in land and fixtures. Several courts have suggested that “[a]rbitration provisions in leases of real property are enforceable under the [FAA] if the leases’ purpose is to either generate or affect activity in interstate commerce.” Courts have thus applied the FAA to shopping mall leases, contracts granting easements for pipelines, contracts for the purchase of fast food stores, mining leases, and contracts for the joint use of utility poles.

329. Prior to the litigation, the Florida bank was acquired by a bank based in North Carolina.

330. Riverfront Properties, 460 So. 2d at 953.

331. Id. at 954; see also Wald v. Tauber, No. CV-86-3104, 1987 WL 19425, at *2 (E.D.N.Y. Oct. 23, 1987) (holding that a partnership agreement between citizens of different states which is restricted to real estate activities in New York does not involve interstate commerce).

332. Kodak Mining Co. v. Cars Fork Corp., 669 S.W.2d 917, 920 (Ky. 1984).

333. See Fairchild & Co. v. Richmond, F.&P. R.R. Co., 516 F. Supp. 1305, 1311-12 (D.D.C. 1981) (applying the FAA to a contract under which a D.C. corporation leased land in Virginia from a Virginia corporation because (i) the lease contemplated extensive commercial development serving the interstate metropolitan D.C. area; (ii) the lease contemplated a construction project that required interstate movement of materials and personnel; (iii) the lease was executed subject to proposals by public authorities for construction of interstate mass transit facilities; and (iv) the lease contained provisions requiring the lessee to maintain easements for the operation of the lessor’s interstate railroad).


335. See Neal v. Hardee’s Food Sys., Inc., 918 F.2d 34 (5th Cir. 1990) (applying the FAA, the court construed an arbitration agreement in a franchise licensing contract to include disputes arising from a separate purchase agreement under which the franchisee purchased the land, buildings, and personal property that comprised six fast food stores).

336. See Kodak Mining Co., 669 S.W.2d at 920 (applying the FAA to coal mining lease
Again, the applicability depends on whether the court construes the FAA to exercise the full extent of Congress’s commerce power or only some portion of that power.338

8. Corporate Acquisition Agreements

The applicability of the FAA has arisen in relatively few contracts for the sale of corporations or corporate assets, but all reported cases apply the FAA. Two cases held that the sale of a corporation or its assets involves interstate commerce when the corporation itself is engaged in interstate commerce.339 Likewise, a court applied the FAA to a corporate acquisition contract between citizens of different states.340 There apparently are no reported cases addressing the applicability of the FAA to the sale of a local business between citizens of the same state.

because “mining activity amounts to transactions in interstate commerce” even if the coal is “mined and sold entirely intrastate”; see also Foster v. Turley, 808 F.2d 38, 40 (10th Cir. 1986) (holding that the FAA applies to the sale of an undivided one-half interest in mining claims where the parties reside in different states and the sales contract also provided for the development and operation of the claims and disbursement of the proceeds). The court in Foster summarized the interstate activity as follows:

The agreement required Foster [the Oregon resident] to make a substantial down payment to Turley [the New Mexico resident], and required Turley to remit proceeds from the mining operation to Foster. Some ore from the mines was milled at facilities outside the state of New Mexico and the parties attempted to market their product all over the country. At one point Foster sent truck transportation from Oregon to haul the ore from the mines. In view of the interstate payments between the parties and the interstate nature of the production and marketing involved, we conclude that the agreement here is clearly within the ambit of the [FAA].

Id. at 40. But see A.J. Taft Coal Co. v. Randolph, 602 So. 2d 395, 397 (Ala. 1992) (holding that a lease of surface mining rights did not involve commerce even though parties were from different states and payments were to be mailed interstate).

337. See Southern Bell Tel. & Tel. Co. v. Louisiana Power & Light Co., 221 F. Supp. 364, 367-68 (D. La. 1963) (holding that the FAA applies to a contract for the joint use of utility poles because one of the parties has extensive interstate operations).


9. Loan Agreements

Litigants have disputed the applicability of the FAA in relatively few reported cases concerning loan agreements. The FAA certainly applies to loan agreements between citizens of different states. It also applies to loans that fund interstate commercial projects. No reported cases address the applicability of the FAA to consumer loans transacted between citizens of the same state.

IV. COMMENTARY ON EXISTING CASE LAW AND A PROPOSAL FOR CHANGE

A. Problems with the Existing Case Law

As the foregoing survey demonstrates, case law on the FAA's commerce requirement is ambiguous and erratic. Most courts—particularly federal courts—apply the FAA expansively to all transactions that "affect" interstate commerce. Even courts that do not expressly apply that standard generally give the Act broad application. Such expansive application of the FAA sweeps away huge bodies of state arbitration law, including state arbitration statutes enacted in the last several years.

Neither the Supreme Court nor Congress, meanwhile,


343. Georgia enacted the Georgia Arbitration Code, for example, in 1988. See GA. CODE ANN. §§ 9-9-1 to 9-9-3 (Cum. Supp. 1992). It made arbitration agreements generally enforceable, but it excepted a number of different types of contracts and disputes that the Georgia legislature apparently believed should not be arbitrable. See supra notes 95-97 and accompanying text (discussing GA. CODE ANN. § 9-9-2). The statute and its exceptions would be meaningless if the FAA broadly applies to all contracts and transactions "affecting" interstate commerce. Consumer financing agreements, contracts for the purchase of consumer goods, contracts relating to the purchase and financing of residential real estate, and probably even agreements to arbitrate future tort claims—all of which the Georgia Code excludes from arbitration—"affect" interstate commerce and would be arbitrable under the FAA if that standard applies.

344. See supra notes 146-64 and accompanying text.

345. The FAA's use of the "involving commerce" language rather than the usual "affecting commerce" language suggests a narrower scope of application for the FAA. See THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 950 (3d ed. 1992). It defines "involve" as follows: "To contain as a part; include." It defines "affect" as follows: "To have
have given clear authority for such complete displacement of state law. A number of courts thus construe the FAA's applicability less broadly, with some articulating standards to determine its applicability.346 The enactment of state arbitration statutes, many in the past several years, indicates that many state legislatures likewise perceive the scope of the FAA's applicability to be more limited than that of most federal commerce legislation.347

The existence of these conflicting approaches to the FAA, and the unpredictability of the interstate commerce inquiry, frustrate the central policy of the statute, i.e., to provide an expeditious and efficient extra-judicial process for settling disputes with minimal judicial involvement.348 Conflicting interpretations of the FAA's commerce requirement create doubt about the Act's applicability to a particular contract or transaction. This uncertainty is compounded by the fact-based nature of the "involving" commerce inquiry, which often requires case-by-case evaluation.349 The uncertainty and unpredictability of the FAA's applicability in turn spurs litigation over the FAA's applicability, whenever a party to an arbitration agreement wants to avoid arbitration or decides that state law is more favorable to his or her case. This litigation, moreover, can only increase as the federal courts expand the federal common law of arbitration that accompanies the FAA,350 thereby increasing the differences between federal and

an influence on or effect a change in." Id. at 29. More importantly, the legislative history of the FAA reveals no indication that Congress intended to supplant state arbitration law nor even an awareness that state law would be affected. See Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 386 (2d Cir.) (Lumbard, J., concurring), cert. denied, 368 U.S. 817 (1961); Atwood, supra note 8, at 79; Hirshman, supra note 4, at 1315 ("Little emerges from the legislative history other than unhappiness with prior law ... ."); 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, 863 (1960); see also authorities cited supra in note 34. Furthermore, contemporary commentators did not perceive an intent to affect state law. See supra note 34.

346. See supra notes 176-206 and accompanying text.

347. Many states include in their arbitration statutes provisions which are meaningless if the FAA applies to all transactions "affecting" interstate commerce. Some state arbitration statutes, for example, preclude the enforcement of arbitration agreements in consumer transactions. See supra note 97. The FAA would preempt these and similar state provisions if the FAA's commerce requirement is interpreted expansively, because consumer transactions "affect" interstate commerce under modern interpretations of the commerce power.

348. Judge Lumbard articulated this purpose of the FAA in Metro Industrial, 287 F.2d at 387 (Lumbard, J., concurring).


350. For a discussion of this expanding federal common law of arbitration, see supra part I.E.
In order to fulfill the FAA’s goal of providing expeditious enforcement of arbitration agreements, a predictable “bright line” rule is needed for determining when a transaction “involves” interstate commerce. This rule must come from the United States Supreme Court or Congress. Even a consensus among the federal courts of appeal would likely be insufficient. Since the FAA does not create federal jurisdiction, numerous FAA cases are heard in state courts. The cases in state court, moreover, are the ones most likely to create litigation over the FAA’s applicability, since they typically involve citizens of the same state or small transactions. In the absence of Supreme Court precedent on the issue, state courts apparently perceive themselves free to pursue their own theories of the FAA’s applicability.

B. Possible Judicial Solutions

The Supreme Court could partially solve the problem by definitively adopting one of the existing standards for applying the FAA’s commerce requirement or articulating a new intermediate standard. Application of a uniform standard would certainly reduce the uncertainty and thus the litigation concerning the Act’s applicability. The existing standards, as well as likely new standards, however, are all problematic.

The Court could adopt Judge Lumbard’s “contemplation of substantial interstate activity” test. This test, however, is unpredictable and thus invites litigation. Not only are inquiries into the parties’ state of mind necessarily ambiguous, but they also entail the use of evidence other than the contract itself. In addition to the terms of the contract, parties can introduce “evidence as to how the parties expect-

351. For a discussion of the many differences between federal and state arbitration law, see supra part II.


353. If they involved citizens of different states and sums in excess of $50,000, of course, these cases likely would find their way into federal court on diversity jurisdiction. Substantial contracts between citizens of different states likely involve interstate commerce even under narrower interpretations of the FAA.

354. Under that test, the court inquires “whether, at the time [the parties] entered into [a contract containing an arbitration provision], they contemplated substantial interstate activity.” Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 387 (2d Cir.) (Lumbard, J., concurring), cert. denied, 368 U.S. 817 (1961). If they did, then the FAA applies. For a discussion of Judge Lumbard’s test and a review of its application and adoption by other courts, see supra notes 175-200 and accompanying text.
This test thus invites conflicting, self-serving testimony about the parties' expectations, which requires a factual hearing to resolve. Moreover, once the court determines that the parties contemplated interstate activity, the court still must make the ambiguous determination whether the contemplated interstate activity was sufficiently "substantially" to invoke the FAA. Courts have reached widely varying conclusions on this issue. Judge Lumbard's test is also troublesome because it is not securely grounded in the language of the FAA. He fashioned the test to inquire into the parties' state of mind because the purpose of the FAA is to give effect to the parties' contractual intent expressed in arbitration provisions. Just because the FAA seeks to give effect to the parties' intent to arbitrate, however, does not mean that the applicability of the FAA should also depend on the parties' expectations. Parties to contracts likely do not think about whether a contract entails interstate or intrastate activity. They think about obtaining an advantageous exchange. Surely the federal policy of enforcing arbitration agreements relating to interstate commerce should not be frustrated just because of the parties' subjective failure to perceive the interstate aspects of the transaction.

Given the difficulties with Judge Lumbard's test, the Court could opt for a more objective standard. Such a standard could take one of two forms: (1) it could inquire whether the performance of the contract at issue actually entailed substantial interstate activity; or (2) it could inquire whether, at the time the contract was entered, a reasonable person would have expected the contract to entail substantial interstate activity.

These options, however, have their own problems. The first option is unfair because it would allow one party to control the choice of law. Even if performance of a contract did not require interstate activity, a party could unilaterally engage in interstate activity in performing his or her duties under the contract, thereby invok-

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355. Metro Indus., 287 F.2d at 387.
356. See authorities cited supra note 200.
357. Metro Indus., 287 F.2d at 386-87.
358. See C.P. Robinson Constr. Co. v. National Corp. for Hous. Partnerships, 375 F. Supp. 446, 450 (M.D.N.C. 1974) ("[S]ubjective intent of the parties [entering into an agreement containing an arbitration clause] is not controlling in determining if the agreement objectively evidences a transaction involving commerce, but it is illuminating as to how the parties interpreted their own contract.").
ing the FAA. Option (2), the reasonable person standard, would be more equitable, and it is more securely rooted in the language of the FAA. Neither of these tests, however, provide the predictability needed to discourage litigation concerning the applicability of the FAA. They are still fact-based standards that would require an independent determination in every close case. Therefore, they would not significantly further the FAA’s goal of expeditiously enforcing arbitration agreements.

Finally, the Court could adopt the “affecting” interstate commerce test or some similarly expansive standard. Such an expansive standard would provide the predictability needed to accomplish the FAA’s efficiency goal. As indicated by the courts’ decisions on Congress’s commerce power in other contexts, every transaction (or nearly every transaction) affects interstate commerce. Universal application of this standard in FAA cases, therefore, would result in the FAA’s clear applicability to every commercial contract and transaction and perhaps even every contract and transaction. Application of this standard would thus discourage litigation of the Act’s applicability. If the issue were raised, it could in most cases be easily determined in minimal time.

The “affecting commerce” standard, however, has other problems. First, application of the “affecting commerce” standard arguably would require overruling Bernhardt. The contract in that case on its face contemplated Bernhardt’s moving from New York to Vermont to be the superintendent of a factory there. Although the Court stated in Bernhardt that “[t]here was no showing that the petitioner . . . was engaging in activity that affected commerce,” it is hard to perceive the contract as not affecting commerce under modern notions of the commerce power or even those of 1956. Second, application of the “affecting commerce” standard would displace the extensive body of state arbitration law. Such extensive preemption of state law should come from Congress with some clarity. As noted

359. For a discussion of the Supreme Court’s ruling in Bernhardt, see supra notes 149-51 and accompanying text.
362. See Wickard v. Filburn, 317 U.S. 111 (1942) (upholding an application of federal quotas to a small amount of wheat that a farmer grew on his own land to be consumed on his own farm, because it affected interstate commerce).
above, however, the FAA does not evince any congressional intent to affect state law, much less an intent to displace a substantial body of state contract law.364 Last, and perhaps most important, this complete preemption of state arbitration law would sweep aside the widespread concerns of state legislatures about the use of arbitration in such contexts as personal injury claims, consumer contracts, and adhesion contracts. Many state statutes that provide for the enforcement of arbitration agreements expressly do not apply to one or more of these types of contracts or disputes.365 Regardless of the source or the wisdom of these exceptions, these statutes embody the policy decision of state legislatures that while arbitration agreements generally should be enforced, their enforcement in certain contexts carries certain dangers and evils. In enacting the FAA, Congress did not consider the problems that are peculiar to arbitration agreements in these contexts. Congress enacted the FAA in 1926, apparently expecting it to apply only in federal court.366 Consumer disputes (and other disputes that are the subject of special consideration in state arbitration statutes) were unlikely to find their way to federal court in 1926, because they seldom involved citizens of more than one state and they usually did not meet the requisite amount in controversy. Indeed, Congress may have considered such disputes beyond its commerce power in 1925. Although these state statutes are preempted by the FAA now when the transaction entails interstate activity, judicial application of the “affecting commerce” standard would remove the only legislative treatment of these policy concerns.

C. A Legislative Solution

The best way to provide the predictability needed for expeditious enforcement of arbitration agreements while at the same time addressing the perceived problems of arbitrating tort claims, consumer disputes and other areas of special state concern is for Congress to amend the FAA. First, Congress should amend § 2 of the Act to make it applicable to all transactions “affecting commerce.” Second, it should expressly exclude from the Act’s coverage those disputes or subjects that it concludes should be decided judicially. Last, it should expressly exclude the disputes and subjects it concludes should be left

364. See supra note 345.
365. See supra notes 97-98.
366. See supra note 34.
for state regulation.

By adopting the "affecting commerce" language, Congress would make clear that the FAA applies to all contracts and transactions. In light of the courts' liberal interpretation of that phrase in the past, there would be no doubt about the intended scope of the Act's applicability. This amendment would thus end much of the current litigation about the FAA's applicability.

While making this change, Congress could consider the need for special provisions relating to arbitration of certain kinds of disputes. It could consider the need perceived by many state legislatures, for example, for special notice provisions to apply to arbitration provisions in consumer contracts or adhesion contracts. It could consider the merit of precluding enforcement of agreements to arbitrate tort or personal injury claims arising after execution of the agreement.

Finally, Congress could leave certain decisions concerning arbitration to the states. It could provide that the broadly applicable FAA does not apply to such areas of traditional state concern as divorce, child custody, and support agreements. Alternatively, it could provide that the FAA governs those areas as it does any other contract or transaction, unless the state whose substantive law governs the dispute specifically precludes or regulates arbitration of those designated types of disputes. It could do the same with consumer contracts, adhesion contracts, and contracts for arbitration of tort claims.

Regardless of whether Congress deems such special provisions necessary, a well-drafted amendment would make the applicability of the FAA more certain, while assuring that these policy concerns receive attention before being swept aside. Congress apparently did not consider these issues before enacting the FAA in its current version. Consequently, expansive judicial interpretation of the FAA—while perhaps justified by the statute's judicial history and beneficial to the FAA's goal of expeditious arbitration enforcement—would preempt state laws that address these issues without the issues having been considered at the federal level. Federal lawmakers should at least consider the issues before federal law sweeps away state legislation addressing them.

367. For state legislation on this point, see supra notes 97-98, 102-04.
368. For state legislation on this point, see supra notes 97-98.