

# FEDERAL ARBITRATION ACT PREEMPTION

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## INTRODUCTION

Courts are now facing the second generation of Federal Arbitration Act (“FAA”)<sup>1</sup> preemption cases. “First generation” cases of FAA preemption involve state laws that invalidate parties’ agreements to arbitrate. Courts now routinely hold

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1. 9 U.S.C. §§ 1-16 (2000). These sections comprise Chapter 1 of the FAA, which deals primarily with domestic arbitration. Chapters 2 and 3 of the FAA apply to international arbitration. *See id.* §§ 201-208, 301-307. My focus here is on domestic arbitration and hence Chapter 1.

such laws preempted,<sup>2</sup> as required by a line of Supreme Court cases dating from *Southland Corp. v. Keating*.<sup>3</sup> With those efforts to restrict the ongoing “consumerization”<sup>4</sup> of arbitration stymied,<sup>5</sup> state legislatures have begun adopting laws that modify the parties’ arbitration agreement rather than invalidating it, regulating the arbitration process rather than the parties’ obligation to arbitrate.<sup>6</sup> California, for example, now requires extensive disclosures by neutral arbitrators of

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2. A recent sampling of cases includes: *Brayman Constr. Co. v. Home Ins. Co.*, 319 F.3d 622, 627 (3rd Cir. 2003) (holding that FAA preempts Pennsylvania rule precluding arbitration of bad faith claims against insurance companies); *Adkins v. Labor Ready, Inc.*, 303 F.3d 496, 506 (4th Cir. 2002) (holding that FAA preempts West Virginia rule precluding arbitration of state human rights claims); *Pine Ridge Coal Co. v. Loftis*, 271 F. Supp. 2d 905, 909 (S.D. W. Va. 2003) (holding that FAA preempts West Virginia law requiring courts rather than arbitrators to adjudicate worker’s compensation claims); *Central Reserve Life Ins. Co. v. Fox*, No. 1011121, 2003 Ala. LEXIS 193, at \* 6 (Ala. June 27, 2003) (holding that FAA preempts Alabama statute precluding specific enforcement of pre-dispute arbitration clause); *Gayfer Montgomery Fair, Inc. v. Austin*, No. 1012159, 2003 Ala. LEXIS 205, at \*26 (Ala. June 27, 2003) (same); *Heaberlin Farms, Inc. v. IGA Ins. Co.*, 641 N.W.2d 816, 819 (Iowa 2002) (holding that FAA preempts Iowa law precluding enforcement of arbitration clauses in adhesion contracts); *Abela v. Gen. Motors Corp.*, 669 N.W.2d 271, 278 (Mich. Ct. App. 2003) (holding that FAA preempts Michigan law precluding arbitration of state lemon law claims); *McMillan v. Gold Kist, Inc.*, 577 S.E.2d 482, 486 (S.C. Ct. App. 2003) (holding that FAA preempts South Carolina law requiring conspicuous notice of arbitration clause); *Blanton v. Stathos*, 570 S.E.2d 565, 568 (S.C. Ct. App. 2002) (same).

3. 465 U.S. 1 (1984); *see also* *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681 (1996); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995); *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995); *Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468 (1989); *Perry v. Thomas*, 482 U.S. 483 (1987). Despite the passage of time and the Supreme Court’s reaffirmance of *Southland* in *Allied-Bruce*, 513 U.S. at 272-73, *Southland*’s holding that the FAA applies in state court remains controversial. *See infra* text accompanying notes 56-58.

4. *See* Thomas J. Stipanowich, *Punitive Damages and the Consumerization of Arbitration*, 92 NW. U. L. REV. 1, 9 (1997); Thomas J. Stipanowich, *The Growing Debate Over ‘Consumerized’ Arbitration: Adding Cole to the Fire*, DISP. RESOL. MAG., Summer 1997, at 20. *Southland* also contributed to the consumerization of arbitration in the first place by removing state law restrictions on pre-dispute arbitration clauses in consumer and employment contracts. *See Southland*, 465 U.S. at 14-16.

5. Congress, of course, can override the FAA and make pre-dispute arbitration agreements unenforceable, although to date it has done so only rarely. *See* 15 U.S.C.S. § 1226(a)(2) (Law. Co-op. Supp. 2003) (making pre-dispute arbitration clauses in motor vehicle franchise agreements unenforceable).

6. State laws precluding the use of pre-dispute arbitration clauses for certain types of claims or certain types of parties continue to apply (i.e., are not preempted) to arbitration agreements not subject to the FAA. Some state courts have construed the scope of the FAA (which applies to any “contract evidencing a transaction involving commerce,” 9 U.S.C. § 2 (2000)) unduly narrowly so as to preserve a wider scope for state arbitration law, prompting Supreme Court intervention. *See* *Citizens Bank v. Alafabco*, 123 S. Ct. 2037, 2041 (2003) (per curiam) (holding that the “decision below . . . adheres to an improperly cramped view of Congress’s Commerce Clause power”); *Allied-Bruce*, 513 U.S. at 273-81 (rejecting “contemplation of the parties” test and holding that the FAA extends to the full reach of Congress’s Commerce Clause power).

potential conflicts of interest<sup>7</sup> and has enacted statutes regulating the conduct of institutions that administer consumer arbitrations.<sup>8</sup> New Mexico, in adopting the Revised Uniform Arbitration Act (“RUAA”),<sup>9</sup> added a provision making a “disabling civil dispute clause”<sup>10</sup>—which the statute defines as including a provision that provides for a less convenient forum, reduced access to discovery, a limited right to appeal, the inability to join class actions, or the like—voidable by consumers, borrowers, tenants and employees in arbitration.<sup>11</sup>

Courts have only begun to address preemption challenges to state laws regulating the arbitration process—what I call “second generation” FAA preemption cases. One such case reached the Supreme Court this past term in *Green Tree Financial Corp. v. Bazzle*,<sup>12</sup> but the Court did not resolve the preemption issue. The Supreme Court granted review in *Bazzle* to consider whether the FAA preempted a South Carolina decision permitting courts to order arbitration on a classwide, rather than individual, basis.<sup>13</sup> The plurality opinion never reached the preemption issue, instead vacating the lower court’s decision for the arbitrator to consider in the first instance whether the parties’ contract precluded classwide arbitration.<sup>14</sup> Three dissenting justices, however, would have held that the South Carolina rule conflicted with the FAA and thus was preempted.<sup>15</sup> Second generation preemption cases arise in a variety of other contexts as well, ranging from arbitrator disclosure to standards for vacating awards. Their frequency will only increase as more states adopt RUAA,<sup>16</sup> which includes a variety of provisions that regulate arbitration procedures.

Despite the importance of FAA preemption, and particularly given the growth in second generation FAA preemption cases, surprisingly little has been written about the topic.<sup>17</sup> And what has been written generally presents the author’s own

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7. Judicial Council of California, *Ethics Standards for Neutral Arbitrators in Contractual Arbitration* (effective Jan. 1, 2003), available at <http://www.courtinfo.ca.gov/rules/appendix/appdiv6.pdf> (last visited Jan. 24, 2004); see also CAL. CIV. PROC. CODE § 1281.9(a) (West Supp. 2003).

8. CAL. CIV. PROC. CODE § 1281.92 (prohibiting private arbitration companies from administering consumer arbitrations for parties in which they have financial interest); *id.* § 1281.96 (requiring disclosures by private arbitration companies administering consumer arbitrations); *id.* § 1284.3 (regulating fees charged in consumer arbitrations).

9. Uniform Arbitration Act, N.M. STAT. ANN. §§ 44-7A-1 to 32 (Michie Supp. 2003) [hereinafter RUAA].

10. N.M. STAT. ANN. § 44-7A-1(b)(4).

11. *Id.* § 44-7A-5.

12. 123 S. Ct. 2402 (2003).

13. The question presented in the cert petition was “[w]hether the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, prohibits class-action procedures from being superimposed onto an arbitration agreement that does not provide for class-action arbitration.” Petition for Writ of Certiorari at i, *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402 (2003) (No. 02-634).

14. See *Bazzle*, 123 S. Ct. at 2408; see also *infra* text accompanying notes 87-90.

15. *Bazzle*, 123 S. Ct. at 2409-11 (Rehnquist, C.J., dissenting).

16. So far, RUAA has been enacted by eight states and introduced in the legislatures of eleven more. Uniform Law Commissioners, *A Few Facts About the Uniform Arbitration Act* (2000), at [http://www.nccusl.org/nccusl/uniformact\\_factsheets/uniformacts-fs-aa.asp](http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-aa.asp) (last visited Oct. 2, 2003).

17. For the leading exceptions to this statement, see 1 IAN R. MACNEIL ET AL., *FEDERAL ARBITRATION LAW* §§ 10:1-10:147 (1994 & Supp. 1999); STEPHEN J. WARE, *ALTERNATIVE DISPUTE RESOLUTION* 26-43 (2001); Stephen L. Hayford & Alan R. Palmiter, *Arbitration*

particular (and distinctive) viewpoint on FAA preemption without considering the differing viewpoints of other commentators. Taking as a given the existing Supreme Court case law, and relying on the perspectives of multiple academic commentators, this Article seeks to develop an overall framework for analyzing FAA preemption cases. The framework is not conclusive but instead highlights areas of uncertainty for future legal development. As part of the framework, the Article identifies and categorizes various theories of FAA preemption and then examines how selected second generation preemption cases likely would be decided under each of those theories. Not only might this approach aid courts in deciding those cases, but it also will be useful in evaluating, after the fact, what theories courts seem to be using in their decisions.

Part I provides a brief overview of general principles of federal preemption, which set the context in which courts decide cases of FAA preemption.<sup>18</sup> Part II describes the Supreme Court's FAA preemption cases.<sup>19</sup> The leading case, of course, is *Southland*, which is examined in detail. Part II then discusses the Court's cases applying and reaffirming *Southland* and concludes with its cases considering how the parties' choice of governing law affects FAA preemption. Taking current Supreme Court jurisprudence as given, Part III sets out a four-step framework for analyzing FAA preemption.<sup>20</sup> Among other things, the framework identifies and categorizes a number of alternative theories suggested by commentators for resolving second generation FAA preemption cases. Finally, Part IV applies these alternative theories to several cases presenting unresolved preemption issues (including *Bazzle*) and explains the likely outcome under each theory.<sup>21</sup>

## I. GENERAL PREEMPTION PRINCIPLES

The Supreme Court decides FAA preemption cases in the context of its broader preemption jurisprudence. This Part provides a brief summary of those general principles of federal preemption.<sup>22</sup>

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*Federalism: A State Role in Commercial Arbitration*, 54 FLA. L. REV. 175 (2002); Stephen L. Hayford, *Federal Preemption and Vacatur: The Bookend Issues Under the Revised Uniform Arbitration Act*, 2001 J. DISP. RESOL. 67; Stephen J. Ware, 'Opt-In' for Judicial Review of Errors of Law Under the Revised Uniform Arbitration Act, 8 AM. REV. INT'L ARB. 263, 269 (1997) [hereinafter Ware, 'Opt-In' for Judicial Review]; Stephen J. Ware, *Punitive Damages in Arbitration: Contracting Out of Government's Role in Punishment and Federal Preemption of State Law*, 63 FORDHAM L. REV. 529, 554 (1994) [hereinafter Ware, *Punitive Damages in Arbitration*]; Alan Scott Rau, *Does State Arbitration Law Matter At All? Part II: A Continuing Role for State Law*, ADR CURRENTS, Dec. 1998, at 20, 20. For a comparison of how these authorities deal with second generation cases, see *infra* text accompanying notes 173-99.

18. See *infra* text accompanying notes 22-39.

19. See *infra* text accompanying notes 40-113.

20. See *infra* text accompanying notes 114-99.

21. See *infra* text accompanying notes 200-39.

22. For more detailed summaries, see CHRISTOPHER R. DRAHOZAL, *THE SUPREMACY CLAUSE* (2004) (forthcoming) (on file with author); KENNETH STARR ET AL., *THE LAW OF PREEMPTION: A REPORT OF THE APPELLATE JUDGES CONFERENCE* (1991). For critical analyses of current preemption doctrine, see, for example, Viet D. Dinh, *Reassessing the Law of Preemption*, 88 GEO. L.J. 2085 (2000); Caleb Nelson, *Preemption*, 86 VA. L. REV. 225 (2000).

“[P]re-emption doctrine is derived” from the Supremacy Clause,<sup>23</sup> which makes federal law the “supreme Law of the Land.”<sup>24</sup> Whether a particular federal statute preempts a particular state law, thus rendering the state law unenforceable, depends on congressional intent.<sup>25</sup> To aid it in determining congressional intent, the Supreme Court takes what has been called a “categorical” approach to preemption issues.<sup>26</sup> The first category is express preemption—when Congress, in the terms of a statute, indicates the extent to which state law is preempted.<sup>27</sup> According to the Supreme Court, “when Congress has made its intent known through explicit statutory language, the courts’ task is any easy one,” an assertion belied by the Court’s own cases.<sup>28</sup> The FAA does not contain an express preemption clause.<sup>29</sup>

The other two categories of preemption analysis are different types of implied preemption: cases in which federal law preempts state law even though Congress has not expressly so stated in the statute itself.<sup>30</sup> One is implied field preemption: when (either because of pervasive federal regulation or a dominant federal interest) federal legislation so occupies a field that state law is completely displaced.<sup>31</sup> The other is implied conflict preemption: state law is preempted when it “actually conflicts” with federal law.<sup>32</sup> Thus, state law is preempted when it is impossible for a party to comply with both federal law and state law (“impossibility preemption”)<sup>33</sup> and when state law “stands as an obstacle to the accomplishment

23. *Gade v. Nat’l Solid Wastes Mgmt. Ass’n*, 505 U.S. 88, 108 (1992).

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

25. *See, e.g., Retail Clerks Int’l Ass’n, Local 1625 v. Schermerhorn*, 375 U.S. 96, 103 (1963) (“The purpose of Congress is the ultimate touchstone.”).

26. Karen A. Jordan, *The Shifting Preemption Paradigm: Conceptual and Interpretative Issues*, 51 VAND. L. REV. 1149, 1151 (1998).

27. An often-quoted statement of the Court’s preemption categories can be found in *English v. Gen. Elec. Co.*, 496 U.S. 72, 78-79 (1990).

28. *See, e.g., Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 529-31 (1992) (holding that the amended Public Health Cigarette Smoking Act of 1969 preempts state law in part).

29. Caleb Nelson argues that there is little difference in substance between section 2 of the FAA and an express preemption provision. According to Nelson, section 2

can readily be recast in the form of an express preemption clause; for most purposes, it is identical to a provision that “no state or local government shall adopt or enforce any law or policy that makes a written arbitration agreement in a contract evidencing a transaction involving commerce invalid, revocable, or unenforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”

Nelson, *supra* note 22, at 299.

30. In fact, the Court’s three categories mix apples with oranges. While express preemption is a distinct category from implied conflict preemption and implied field preemption, express preemption clauses can preempt conflicting state laws or can preempt the entire field. *See S. Candice Hoke, Preemption Pathologies and Civic Republican Virtues*, 71 B.U. L. REV. 685, 735-36, fig. 1 (1991). On this view, there should be at least four preemption categories, rather than three.

31. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

32. *English*, 496 U.S. at 79.

33. *See Fla. Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963). In *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996), the Supreme Court

and execution of the full purposes and objectives of Congress" ("obstacle preemption").<sup>34</sup> Most implied preemption cases involve obstacle preemption. True impossibility preemption is rare,<sup>35</sup> and in recent years the Supreme Court has become much less likely to find field preemption than in the past.<sup>36</sup>

Finally, in subject matter areas "traditionally occupied" by the states, the Court applies a presumption against preemption: it presumes "that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress."<sup>37</sup> The "presumption against preemption" is just that—a presumption, which can be overcome by making the necessary showing.<sup>38</sup> Contract law certainly would be an area that states have "traditionally occupied,"<sup>39</sup> so that the presumption against preemption should apply.

## II. LEADING FAA PREEMPTION CASES

Section 2 of the Federal Arbitration Act provides that both pre-dispute and post-dispute arbitration agreements<sup>40</sup> within its scope "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."<sup>41</sup> Twenty years ago, the Supreme Court held in *Southland Corp. v. Keating* that section 2 applies in state court and preempts conflicting state laws.<sup>42</sup> This Part first describes the *Southland* case, and then discusses subsequent Supreme Court cases applying and reaffirming *Southland*.

gave as an example of impossibility preemption a case in which state law forbids banks to sell insurance and federal law requires them to do so. *Id.*

34. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Although this language from *Hines* regularly is quoted as the standard for obstacle preemption, the case itself appears to involve field preemption. See STARR ET AL., *supra* note 22, at 27; ERWIN CHERMERINSKY, *CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES* 292 (1997). *But see* Jack Goldsmith, *Statutory Foreign Affairs Preemption*, 2000 SUP. CT. REV. 175, 187-88 (arguing that *Hines* is an obstacle preemption case).

35. Nelson, *supra* note 22, at 228 (describing the test for impossibility preemption as "vanishingly narrow").

36. Goldsmith, *supra* note 34, at 213 (discussing "Court's attenuated use of field preemption in general in recent years"); Nelson, *supra* note 22, at 227 ("The Court has grown increasingly hesitant to read implicit field preemption clauses into federal statutes.").

37. *Rice*, 331 U.S. at 230.

38. Indeed, one commentator argues that, based on how the Court actually decides preemption cases, the presumption against preemption actually is a presumption *in favor* of preemption. See Mary J. Davis, *Unmasking the Presumption in Favor of Preemption*, 53 S. CAR. L. REV. 967, 971 (2002).

39. It falls within the state police power, and is not an area where "there has been a history of significant federal presence." *United States v. Locke*, 529 U.S. 89, 1108 (2000) (stating that there is no presumption against preemption in the field of "national and international maritime commerce" because "Congress has legislated in the field from the earliest days of the Republic, creating an extensive federal statutory and regulatory scheme").

40. Post-dispute arbitration agreements are also called submission agreements. The ongoing controversies over consumer and employment arbitration involve only pre-dispute, and not post-dispute, arbitration agreements.

41. 9 U.S.C. § 2 (2000).

42. 465 U.S. 1, 16 (1984).

Finally, it examines the effect of choice-of-law clauses on FAA preemption as a possible way for parties to contract around *Southland*.

#### A. *Southland Corp. v. Keating*

The Supreme Court first held that the FAA applies in state court and preempts conflicting state laws in *Southland Corp. v. Keating*.<sup>43</sup> Southland Corporation, the franchisor of 7-Eleven convenience stores, was sued by a class of its franchisees in California state court.<sup>44</sup> The franchisees asserted a variety of claims, including a claim that Southland had violated the disclosure requirements of the California Franchise Investment Law ("FIL"),<sup>45</sup> a law enacted to protect franchisees from unfair practices by franchisors.<sup>46</sup> Southland moved to compel arbitration of all the claims based on an arbitration clause in the franchise agreement. The trial court granted the motion to compel except as to the FIL claim. The court of appeal reversed as to that claim and ordered it to arbitration.<sup>47</sup> The California Supreme Court reversed the court of appeal, holding that (1) the FIL claim was not subject to arbitration because the arbitration clause was an invalid "condition, stipulation or provision purporting . . . to waive compliance with any provision of this law"; and (2) the FAA did not preempt the California antiwaiver provision.<sup>48</sup>

The United States Supreme Court reversed the California Supreme Court, holding that the FAA applied in state court and preempted the California antiwaiver provision as applied to arbitration clauses.<sup>49</sup> The Court began by identifying

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43. *Id.*

44. A number of individual franchisees also filed actions, which were consolidated with the class action. *Keating v. Superior Court*, 167 Cal. Rptr. 481, 484 n.1 (Ct. App. 1980).

45. *Id.* at 485; CAL. CORP. CODE §§ 31000-31516 (West 1977 & Supp. 2003).

46. Some commentators are skeptical of the effects of franchisee protection statutes. See Bruce H. Kobayashi & Larry E. Ribstein, *Contract and Jurisdictional Freedom*, in *THE FALL AND RISE OF FREEDOM OF CONTRACT* 325, 339 (F.H. Buckley ed., 1999) ("[S]tate laws may benefit local franchisees at the expense of national franchisors or consumers."); James A. Brickley et al., *The Economic Effects of Franchisee Termination Laws*, 34 J.L. & ECON. 101, 115-16 (1991). For an empirical analysis of the use of arbitration clauses in franchise contracts, including consideration of franchisee protection laws like the California FIL, see Christopher R. Drahozal & Keith N. Hylton, *The Economics of Litigation and Arbitration: An Application to Franchise Contracts*, 32 J. LEGAL STUD. 549 (2003).

47. *Keating*, 167 Cal. Rptr. at 493-95. The court of appeal also found "no insurmountable obstacle" to having the arbitration proceed on a classwide basis, and directed the trial court on remand to determine whether classwide arbitration was appropriate. *Id.* at 492.

48. *Keating v. Superior Court*, 645 P.2d 1192, 1198, 1203-04 (Cal. 1982), *rev'd sub nom.* *Southland Corp. v. Keating*, 465 U.S. 1 (1984) (quoting CAL. CORP. CODE § 31512). The California Supreme Court modified the ruling of the court of appeal as to classwide arbitration, determining that classwide arbitration of the rest of the franchisees' claims was permissible, but remanding to the trial court to determine whether classwide arbitration was appropriate in this case. *Id.* at 1209.

49. The Court refused to consider whether the FAA also preempted the state court order that arbitration proceed on a classwide basis. According to the Court, it lacked jurisdiction to consider the matter, because Southland opposed classwide arbitration only on state law, not federal law, grounds in the California courts, and because the California Supreme Court did not rule on the federal issue asserted by Southland. *Southland*, 465 U.S. at 8-9 nn.3-4. Jean Sternlight reports that the case then proceeded to arbitration on a classwide basis, with the

a “national policy favoring arbitration” in the FAA.<sup>50</sup> It found “nothing in the Act indicating that the broad principle of enforceability [in section 2 of the Act] is subject to any additional limitations under state law.”<sup>51</sup> The Court also relied on the legislative history of the Act, stating famously that “[a]lthough the legislative history is not without ambiguities, there are strong indications that Congress had in mind something more than making arbitration agreements enforceable only in the federal courts.”<sup>52</sup> In a footnote, the Court made clear that only section 2 of the FAA applies in state courts;<sup>53</sup> sections 3 and 4, which set out procedures for enforcing arbitration agreements, by their terms apply only in federal court.<sup>54</sup> In sum, the majority concluded: “In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements.”<sup>55</sup> Accordingly, the FAA preempted the California antiwaiver provision as applied to arbitration clauses. The franchisee had to arbitrate its FIL claim.

In dissent, Justice O’Connor criticized the majority’s analysis of the FAA’s legislative history. The majority’s “exercise in judicial revisionism,” according to Justice O’Connor, “is unfaithful to congressional intent, unnecessary, and, in light of the FAA’s antecedents and the intervening contraction of federal power, inexplicable.”<sup>56</sup> She concluded, as have most—but not all—scholars to consider the issue since *Southland* (some quite harshly),<sup>57</sup> that the unambiguous legislative

trial court judge playing a significant role in the proceedings, and ultimately settled after the arbitrators issued findings of fact. Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 WM. & MARY L. REV. 1, 41 nn.149-50 (2000).

50. *Southland*, 465 U.S. at 10; see also *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 947 (1995) (noting a “national policy favoring arbitration”); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 631 (1985) (finding an “emphatic federal policy in favor of arbitral dispute resolution”).

51. *Southland*, 465 U.S. at 11.

52. *Id.* at 12.

53. See *id.* at 16 n.10.

54. 9 U.S.C. § 3 (2000) (authorizing a stay pending arbitration in action “brought in any of the courts of the United States”); *id.* § 4 (permitting order to compel arbitration in “any United States district court which, save for such agreement, would have jurisdiction under Title 28”).

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

56. *Id.* at 36 (O’Connor, J., dissenting).

57. See, e.g., Edward Brunet, *Toward Changing Models of Securities Arbitration*, 62 BROOK. L. REV. 1459, 1469 n.33 (1996) (“The *Southland* decision is remarkable for its preemption holding that blatantly ignores legislative intent.”); Paul D. Carrington & Paul H. Haagen, *Contract and Jurisdiction*, 1996 SUP. CT. REV. 331, 380 (“[T]he opinion of the Court was an extraordinarily disingenuous manipulation of the history of the 1925 Act.”); Hayford & Palmiter, *supra* note 17, at 183 (stating that the FAA “was meant to extend only to the validation and enforcement of arbitration agreements in federal courts is clear from every direction” (emphasis in original)); 1 MACNEIL ET AL., *supra* note 17, § 10.2, at 10:5 (describing majority opinion in *Southland* as setting out a “painfully misleading history of the FAA”); David S. Schwartz, *Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act*, 67 LAW & CONTEMP. PROBS. (forthcoming 2004), <http://www.roscoepound.org/new/schwartz.pdf> (last visited Jan. 24, 2004). See generally IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION 117 (1992) (examining legislative history and concluding that it unambiguously shows that “the proposed [FAA] was intended to apply only in federal courts” and that “[i]t was never intended to create substantive federal



history of the FAA “establishes conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only in federal courts.”<sup>58</sup> As such, it did not preempt the California law in this state court case.

Justice Stevens also dissented, relying on the language in section 2 that permits arbitration agreements to be revoked upon “such grounds as exist at law or in equity for the revocation of any contract.”<sup>59</sup> One common law ground for revocation is that a contract is void as against public policy. The California anti-waiver provision was just such a public policy ground for revocation, Justice Stevens argued, and thus should have been saved from preemption.<sup>60</sup> Reinforcing this conclusion, according to Justice Stevens, was the presumption against preemption in areas traditionally occupied by the states (contract law presumably being such an area).<sup>61</sup> The majority did not discuss whether or how the presumption against preemption applied to the FAA.

### B. Post-Southland Cases

After *Southland*, the Supreme Court next considered FAA preemption in *Perry v. Thomas*.<sup>62</sup> In *Perry*, the Court held that section 2 of the FAA preempted a provision of the California Labor Code that permitted court actions to collect wages “without regard to the existence of any private agreement to arbitrate.”<sup>63</sup> The main issue in *Perry* was whether the preemption issue already had been decided in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*.<sup>64</sup> The Supreme Court ruled otherwise, holding that *Ware* resolved only the preemptive effect of the 1934 Securities Exchange Act<sup>65</sup> and not the Federal Arbitration Act.<sup>66</sup> Now considering the FAA preemption issue, the Court held that the California statute, which in the Court’s words required “that litigants be provided a judicial forum for resolving wage disputes,” was “in unmistakable conflict” with section 2 of the FAA and thus was preempted.<sup>67</sup> In a footnote, the Court addressed the availability of general contract law defenses, such as unconscionability, in a challenge to an arbitration agreement. Such a state law defense, “whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability,

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regulatory law superseding state law under the Supremacy Clause of the federal Constitution”). *But see* Christopher R. Drahozal, *In Defense of Southland: Reexamining the Legislative History of the Federal Arbitration Act*, 78 NOTRE DAME L. REV. 101, 107 (2002) (concluding that “construing the Act as applicable in state court is more consistent with the legislative history—that is, it leaves fewer ambiguities unexplained—than the Macneil interpretation”).

58. *Southland*, 465 U.S. at 25 (O’Connor, J., dissenting).

59. *Id.* at 18 (Stevens, J., concurring in part and dissenting in part) (quoting 9 U.S.C. § 2 (2000)).

60. *Id.* at 20 (Stevens, J., concurring in part and dissenting in part). In support of his argument, Justice Stevens explained that “the California Legislature has declared all conditions purporting to waive compliance with the protections of the Franchise Investment Law, including but not limited to arbitration provisions, void as a matter of public policy.” *Id.*

61. *Id.* at 18-19.

62. 482 U.S. 483 (1987).

63. CAL. LAB. CODE § 229 (West 1989 & Supp. 2003).

64. 414 U.S. 117 (1973).

65. *See* 15 U.S.C. § 78f (2000).

66. *Perry*, 482 U.S. at 491.

67. *Id.*

and enforceability of contracts generally.”<sup>68</sup> A court may not, however, “rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable, for this would enable the court to effect what we hold today the state legislature cannot.”<sup>69</sup>

Although the primary issue in *Allied-Bruce Terminix Cos. v. Dobson*<sup>70</sup> was the scope of the FAA, the Court also addressed the Act’s preemptive effect. Before reaching the scope issue, the Court set out three background points. First, “the basic purpose of the Federal Arbitration Act is to overcome courts’ refusals to enforce agreements to arbitrate.”<sup>71</sup> Second, in enacting the FAA, Congress relied at least in part on its power to regulate interstate commerce.<sup>72</sup> Third, the Court had held in *Southland* that the FAA applies in state court and, thus, “state courts cannot apply state statutes that invalidate arbitration agreements.”<sup>73</sup> After setting out that legal background, the Court declined the request of the Dobsons and twenty state attorneys general that it overrule *Southland*.<sup>74</sup> It did not reexamine the merits of the *Southland* decision. Instead, for a number of reasons (the Court had considered the same arguments in *Southland*; no subsequent cases had eroded *Southland*’s holding; parties had relied on *Southland* by entering arbitration agreements; and Congress had enacted laws since *Southland* that expanded the enforceability of arbitration agreements), the Court found “it inappropriate to reconsider what is by now well-established law.”<sup>75</sup> After reaffirming *Southland*, the Court then construed the scope of the FAA as extending to the full reach of Congress’s power under the Commerce Clause.<sup>76</sup> Because the parties agreed that the transaction involved in the case was within the scope of the commerce power, the FAA applied and preempted an Alabama law that precluded specific enforcement of pre-dispute arbitration agreements.<sup>77</sup>

Justice O’Connor, who had dissented in *Southland*, reiterated her views from that case but decided, for “considerations of *stare decisis*,” to go along with the majority.<sup>78</sup> Justices Thomas and Scalia dissented, arguing that *Southland* was wrongly decided and should be overruled.<sup>79</sup> Justice Scalia wrote separately to add

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68. *Id.* at 492 n.9 (emphasis omitted).

69. *Id.*

70. 513 U.S. 265 (1995).

71. *Id.* at 270.

72. *Id.* at 271; see also *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 405 (1967) (concluding that FAA “is based upon and confined to the incontestable federal foundations of ‘control over interstate commerce and over admiralty’”) (quoting H.R. REP. NO. 68-96, at 1 (1924)).

73. *Allied-Bruce*, 513 U.S. at 272.

74. *Id.*

75. *Id.*

76. *Id.* at 273-77.

77. The Alabama statute included pre-dispute arbitration agreements in a listing of several other types of contracts for which specific performance was not available. See ALA. CODE § 8-1-41 (1975).

78. *Allied-Bruce*, 513 U.S. at 284 (O’Connor, J., concurring) (emphasis in original).

79. *Id.* at 296 (Thomas, J., dissenting) (concluding that “the necessity of ‘preserv[ing] state autonomy in state courts’” is sufficient justification for overruling *Southland*) (quoting *id.* at 284 (O’Connor, J., concurring) (alteration in original)). In his dissent, Justice Thomas cited the “clear statement” rule of *Gregory v. Ashcroft*, 501 U.S. 452 (1991), which demands even more clarity from Congress than the presumption against preemption. *Allied-Bruce*,

that he would not dissent in the future from FAA preemption cases, but would vote to overrule *Southland* should four other Justices do so as well.<sup>80</sup>

In *Doctor's Associates, Inc. v. Casarotto*,<sup>81</sup> the Court held preempted a different type of state statute than those it had faced previously. The Montana statute at issue in *Doctor's Associates* required conspicuous notice on the front page of a contract that the contract included an arbitration clause. "Unless such notice is displayed thereon," the law provided, "the contract may not be subject to arbitration."<sup>82</sup> When the Montana courts refused to enforce an arbitration agreement that did not meet the statutory requirements, the Supreme Court had little difficulty in holding the statute preempted. According to the Court, the Montana statute "directly conflicts with § 2 of the FAA because the State's law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally."<sup>83</sup> The Court emphasized that the statutory provision "would not enforce the arbitration clause in the contract between [Doctor's Associates] and Casarotto," but rather "would invalidate the clause."<sup>84</sup> By "plac[ing] arbitration agreements in a class apart from 'any contract'"—unlike generally applicable contract law defenses such as fraud, duress, or unconscionability—the provision "singularly limits their validity" and thus is preempted.<sup>85</sup>

The most recent case in which the Court considered FAA preemption is *Green Financial Corp. v. Bazzle*.<sup>86</sup> In *Bazzle*, the Court granted review to decide whether

513 U.S. at 292 (Thomas, J., dissenting); see 1 LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-28, at 1176 n.21 (3d ed. 2000).

80. *Allied-Bruce*, 513 U.S. at 285 (Scalia, J., dissenting).

81. 517 U.S. 681 (1996).

82. MONT. CODE ANN. § 27-5-114(4) (1995) (amended 1997).

83. *Doctor's Assocs.*, 517 U.S. at 687.

84. *Id.* at 688.

85. *Id.* (quoting 9 U.S.C. § 2). Perhaps the most interesting aspect of the case occurred prior to the Supreme Court's ultimate decision. Concurring in the original decision of the Montana Supreme Court (see *Casarotto v. Lombardi*, 886 P.2d 931 (Mont. 1994), *vacated sub. nom. Doctor's Assocs., Inc. v. Casarotto*, 515 U.S. 1129 (1995)), Justice Terry N. Triewiler wrote a lengthy opinion criticizing the federal courts for enforcing pre-dispute arbitration clauses. *Casarotto*, 886 P.2d at 939-41. Justice Triewiler's opinion gives a good sense of the frustration some state court judges feel as a result of *Southland* and FAA preemption.

86. 123 S. Ct. 2402 (2003). The Court also touched on FAA preemption briefly in *Circuit City Stores, Inc. v. Adams*, 532 U.S. 105 (2001). The issue in *Circuit City* was whether the employment exclusion of the FAA (for "contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce," 9 U.S.C. § 1 (2000)) excluded all employment contracts from the scope of the FAA or simply employment contracts of transportation workers. In the course of adopting the latter interpretation, *Circuit City*, 532 U.S. at 119, the Court dismissed the concern raised by various amici about the federalism implications of its holding. Amici argued that if the employment exclusion were construed narrowly, the FAA would more broadly preempt state laws restricting the enforceability of arbitration clauses in employment contracts. The Court responded that the criticism was more properly directed at *Southland* and its holding that the FAA applies in state court and preempts "state antiarbitration laws." *Id.* at 122. But, according to the Court:

The question of *Southland's* continuing vitality was given explicit consideration in *Allied-Bruce*, and the Court declined to overrule it. The decision, furthermore, is not directly implicated in this case, which concerns the application of the FAA in a federal, rather than in a state,

a state court could order arbitration on a classwide basis (i.e., with the plaintiff acting on behalf of all similarly situated parties in a combined arbitration proceeding, like a class action in court).<sup>87</sup> The South Carolina Supreme Court had held that a court could order classwide arbitration, at least when the parties' arbitration agreement was silent on the question.<sup>88</sup> Green Tree argued that the parties' arbitration agreement precluded classwide arbitration and that a state rule overriding that agreement was preempted by the FAA.

In the end, the plurality opinion did not address the preemption issue, holding instead that the arbitrator, rather than the South Carolina court, should have determined whether the contract precluded classwide arbitration.<sup>89</sup> Justice Thomas adhered to his prior view that the FAA does not apply in state court and thus would have affirmed the South Carolina court's decision.<sup>90</sup> However, three dissenting Justices, in an opinion by Chief Justice Rehnquist, concluded that the contract did clearly preclude classwide arbitration and so went on to discuss the preemption issue.

The Chief Justice's opinion identified the purpose (or purposes) of the Federal Arbitration Act as follows: "The 'central purpose' of the FAA is 'to ensure that private agreements to arbitrate are enforced according to their terms.' In other words, Congress sought simply to 'place such agreements upon the same footing as other contracts.'"<sup>91</sup> Here, the parties provided in their arbitration agreement that classwide arbitration was not permitted, according to the dissent, by requiring the parties to each individual contract (rather than the entire class of contracts) to agree to a particular arbitrator. By certifying a classwide arbitration proceeding, "the Supreme Court of South Carolina imposed a regime that was contrary to the

court. The Court should not chip away at *Southland* by indirection, especially by the adoption of the variable statutory interpretation theory advanced by the respondent in the instant case. Not all of the Justices who join today's holding agreed with *Allied-Bruce*, but it would be incongruous to adopt, as we did in *Allied-Bruce*, a conventional reading of the FAA's coverage in § 2 in order to implement proarbitration policies and an unconventional reading of the reach of § 1 in order to undo the same coverage. In *Allied-Bruce* the Court noted that Congress had not moved to overturn *Southland*, and we now note that it has not done so in response to *Allied-Bruce* itself.

*Id.* at 122 (citations omitted).

87. See *supra* text accompanying note 13.

88. *Bazzle v. Green Tree Fin. Corp.*, 569 S.E.2d 349, 359 (S.C. 2002), *vacated*, 123 S. Ct. 2402 (2003).

89. *Bazzle*, 123 S. Ct. at 2408. The outcome of the case actually was more complicated, with the Justices issuing four different opinions, none of which commanded a majority of the Court. Four Justices voted to vacate the lower court decision and to have the arbitrator determine whether the contract precluded classwide arbitration. *Id.* at 2407-08. Three Justices would have reversed the lower court outright on grounds of FAA preemption. *Id.* at 2410-11 (Rehnquist, C.J., dissenting). Two Justices would have affirmed, each for different reasons. *Id.* at 2411 (Thomas, J., dissenting); *id.* at 2408 (Stevens, J., concurring in the judgment and dissenting in part). One of those Justices, Justice Stevens, joined the plurality opinion only so that there would be a controlling judgment of the Court. *Id.* at 2408-09 (Stevens, J., concurring in the judgment and dissenting in part).

90. *Id.* at 2411 (Thomas, J., dissenting).

91. *Id.* at 2410 (Rehnquist, C.J., dissenting) (quoting *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 53-54 (1995) and *Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468, 474 (1989) respectively).

express agreement of the parties as to how the arbitrator would be chosen.”<sup>92</sup> Because the South Carolina court did not enforce the parties’ arbitration agreement according to its terms, the dissent would have held that the decision was contrary to the FAA and thus preempted.<sup>93</sup>

### C. Choice-of-Law Clauses and FAA Preemption

The Supreme Court has addressed FAA preemption in two additional cases—*Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*<sup>94</sup> and *Mastrobuono v. Shearson Lehman Hutton, Inc.*<sup>95</sup>—which are discussed separately because the Court considered an important factual variation: the parties had included in their contracts not only an arbitration clause, but also a choice-of-law clause specifying that a particular state’s law governed the contract. The issue in *Volt* and *Mastrobuono* was what effect the choice-of-law clause had on FAA preemption.

In *Volt*, the case came to the Supreme Court from the California state courts, which had construed the choice-of-law clause as referring not only to substantive contract law but also to California arbitration law.<sup>96</sup> Thus, according to the California courts, the parties in *Volt* had agreed that the provisions of California arbitration law would govern any arbitration proceeding under the contract.<sup>97</sup> One such provision was § 1281.2(c) of the California Civil Procedure Code, which permits a court to stay an arbitration proceeding while it resolves a related issue in a case between a party to the arbitration agreement and a third party.<sup>98</sup> Relying on what it found to be the parties’ agreement (via the choice-of-law clause), the trial court had stayed the construction arbitration between Volt (an electrical contractor) and Stanford pending resolution of related claims Stanford had against two other construction companies.

The United States Supreme Court affirmed. Initially, the Court deferred to the California courts’ interpretation of the choice-of-law clause.<sup>99</sup> It concluded that “[i]nterpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration—rules which are manifestly designed to encourage resort to the arbitral process—simply does not offend the rule of liberal construction” of arbitration agreements under the FAA.<sup>100</sup> Because the parties had “incorporated the California rules of arbitration into their arbitration agreement,”<sup>101</sup> those rules were not preempted by the FAA. The Court explained that the FAA did not contain an express preemption clause and did not preempt the entire field of arbitration law.<sup>102</sup> Nor was state law an obstacle to Congress’s purpose in enacting the FAA, which was to “require[] courts to enforce privately negotiated agreements to arbitrate, like

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92. *Id.* at 2411 (Rehnquist, C.J., dissenting).

93. *Id.* at 2409, 2411 (Rehnquist, C.J., dissenting).

94. 489 U.S. 468 (1989).

95. 514 U.S. 52 (1995).

96. 489 U.S. at 472.

97. *Id.* at 479.

98. CAL. CIV. PROC. CODE § 1281.2(c) (West 1982).

99. 489 U.S. at 474-75.

100. *Id.* at 476.

101. *Id.* at 474.

102. *Id.* at 477.

other contracts, in accordance with their terms.”<sup>103</sup> Because the “parties have agreed to abide by state rules of arbitration, enforcing those rules according to the terms of the agreement is fully consistent with the goals of the FAA, even if the result is that arbitration is stayed where the Act would otherwise permit it to go forward.”<sup>104</sup>

Although the Court did not say so in *Volt*, § 1281.2(c) likely would have been preempted by the FAA in the absence of the choice-of-law clause.<sup>105</sup> (Indeed, the entire rationale of *Volt* would have been unnecessary otherwise.) As a result, *Volt* opened a potentially significant loophole to the *Southland* decision.<sup>106</sup> After the decision in *Volt*, for any contract containing a standard choice-of-law clause, a state court could construe the clause as an agreement to follow the state arbitration law, and continue to enforce at least some state laws that otherwise would be preempted under *Southland*.

*Mastrobuono v. Shearson Lehman Hutton, Inc.*<sup>107</sup> tried to close that loophole (to some degree). In *Mastrobuono*, a securities brokerage sought to vacate an arbitration award of punitive damages in favor of a former customer.<sup>108</sup> The brokerage argued that the arbitrators lacked the authority to award punitive damages because New York law—to which the parties had allegedly agreed by use of a general choice-of-law clause—precluded arbitrators from awarding punitive damages.<sup>109</sup>

The Supreme Court rejected the argument and upheld the arbitration award.<sup>110</sup> The Court began by stating that “our decisions in *Allied-Bruce*, *Southland*, and *Perry* make clear that if contracting parties agree to *include* claims for punitive damages within the issues to be arbitrated, the FAA ensures that their agreement will be enforced according to its terms even if a rule of state law would otherwise exclude such claims from arbitration.”<sup>111</sup> In other words, in the absence of the choice-of-law clause, the FAA would preempt the New York rule on punitive

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103. *Id.* at 478.

104. *Id.* at 479.

105. See *Warren-Guthrie v. Health Net*, 101 Cal. Rptr. 2d 260, 266 (Ct. App. 2000) (holding § 1281.2(c) preempted by the FAA); *Liddington v. Energy Group*, 238 Cal. Rptr. 202, 207 (Ct. App. 1997) (same). *But see Chronus Invs., Inc. v. Concierge Servs., LLC*, 133 Cal. Rptr. 2d 384, 392 (Ct. App. 2003) (stating *Warren-Guthrie* and *Energy Group* “are wrongly decided”), *review granted*, 72 P.3d 1166 (Cal. 2003). In *Doctor's Associates, Inc.*, the Supreme Court distinguished *Volt* on the ground that “[t]he state rule examined in *Volt* determined only the efficient order of proceedings; it did not affect the enforceability of the arbitration agreement itself.” *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 688 (1996). The better distinction, of course, is that in *Volt* the parties had agreed (at least according to the California courts) that the rule at issue would apply to their arbitration proceeding. In *Doctor's Associates*, there was no such agreement. The subject of the state law would, however, be relevant to the reasonableness of interpreting a choice-of-law clause as incorporating state arbitration law.

106. See Katherine Van Wezel Stone, *Rustic Justice: Community and Coercion Under the Federal Arbitration Act*, 77 N.C. L. REV. 931, 947 n.74 (1999) (describing *Volt* as creating a “narrow exception to the broad preemption of *Southland*”).

107. 514 U.S. 52 (1995).

108. *Id.* at 54.

109. *Id.*

110. *Id.* at 64.

111. *Id.* at 58 (emphasis in original).

damages. But unlike *Volt*, here the Supreme Court concluded that the parties did not contract for application of New York arbitration law. Instead, the choice-of-law clause was an agreement that “New York’s substantive rights and obligations, and not the State’s allocation of power between alternative tribunals,” governed the parties’ relationship.<sup>112</sup> The Court distinguished *Volt* as a case in which it deferred to the California courts’ contract interpretation, whereas here it was reviewing a federal court interpretation to which it owed no deference.<sup>113</sup> Construing the choice-of-law clause on its own, the Supreme Court held that it did not constitute an agreement to the New York punitive damages rule.

### III. FAA PREEMPTION: AN ANALYTICAL FRAMEWORK

Given the Supreme Court’s cases to date, how should one analyze whether the FAA preempts a particular state law?<sup>114</sup> The starting point is that preemption under the FAA is a form of conflict preemption, with state laws preempted when they conflict with the dictate of § 2 that arbitration agreements be “valid, irrevocable, and enforceable.”<sup>115</sup> Then the question is: when do state arbitration laws conflict with the FAA? The focus here is on FAA preemption issues as they arise in state courts, the issue addressed by the Supreme Court in virtually all of its FAA preemption cases. In some respects, the analysis may differ in federal courts (as noted when appropriate).

This Part sets out a basic framework for analyzing FAA preemption, taking as given the Supreme Court’s cases to date. The analytical framework consists of four steps:

1. Does the state law apply to contracts generally or does it “single out” arbitration agreements for different treatment than other contracts? If the law applies to contracts generally, it is not

112. *Id.* at 60.

113. *Id.* at 60 n.4.

114. I do not consider here federal statutes, such as the McCarran-Ferguson Act, 15 U.S.C. § 1012(b) (2000), which save otherwise preempted state laws from preemption. A number of courts have held that state laws restricting arbitration of insurance disputes are saved from preemption by the McCarran-Ferguson Act. *E.g.*, *Allen v. Pacheco*, 71 P.3d 375, 381 (Colo. 2003); *Friday v. Trinity Universal*, 939 P.2d 869, 872 (Kan. 1997). *But see* *Little v. Allstate Ins. Co.*, 705 A.2d 538, 539 (Vt. 1997). I also assume that the arbitration clause is in a “maritime transaction or a contract evidencing a transaction involving commerce,” 9 U.S.C. § 2—in other words, that the FAA applies. *See* *Citizens Bank v. Alafabco, Inc.*, 123 S. Ct. 2037 (2003); *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265 (1995).

115. 9 U.S.C. § 2 (2000); *see, e.g., Volt*, 489 U.S. at 477-78 (describing issue as whether the California law “would undermine the goals and policies of the FAA”). Academic commentators are divided, however, on whether FAA preemption is a form of impossibility preemption or whether it is a form of obstacle preemption. *Compare* 1 *TRIBE*, *supra* note 79, § 6-29, at 1179-80 (listing *Southland* as case in which “compliance with both [state law and federal law] is a literal impossibility”) with *Nelson*, *supra* note 22, at 228 n.15 (The Supreme Court “made clear that even if one sovereign’s law purports to give people a right to engage in conduct that the other sovereign’s law purports to prohibit, the ‘physical impossibility’ test is not satisfied; a person could comply with both state and federal law simply by refraining from the conduct.”).

preempted. If it singles out arbitration agreements for different treatment than other contracts, continue with the next step.

2. Have the parties expressly contracted for application of the state law to the arbitration proceeding? If so, the law is not preempted. If not, continue with the next step.

3. Does the state law invalidate the parties' arbitration agreement, in whole or in part, conditionally or unconditionally (i.e., does application of the state law result in the parties going to court even though they have agreed to arbitrate their dispute)? If so, the law is preempted. If not, continue with the final step.

4. Evaluate the state law under one of the following alternative preemption theories (described below): the *Keystone* Theory; the *RUAA* Theory; the *Anti-FAA* Theory; the *Pro-Contract* Theory; or the *FAA Exclusivity* Theory.

The rest of this Part discusses each of the steps in more detail.

*A. Step One: Does the State Law Apply to Contracts Generally or Does it Single Out Arbitration Agreements for Different Treatment?*

This step comes from the saving clause in § 2 of the FAA, which makes agreements to arbitrate "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."<sup>116</sup> The Supreme Court has repeatedly held that state laws which single out arbitration agreements are subject to preemption by the FAA, while stating that general contract law defenses are not.<sup>117</sup> As the Court explained in *Allied-Bruce*:

States may regulate contracts, including arbitration clauses, under general contract law principles and they may invalidate an arbitration clause "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2 (emphasis added). What States may not do is decide that a contract is fair enough to enforce all its basic terms (price, service, credit), but not fair enough to enforce its arbitration clause. The Act makes any such state policy unlawful, for that kind of policy would place arbitration clauses on an unequal "footing," directly contrary to the Act's language and Congress' intent.<sup>118</sup>

Although this distinction seems straightforward, uncertainty remains in the lower courts on at least two issues.

First, how general must the state law be to avoid preemption? Certainly state laws that apply only to arbitration agreements do not qualify. Conversely, general contract law defenses usually are okay, subject to the caveat discussed below.<sup>119</sup>

116. 9 U.S.C. § 2.

117. *E.g.*, *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686-87 (1996).

118. 513 U.S. 265, 281 (1995).

119. *See infra* text accompanying notes 134-38.



The uncertainty is how to deal with state laws that apply to arbitration clauses and some other type of contract clause, but not to contracts generally. The most commonly litigated example involves state statutes that preclude the parties from contracting for an out-of-state dispute resolution forum, effectively requiring that any arbitration proceeding or court case be brought in the state.<sup>120</sup> Such statutes apply to only two types of contract clauses, not to all contracts. But they do not single out arbitration clauses. Lower courts are split on whether such statutes fall under the saving clause and avoid preemption.<sup>121</sup>

In my view, the courts should hold that state laws that apply to arbitration clauses and some other type of contract clause are preempted. In other words, they should reject the interpretation of the FAA as preempting only state laws that “single out” arbitration clauses.<sup>122</sup> The argument is threefold. First, that interpretation conflicts with the plain language of § 2, which permits invalidation of arbitration agreements only on “such grounds as exist at law or in equity for the revocation of *any contract*.”<sup>123</sup> State laws applicable to arbitration clauses and some other types of contracts, but not all contracts, are not “grounds . . . for the revocation of *any contract*.”<sup>124</sup> Instead, the plain meaning of the saving clause in § 2 is to preserve only such general contract defenses as lack of assent, fraud, duress, and so forth, that truly can apply to any contract. The “singling out” phrasing comes from language in Supreme Court cases,<sup>125</sup> not from the statute itself, and is contradicted by other language in the Court’s own opinions.<sup>126</sup>

Second, the “singling out” interpretation of the FAA is inconsistent with *Southland*. The California statute held preempted in *Southland* did not “single out” arbitration clauses; instead, it was a broad anti-waiver provision of the sort common in franchisee protection statutes<sup>127</sup> and other regulatory

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120. See *infra* note 209 and accompanying text.

121. Compare *Keystone, Inc. v. Triad Sys. Corp.*, 971 P.2d 1240, 1244 (Mont. 1998) *cert. denied*, 123 S. Ct. 1633 (2003) (holding statute not preempted) with *Bradley v. Harris Research, Inc.*, 275 F.3d 884, 888 (9th Cir. 2001) (holding statute preempted). See also *Kloss v. Edward D. Jones & Co.*, 54 P.3d 1, 15-17 (Mont. 2002) (Nelson, J., specially concurring) (contending that the Montana requirement that waivers of state constitutional rights be voluntary, knowing, and intelligent is not preempted by FAA because it does not single out arbitration agreements) (citing *Keystone*, 971 P.2d at 1244-45); *Patterson v. Piano Craft Guild Assocs.*, No. 01-4376, 2002 WL 31931580, at \*5-7 (Mass. Super. Ct. 2002) (holding Massachusetts law invalidating clauses that waive right to jury trial preempted even though not limited to arbitration clauses).

122. See also Rau, *supra* note 17, at 20. For other views, see Jean R. Sternlight, *The Rise and Spread of Mandatory Arbitration as a Substitute for the Jury Trial*, 38 U. SAN FRAN. L. REV. 17 (2003); Stephen J. Ware, *Contractual Arbitration, Mandatory Arbitration and State Constitutional Jury-Trial Rights*, 38 U. SAN FRAN. L. REV. 39 (2003); David Schwartz, *State Judges as Guardians of Federalism: Resisting the Federal Arbitration Act’s Encroachment on State Law*, at <http://www.roscoepound.org/new/updates/schwartz.pdf> (last visited Oct. 2, 2003).

123. 9 U.S.C. § 2 (2000) (emphasis added).

124. See *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995) (citing 9 U.S.C. § 2 (emphasis in original)).

125. *Doctor’s Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996) (“Congress precluded States from singling out arbitration provisions for suspect status . . .”).

126. See, e.g., *supra* text accompanying note 118.

127. E.g., HAW. REV. STAT. § 482E-6(2)(F) (1993); 815 ILL. COMP. STAT. ANN. 705/41 (1999); MICH. COMP. LAWS § 445.1527(b) (2002); MINN. STAT. § 80C.21 (1998); N.Y. GEN.

statutes.<sup>128</sup> It provided that “[a]ny condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.”<sup>129</sup> The California Supreme Court in *Southland* held that the anti-waiver provision precluded the arbitration of disputes under the Franchise Investment Law, but did not purport to limit the reach of the statute to arbitration clauses. To the contrary, anti-waiver provisions in franchisee protection statutes have been applied in California and elsewhere to invalidate a wide variety of contract provisions in addition to arbitration clauses.<sup>130</sup> Thus, the holding in *Southland* was that a state law which applies to more than just arbitration clauses nonetheless is preempted.<sup>131</sup> The “singling out” theory seems to be a backdoor attempt to have the Supreme Court overrule *Southland*, which it already has refused to do.<sup>132</sup>

Finally, the “singling out” interpretation of FAA preemption would permit states to eviscerate the FAA entirely. Under that interpretation, a state law that invalidated all pre-dispute waivers of the right to jury trial would not be preempted by the FAA because it did not single out arbitration clauses: it also would invalidate jury trial waivers in court selection clauses. And yet such a state law would make arbitration agreements wholly unenforceable in the state, because by definition arbitration clauses provide for an arbitrator, rather than a jury, to resolve the parties’ dispute. Nothing in the FAA or the Supreme Court’s interpretations of the FAA supports such a result.<sup>133</sup> In short, courts should reject the view that the FAA preempts only state laws that single out arbitration clauses.

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BUS. LAW § 687(4) (McKinney 1996); N.D. CENT. CODE § 51-19-16(7) (1999); OKLA. STAT. ANN. tit. 71, § 826(C) (West 2002); WASH. REV. CODE ANN. § 19.100.220(2) (West 1999); WIS. STAT. ANN. § 553.76 (West 1998).

128. *E.g.*, 15 U.S.C. §§ 77n, 78cc(a) (2000).

129. *Southland Corp. v. Keating*, 465 U.S. 1, 5 n.1 (1984) (quoting CAL. CORP. CODE § 31512 (West 1977)). The “singling out” argument does not seem to have been addressed by the parties in *Southland*, although Justice Stevens, in his concurring and dissenting opinion, stated that “the California Legislature has declared all conditions purporting to waive compliance with the protections of the Franchise Investment Law, including but not limited to arbitration provisions, void as a matter of public policy.” *Id.* at 20 (Stevens, J., concurring in part and dissenting in part). The majority, in its response to Justice Stevens’ opinion, asserted that “the defense to arbitration found in the California Franchise Investment Law is not a ground that exists at law or in equity ‘for the revocation of any contract’ but merely a ground that exists for the revocation of arbitration provisions . . . subject to the California Franchise Investment Law.” *Id.* at 16 n.11 (quoting 9 U.S.C. § 2) (emphasis in original).

130. *E.g.*, *Lulling v. Barnaby’s Family Inns, Inc.*, 482 F. Supp. 318, 320 (E.D. Wis. 1980) (holding anti-waiver provision invalidates choice-of-law clauses); *Wimsatt v. Beverly Hills Weight Loss Clinics Int’l, Inc.*, 38 Cal. Rptr. 2d 612, 613 (Ct. App. 1995) (holding anti-waiver provision invalidates forum selection clauses). In addition, the anti-waiver provision expressly precludes waiver of express statutory rights of the franchisee. *See, e.g.*, MINN. R. 2860.5400(G) (2003) (applying anti-waiver provision to invalidate waivers of numerous statutory rights of franchisee).

131. *See also Allied-Bruce*, 513 U.S. at 269 (holding preempted section 8-1-4I of the Alabama Code, which precludes specific performance of agreements to arbitrate and other contract provisions).

132. *Id.* at 272 (“[W]e find it inappropriate to reconsider what is by now well-established law.”).

133. *See Southland*, 465 U.S. at 16 n.11.

Second, when, if ever, do general contract law defenses, as applied, single out arbitration clauses?<sup>134</sup> In *Perry*, the Supreme Court stated, in dicta, that a court may not “rely on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable.”<sup>135</sup> Thus, courts generally assume that they cannot base a finding of unconscionability solely on the fact that a contract contains an arbitration clause. But a growing number of courts have found provisions included in an arbitration clause unconscionable (such as provisions requiring cost-sharing, limiting remedies, shortening the statute of limitations, restricting the availability of class relief, and so forth)<sup>136</sup> and then proceeded to invalidate the arbitration clause because it included such provisions. Lower courts generally have rejected the argument that such holdings are preempted,<sup>137</sup> but the United States Supreme Court so far has not addressed the issue.<sup>138</sup>

*B. Step Two: Have the Parties Contracted for Application of the State Law to the Arbitration Proceeding?*

This step is derived from the Supreme Court’s decision in *Volt*<sup>139</sup> (as explained in *Mastrobuono*<sup>140</sup>). The best way to understand the decision in *Volt* is based on the idea of incorporation by reference: by choosing a state’s arbitration law, the parties are making it part of their agreement, just like agreeing to arbitrate under a particular set of institutional rules incorporates those rules into their agreement. If the parties incorporate a state arbitration law by reference into their arbitration agreement, that law becomes part of their agreement and thus not subject to preemption. The fact setting of *Mastrobuono* illustrates the point. Under ordinary FAA preemption principles, the New York law that precludes arbitrators from awarding punitive damages would be preempted.<sup>141</sup> But nothing in the FAA requires the parties to arbitrate claims for punitive damages. If the parties wish to

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134. See Rau, *supra* note 17, at 21-22.

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

136. The ongoing litigation involving the Circuit City arbitration clause is only one example. See *Circuit City Stores, Inc. v. Mantor*, 335 F.3d 1101, 1109 (9th Cir. 2003) (holding arbitration clause unconscionable); *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165, 1171-78 (9th Cir. 2003) (same); *Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 893 (9th Cir. 2002) (same), *cert. denied*, 535 U.S. 1112 (2002). *But see* *Circuit City Stores, Inc. v. Najd*, 294 F.3d 1104, 1109 (9th Cir. 2002) (finding no procedural unconscionability due to opt-out provision); *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198, 1199-1200 (9th Cir. 2002) (same).

137. *E.g.*, *Ticknor v. Choice Hotels Int’l, Inc.*, 265 F.3d 931 (9th Cir. 2001), *cert. denied*, 534 U.S. 1133 (2002).

138. A clear example of a state’s application of a “general” contract defense in a manner preempted by the FAA is the Arkansas Supreme Court’s adoption of a special mutuality requirement only for arbitration clauses. *Money Place, LLC v. Barnes*, 78 S.W.3d 714, 717 (Ark. 2002); *E-Z Cash Advance, Inc. v. Harris*, 60 S.W.3d 436 (Ark. 2000); see 2 MACNEIL ET AL., *supra* note 17, § 17.4.2, at 17:59. See generally Christopher R. Drahozal, *Nonmutual Agreements to Arbitrate*, 27 J. CORP. L. 537 (2002) (arguing that mutuality requirement as applied to arbitration clauses is misguided as a policy matter).

139. *Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468, 477 (1989).

140. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 57 (1995).

141. *Id.* at 58; see *supra* text accompanying notes 111-13.

exclude punitive damages claims from arbitration, they are free so to provide in their contract. Even though the result is the same as under the New York law, there is nothing for the FAA to preempt: it is the parties' agreement, and not New York law, that prevents arbitration of the punitive damages claim.

There are a variety of ways that parties can draft a contract provision that precludes the award of punitive damages.<sup>142</sup> They can waive any claim for punitive damages. They can deny the arbitrator the authority to award punitive damages. They can do both. Such clauses are common ways to exclude punitive damages claims from arbitration.<sup>143</sup> But there are other ways the parties might draft such a provision. They could state that New York law precluding the award of punitive damages applies to their arbitration proceeding. More generally, they could agree that New York arbitration law governs their arbitration. Or they could agree that New York law governs their contract. It is by no means clear that this last provision incorporates the New York rule on punitive damages into the parties' contract, but arguably that is what it does. Indeed, in *Volt* the Supreme Court took as given the California court's interpretation of a general choice-of-law clause as incorporating by reference California arbitration law,<sup>144</sup> although the Court rejected such an interpretation on its own in *Mastrobuono*.<sup>145</sup>

It does not matter whether the state rule at issue or the state's arbitration law generally is pro-arbitration, at least as to this incorporation by reference issue.<sup>146</sup> Indeed, in the illustration above, the state rule plainly is not pro-arbitration in any reasonable sense of the word. A simple example makes the point even more clear. Under the FAA, the parties clearly could exclude tort claims from their arbitration agreement. Nothing in the FAA requires them to arbitrate tort claims; instead, the FAA requires enforcement of the parties' agreement to arbitrate. Kansas law precludes arbitration of tort claims.<sup>147</sup> Application of such a law to an arbitration agreement governed by the FAA ordinarily would be preempted by the Act.<sup>148</sup> If, however, the parties define the scope of their arbitration agreement as "we agree to arbitrate all claims that are arbitrable under Kansas law (ignoring federal law<sup>149</sup>)," the result should be the same as if they contracted expressly for tort claims not to

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142. For examples, see CHRISTOPHER R. DRAHOZAL, *COMMERCIAL ARBITRATION: CASES AND PROBLEMS* 264, prob. 4.13 (2002).

143. Christopher R. Drahozal, "*Unfair*" Arbitration Clauses, 2001 U. ILL. L. REV. 695, 737-38.

144. 489 U.S. at 474-75.

145. 514 U.S. at 60.

146. It certainly may matter, however, in determining the reasonableness of interpreting a general choice-of-law clause as incorporating by reference state arbitration law. That was the tough issue in *Volt*, 489 U.S. at 474-76.

147. KAN. STAT. ANN. § 5-401(c) (2001).

148. *E.g.*, *Skewes v. Shearson Lehman Bros.*, 829 P.2d 874, 875 (Kan. 1992).

149. The "ignoring federal law" language in the sample clause above is important because a reference to Kansas law alone is ambiguous. Given that federal law is the supreme law of the land in Kansas as in the other states, the phrase "Kansas law" may mean "Kansas law as modified by applicable federal law." Under such an interpretation, a clause providing for Kansas law to apply would not incorporate the applicable state law if state law were preempted by the FAA. See *Mastrobuono*, 514 U.S. at 59 (The *Volt* interpretation assumes that a choice-of-law clause "includes the caveat, 'detached from otherwise-applicable federal law.'").

be arbitrable. It does not matter whether the state law is pro- or anti-arbitration, so long as the parties agree to it.

The trickier issue under *Volt* is identifying when such an incorporation by reference occurs.<sup>150</sup> An easy case is when the parties expressly reference a particular state law rule in their contract. A much harder case is when the parties include a general choice-of-law clause in their contract. In *Mastrobuono*, the Supreme Court construed such a clause as only referring to state substantive contract law, not state arbitration law.<sup>151</sup> But as *Volt* indicates, interpreting such clauses generally is up to the state courts,<sup>152</sup> so long as the state courts' interpretation is not so unreasonable as itself to be preempted by the FAA.<sup>153</sup>

Finally, what about the default provisions of state arbitration laws,<sup>154</sup> which fill gaps in an arbitration agreement? In the case of default rules to which the parties have not expressly agreed, is there sufficient consent by the parties such that the incorporation-by-reference rationale of *Volt* applies? If a state has a set of default rules dealing with arbitration, such as the Revised Uniform Arbitration Act

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150. See Thomas A. Diamond, *Choice of Law Clauses and Their Preemptive Effect Upon the Federal Arbitration Act: Reconciling the Supreme Court with Itself*, 39 ARIZ. L. REV. 35, 44-45 (1997).

151. 514 U.S. at 62; see Diamond, *supra* note 150, at 61 ("*Volt* thus stands for the proposition that there is no violation of the FAA's underlying policy if an ambiguous choice of law clause is interpreted to encompass a state's rules of arbitration procedure. . . . *Mastrobuono* stands for the proposition that there would be a violation of the FAA's policies if an ambiguous choice of law clause were interpreted to encompass a state's rules of arbitration substance . . .").

152. Even after *Mastrobuono*, many courts, although a minority, construe general choice-of-law clauses as including state arbitration law. See DRAHOZAL, *supra* note 142, at 263; see also Note, *An Unnecessary Choice of Law: Volt, Mastrobuono, and Federal Arbitration Act Preemption*, 115 HARV. L. REV. 2250, 2260 (2002) (citing conflicting approaches taken by federal courts). Indeed, Justice Stevens did so in *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402, 2408-09 (2003) (Stevens, J., concurring in the judgment and dissenting in part), as did Justice Thomas in *Howsam v. Dean Witter Reynolds, Inc.*, 123 S. Ct. 588, 594 (2002) (Thomas, J., dissenting).

153. For an example of a case in which construing a general choice-of-law clause as incorporating state arbitration law would be unreasonable, see *Woodmen of the World Life Ins. Co. v. White*, 35 F. Supp. 2d 1349, 1353-55 (M.D. Ala. 1999) (rejecting the argument that the general choice-of-law clause incorporated by reference an Alabama statute that makes pre-dispute arbitration clauses unenforceable); see also Alan Scott Rau, *Does State Arbitration Law Matter At All? Part I: Federal Preemption*, ADR CURRENTS, June 1998, at 19, 20 ("Are we to suppose that the parties to this contract agreed to arbitration, while at the same time intending to adopt a body of state law that would in all possible circumstances make their agreement to arbitrate invalid? One who believes that is capable of believing anything.").

154. For general discussions of default rules, see, for example, Ian Ayres, *Default Rules for Incomplete Contracts*, in 1 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 585, 585 (Peter Newman ed., 1998); Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989); Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591 (1999); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489 (1989); Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. LEGAL STUD. 535 (1990); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An*

contains,<sup>155</sup> then those default rules will be incorporated as a matter of law into the parties' contract to fill any gaps. The parties are free to change the rules if they want (which is the defining characteristic of a default rule), but if they do not do so, their contract will contain those terms.

The legal literature is divided on the degree to which default rules can be justified on the basis of consent by the parties.<sup>156</sup> In some circumstances, it seems clear that the parties assent to incorporation of a default rule into their contract. If, for example, the reason for the gap in the contract is that the parties knew about the default rule and so did not bother to include a contract provision on point, it seems fair to presume that they consented to inclusion of the default rule. In other circumstances, however, consent is not so clear. If the reason for the gap was that the parties did not even consider the issue addressed by the default rule, it is much harder to infer consent to the rule. Indeed, there are a variety of possible explanations for contractual silence, with varying degrees of consent imputed to the parties. Clayton Gillette summarizes as follows: "[C]ontractual incompleteness, and hence the need for defaults, results from a variety of conditions, some of which involve explicit consent, some hypothetical consent, and some only consent of the crudest sort involved in failing to object."<sup>157</sup>

Under *Volt*, the question is whether this sort of imputed assent is sufficient to avoid FAA preemption the same way that express assent does.<sup>158</sup> Given the varying degrees of "assent" to default rules, the answer is that it likely does not. The Supreme Court's decision in *Egelhoff v. Egelhoff*,<sup>159</sup> dealing with ERISA preemption, provides some support for that conclusion. In *Egelhoff*, the Court held that ERISA preempted a state default ("opt-out") rule that divorce automatically

*Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261 (1985); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615 (1990); Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597 (1990); J. Hoult Verkerke, *An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate*, 1995 WIS. L. REV. 837, 869-97 (1985). See generally *Symposium on Default Rules and Contractual Consent*, 3 S. CAL. INTERDISC. L.J. 1 (1993).

155. See RUA, *supra* note 9, § 4.

156. Compare, e.g., Steven J. Burton, *Default Principles, Legitimacy, and the Authority of a Contract*, 3 S. CAL. INTERDISC. L.J. 115, 117 (1993) ("Consent-based default principles respect the authority of the contract, but valid consent cannot reach beyond the agreement as needed to provide a legitimate basis for enforcing all needed default rules.") with Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 826 (1992) ("In a very real sense, such [default] terms can be and often are indirectly consented to by parties who could have contracted around them—but did not.") and Randy E. Barnett, . . . and *Contractual Consent*, 3 S. CAL. INTERDISC. L.J. 421, 434 (1993) ("This act of communicating consent [i.e., a voluntary act that expresses an intention to be legally bound] can justify the enforcement of any default rule when parties are rationally informed, and can justify the enforcement of conventionalist default rules under many circumstances when they are not.").

157. Clayton P. Gillette, *Cooperation and Convention in Contractual Defaults*, 3 S. CAL. INTERDISC. L.J. 167, 172-73 (1993).

158. State default rules may still avoid preemption by the FAA if they satisfy steps three and four of the framework. The point here is that state default rules likely are not wholly immune from FAA preemption analysis. Cf. Rau, *supra* note 17, at 22 ("[T]he courts must still ask whether the state's background rule will 'effectuate federal policy.'").

159. 532 U.S. 141 (2001).

revokes designation of the former spouse as beneficiary of an insurance policy.<sup>160</sup> Had the insurance policy by its terms provided for automatic revocation upon divorce, that provision would have been enforceable under ERISA, much as parties can incorporate by reference state law provisions into arbitration agreements under *Volt*. The Supreme Court explicitly rejected the argument that the fact that the state law was only a default rule saved it from preemption.<sup>161</sup> Certainly there are differences between ERISA preemption and FAA preemption (such as that ERISA has an express preemption clause and the FAA does not).<sup>162</sup> Nonetheless, the Court's holding cautions against adopting too broad of a notion of assent under *Volt*.<sup>163</sup>

*C. Step Three: Does the State Law Invalidate the Parties' Agreement to Arbitrate?*

The third step is whether application of the state law results in the parties' arbitration agreement being held unenforceable, in whole or in part, conditionally or unconditionally. This step is based on the holdings of the Supreme Court's FAA preemption cases to date, all of which (with the possible exception of *Volt*) have dealt exclusively with the enforceability of agreements to arbitrate.<sup>164</sup> Thus, in *Allied-Bruce*, the Supreme Court held that the FAA preempted an Alabama law making all pre-dispute arbitration agreements unenforceable.<sup>165</sup> In *Southland*<sup>166</sup> and *Perry*,<sup>167</sup> the Court held that the FAA preempted state statutes precluding enforcement of pre-dispute arbitration clauses, instead permitting the parties to go to court to resolve those claims. In *Doctor's Associates*, the Court held that the FAA preempted a Montana statute invalidating an arbitration agreement (and permitting the parties to go to court) due to a lack of conspicuous notice of the arbitration clause in a contract.<sup>168</sup> Finally, in *Mastrobuono*, the Court stated, albeit in dicta, that "if contracting parties agree to *include* claims for punitive damages within the issues to be arbitrated, the FAA ensures that their agreement will be enforced according to its terms even if a rule of state law would otherwise exclude such claims from arbitration."<sup>169</sup> Accordingly, if the state rule precludes the parties from arbitrating disputes they otherwise have agreed to arbitrate, in whole or in part, conditionally or unconditionally, the FAA preempts the state rule.

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160. *Id.* at 143.

161. *Id.* at 150 ("We do not believe that the statute is saved from pre-emption simply because it is, at least in a broad sense, a default rule.").

162. For example, "one of the principal goals of ERISA is to enable employers 'to establish a uniform administrative scheme.'" *Id.* at 148 (quoting *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 9 (1987)). The Court concluded in *Egelhoff* that the possibility of differing default rules imposes a burden on plan administrators that was precisely the sort Congress intended to prevent. *Id.* at 149-50. Nothing in the Supreme Court's FAA preemption cases suggests a similar congressional purpose to promote the uniformity of arbitration law.

163. *Id.* at 146.

164. For a good categorization of the sorts of state laws the Supreme Court has held preempted, see WARE, *supra* note 17, at 32-37.

165. *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 271-72 (1995).

166. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984).

167. *Perry v. Thomas*, 482 U.S. 483, 491 (1987).

168. *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 687 (1996).

169. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52, 58 (1995).

One of the few unsettled questions with respect to this step in the framework involves *Broughton v. Cigna Healthplans of California*.<sup>170</sup> In *Broughton*, the California Supreme Court held that the FAA does not preempt state rules precluding arbitration of “public injunction” actions—actions brought by individuals acting as “private attorneys general” seeking the sole remedy of an injunction against future bad conduct. The court explained that its decision was not based on any hostility to arbitration but instead on

a recognition that arbitration cannot necessarily afford all the advantages of adjudication in the area of private attorney general actions, that in a narrow class of such actions arbitration is inappropriate, and that this inappropriateness does not turn on the happenstance of whether the rights and remedies being adjudicated are of state or federal derivation.<sup>171</sup>

A pair of federal district court cases have refused to follow *Broughton*, holding—correctly—that a state rule excluding claims from arbitration because arbitration is “inappropriate” is preempted by the FAA.<sup>172</sup> *Broughton* and its progeny exhibit the exact same hostility to arbitration that the U.S. Supreme Court has found objectionable in its FAA preemption cases to date. The difference between the federal and state source of rights is not mere happenstance, but is the centerpiece of federal preemption doctrine under the Supremacy Clause.

*D. Step Four: If the State Law Does Not Invalidate the Parties' Arbitration Agreement, Evaluate the Law Under One of Several Alternative Preemption Theories.*

The Supreme Court has not yet determined how to analyze FAA preemption of state laws that regulate the arbitration process rather than invalidate the arbitration agreement—what I have called “second generation” FAA preemption cases. Commentators and lower courts have set out a number of possible theories that might be applied to such laws. I label these theories: (1) the *Keystone* Theory; (2) the RUA Theory; (3) the Anti-FAA Theory; (4) the Pro-Contract Theory; and (5) the FAA Exclusivity Theory.<sup>173</sup>

170. 988 P.2d 67 (Cal. 1999); see also *Cruz v. PacifiCare Health Sys., Inc.*, 66 P.3d 1157, 1165 (Cal. 2003) (extending *Broughton* to other “public injunction” actions but refusing to extend it to claims for restitution and disgorgement).

171. 988 P.2d at 79.

172. *Arriaga v. Cross Country Bank*, 163 F. Supp. 2d 1189, 1197-1200 (S.D. Cal. 2001), overruled on other grounds, *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); *Lozano v. AT&T Wireless*, 216 F. Supp. 2d 1071, 1076 (C.D. Cal. 2002), overruled on other grounds, *Ingle v. Circuit City Stores, Inc.*, 328 F.3d 1165 (9th Cir. 2003); see also Thomas Manakides, Note, *Arbitration of “Public Injunctions”: Clash Between State Statutory Remedies and the Federal Arbitration Act*, 76 S. CAL. L. REV. 433 (2003).

173. Application of these theories may differ depending on whether the case is in state court or in federal court. The key distinction is that while the entire FAA by its terms applies in federal court, several of these theories assume (correctly in my view) that only section 2 applies in state court. On this assumption, the preemptive scope of the FAA may be broader in federal court than in state court. One example is the appealability of orders concerning arbitration. In federal court, appealability issues plainly are dealt with by section 16 of the



### 1. *Keystone* Theory

A state law is not preempted, even if it singles out arbitration, so long as the law does not invalidate the parties' arbitration agreement. The *Keystone* Theory is named after the Montana Supreme Court's decision in *Keystone, Inc. v. Triad Systems Corp.*,<sup>174</sup> in which the court held that a Montana statute requiring arbitration to take place in Montana was not preempted because it did not "nullif[y] either party's obligation to arbitrate their dispute."<sup>175</sup> The theory can be categorized as involving a very narrow form of obstacle preemption, with the state law standing as an obstacle to Congress's purpose of overcoming common law barriers to the enforcement of arbitration agreements. (Alternatively, it might be characterized as impossibility preemption under the broader view of impossibility.<sup>176</sup>) The *Keystone* Theory is the narrowest theory described here, as it essentially limits FAA preemption to the sorts of state laws the Supreme Court already has held preempted.

### 2. RUAA Theory

A state law that does not invalidate the parties' arbitration agreement is preempted if the state law conflicts with terms in the arbitration agreement addressing "the most essential dimensions of the commercial arbitration process"—that is, that "go to the essence of the agreement to arbitrate and the role of the judiciary in holding parties to those agreements."<sup>177</sup> The theory is called the RUAA Theory because it is the view of FAA preemption used by the drafters of the Revised Uniform Arbitration Act ("RUAA").<sup>178</sup> In determining the provisions to be included in RUAA, the drafters identified a "preemption continuum."<sup>179</sup> At one end of the continuum, state laws that deal with "front-end" issues (the agreement to arbitrate and the arbitrability of a dispute) and "back-end" issues (modification, confirmation, and vacatur of awards) are most likely to be preempted.<sup>180</sup> At the other end of the continuum, state laws that deal with "procedural" issues in the arbitration proceeding (e.g. discovery, consolidation, and the immunity of arbitrators from suit) are least likely to be preempted.<sup>181</sup> In between are "borderline" issues (such as the authority of arbitrators to award punitive damages

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FAA. 9 U.S.C. § 16. In state court, the resolution is not so clear. *See infra* text accompanying notes 230-39. For other issues, however, the difference is not so stark. *See infra* text accompanying notes 206-29.

One final note on these alternative theories: My characterization and application of each of the theories is based on my best understanding of the theories and how they would apply. Others (including those whose theories I am describing) may, of course, disagree.

174. 971 P.2d 1240 (Mont. 1998). Justice Trieweiler wrote the opinion for the court. *See supra* note 85.

175. *Id.* at 1245.

176. *See supra* note 115.

177. Hayford, *supra* note 17, at 75; *see also* Hayford & Palmiter, *supra* note 17, at 213-26.

178. RUAA, *supra* note 9.

179. Hayford, *supra* note 17, at 74-75.

180. *Id.*

181. *Id.*

and provisional remedies, arbitrator disclosure of conflicts of interest, and the right to counsel in arbitration proceedings).<sup>182</sup>

Although not articulated by the RUAA drafters, a possible rationale for the RUAA Theory might go as follows: Section 2 of the FAA, the provision that applies in state court and preempts state law, provides that agreements to arbitrate shall be “valid, irrevocable, and enforceable.”<sup>183</sup> A state law can conflict with this provision in two ways. First, the law can make an arbitration agreement invalid, revocable, or unenforceable, such that the parties must go to court instead of arbitration to resolve their dispute. This describes the Supreme Court’s cases to date.<sup>184</sup> Second, the law can alter the terms of the parties’ agreement such that the procedure being enforced is no longer “arbitration.”<sup>185</sup> For example, a state law providing that all arbitration proceedings shall be presided over by a state court judge would be preempted under this theory, even though the parties proceeded to “arbitration.” This theory might be categorized as a form of obstacle preemption, under which state laws are preempted when they conflict with Congress’s purpose of making arbitration agreements as enforceable as other contract terms.

### 3. Anti-FAA Theory

A state law that does not invalidate the parties’ arbitration agreement is preempted if it “limit[s] or obstruct[s] explicit FAA provisions or general federal arbitration law” (such as the doctrine that arbitration agreements should be construed in favor of finding a dispute within their scope)—in other words, if the state law is “anti-FAA.”<sup>186</sup> This theory comes from Professors Ian Macneil et al. in their *Federal Arbitration Law* treatise.<sup>187</sup> They acknowledge that most provisions of the FAA by their terms apply only in federal court,<sup>188</sup> but they find preemptive force in “emanations from FAA § 2” as well as in general principles of federal arbitration law derived from the “pro-arbitration” policy of the FAA.<sup>189</sup> Macneil et al. seem to suggest that a state law is preempted when it provides for a different rule than the FAA does (including an FAA provision that does not by its terms apply in state court), at least when the FAA provision is “an essential aspect of any modern arbitration statute.”<sup>190</sup> On this view, the Anti-FAA Theory differs from the

182. *Id.* at 75.

183. 9 U.S.C. § 2 (2000).

184. *See supra* Part II.

185. Defining “arbitration” is not an easy task, however. *See* DRAHOZAL, *supra* note 142, § 1.03; *see also* Amy J. Schmitz, *Ending a Mud Bowl: Defining Arbitration’s Finality Through Functional Analysis*, 37 GA. L. REV. 123 (2002).

186. *See* 1 MACNEIL ET AL., *supra* note 17, § 10.8.2.4, at 10:93.

187. *Id.* §§ 10.8.2.4, 10.8.3.

188. *Id.* § 10.8.2.4, at 10:91-92 (“[A]lthough the Court holds that FAA §§ 3 and 4 do not govern in state courts, it is equally clear that FAA § 2, which does govern in state courts, carries with it duties indistinguishable from those imposed on federal courts by FAA §§ 3 and 4.”).

189. *Id.* § 10.8.3, at 10:99.

190. *Id.* (concluding that state courts have an obligation to appoint arbitrators if the parties fail to do so because it is “such an essential aspect of any modern arbitration statute that such an obligation almost certainly follows from FAA § 2—if not directly from § 5 itself”); *see also id.* § 10.8.3.2, at 10:97 (“One thing remains clear, however: state law may not contravene FAA provisions. Thus, for example, a state court vacating an award on

RUAA Theory because the Anti-FAA Theory focuses on what is essential to a modern arbitration law rather than on the essential aspects of the parties' obligation to arbitrate. This theory might be characterized as a form of obstacle preemption based on Congress's purpose of establishing a national policy in favor of arbitration. A variation on this theory would require state laws to be less favorable than, rather than simply different from, the FAA in order to be preempted.

#### 4. Pro-Contract Theory

A state law that does not invalidate the parties' arbitration agreement is preempted if it conflicts with a provision in that agreement. Professor Stephen J. Ware is a proponent of the Pro-Contract Theory.<sup>191</sup> He argues that the FAA takes a "resolutely pro-contract stance"<sup>192</sup> and that Section 2 of the FAA "gives the terms of arbitration agreements the force of federal law."<sup>193</sup> According to Professor Ware, "if one can imagine an arbitration agreement that might be rendered unenforceable by the state law then that state law is almost sure to be preempted unless it falls into the 'general contract law' category."<sup>194</sup> The Pro-Contract Theory is similar to the RUAA Theory, only broader. Under the Pro-Contract Theory, any state law that conflicts with a term in the parties' arbitration agreement (by singling out arbitration) is preempted. By comparison, under the RUAA Theory, only state laws that conflict with a term "essential" to arbitration are preempted. The preemption theory relied on by the dissenting Justices in *Bazzle* most closely resembles the Pro-Contract Theory.<sup>195</sup>

#### 5. FAA Exclusivity Theory

All state laws that single out arbitration are preempted. Macneil et al. identify "strong arguments for interpreting the FAA as both exclusive and unitary and, when it is applicable, preempting entirely all state arbitration law."<sup>196</sup> As such, according to Macneil et al., "the better course would be for the Supreme Court to hold that where the FAA governs a case, state arbitration law is entirely preempted."<sup>197</sup> The argument is that the FAA occupies (or at least should be held to occupy) the field of arbitration law. As Macneil et al. recognize, however, current

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grounds other than those allowed under the FAA would be violating the principles of *Perry v. Thomas* (U.S. 1987)." (footnote omitted)).

191. For a contrary view, see Schwartz, *supra* note 122, at 5-8 (critiquing what he calls the "enforce as written" rule).

192. See WARE, *supra* note 17, at 32.

193. See Ware, *Punitive Damages in Arbitration*, *supra* note 17, at 554.

194. See Ware, 'Opt-in' for Judicial Review, *supra* note 17, at 269.

195. See *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402, 2409-11 (2003). Although the Chief Justice's dissent in *Bazzle* cites extensively from *Volt Info. Scis., Inc. v. Bd. of Trs. of the Leland Stanford Junior Univ.*, 489 U.S. 468 (1989), that case does not support a Pro-Contract (or any other) theory of FAA preemption. Fundamentally, *Volt* was a case about when the FAA does *not* preempt state law. The Court held that when the parties choose state arbitration law to govern their contract, they can avoid preemption of (at least some) provisions of state law that otherwise might be preempted by the FAA. Relying on *Volt* to define when the FAA preempts state law (rather than when it does not preempt state law) turns *Volt* on its head.

196. See 1 MACNEIL ET AL., *supra* note 17, § 10.8.2.2, at 10:76.

197. *Id.* § 10.8.2.2, at 10:84.

case law does not support this theory.<sup>198</sup> Indeed, the Supreme Court flatly stated in *Volt* that the FAA does not “reflect a congressional intent to occupy the entire field of arbitration.”<sup>199</sup> Nonetheless, it is useful to consider the FAA Exclusivity Theory for purposes of comparing it with the other theories.

#### IV. APPLICATIONS TO SECOND GENERATION CASES

The differences between the alternative preemption theories in step four can be illustrated by applying them to the facts of four recent cases presenting unresolved issues of FAA preemption—all of which are “second generation” FAA preemption cases.<sup>200</sup> The cases are: *Bradley v. Harris Research, Inc.*,<sup>201</sup> in which the Ninth Circuit held that the FAA preempted a California law requiring the arbitration hearing to take place in-state; *Bazzle v. Green Tree Financial Corp.*,<sup>202</sup> in which the South Carolina Supreme Court (in a holding vacated by the U.S. Supreme Court on other grounds<sup>203</sup>) rejected a preemption challenge to a court-ordered classwide arbitration proceeding; *Mayo v. Dean Witter Reynolds, Inc.*,<sup>204</sup> in which a federal district court held that the FAA preempted application of the California arbitrator ethics rules; and *Wells v. Chevy Chase Bank, F.S.B.*,<sup>205</sup> in which the Maryland Court of Appeals upheld against a preemption challenge a Maryland procedural rule permitting immediate appeal of a court order compelling arbitration. The likely outcomes of the cases under the alternative preemption theories (i.e., step four of the analytical framework) are summarized in Table 1.

TABLE 1  
APPLICATION OF ALTERNATIVE PREEMPTION THEORIES TO  
“SECOND GENERATION” FAA PREEMPTION CASES

	<i>Bradley</i>	<i>Bazzle</i>	<i>Mayo</i>	<i>Wells</i>
		Contract Silent	Contract Bars	
<i>Keystone</i> Theory	Uphold	Uphold	Uphold	Uphold
RUAA Theory	Uphold	Uncertain	Uncertain	Uphold*
Anti-FAA Theory	Uphold	Uncertain	Uncertain	Uphold*
Pro-Contract Theory	Strike Down	Uphold	Strike Down	Strike Down
FAA Exclusivity Theory	Strike Down	Strike Down	Strike Down	Strike Down

\* Except as applied in an action to vacate the award.

198. *Id.* § 10.8.2.3, at 10:84.

199. *Volt*, 489 U.S. at 477.

200. *See supra* text accompanying notes 6-16.

201. 275 F.3d 884 (9th Cir. 2001).

202. 569 S.E.2d 349 (S.C. 2002), vacated by 123 S. Ct. 2402 (2003).

203. 123 S. Ct. 2402 (2003); *see supra* text accompanying notes 86-93.

204. 258 F. Supp. 2d 1097 (N.D. Cal. 2003).

205. 768 A.2d 620 (Md. 2001).

A. *Location of Arbitration Proceedings*: *Bradley v. Harris Research, Inc.*

In *Bradley v. Harris Research, Inc.*,<sup>206</sup> the Ninth Circuit considered a California law that invalidated any provision in a franchise agreement “restricting venue to a forum outside this state.”<sup>207</sup> As applied to an arbitration agreement, the provision would require the arbitration proceeding to be held in California, even if the franchise agreement provided otherwise. (If the statute invalidated the arbitration clause altogether, then presumably it would be preempted under step three of this analysis.) In *Bradley*, the Ninth Circuit held the statute to be preempted by the FAA.<sup>208</sup> Most courts dealing with such statutes have held the same.<sup>209</sup> An exception is the Montana Supreme Court’s decision in *Keystone*, which upheld a similar Montana statute.<sup>210</sup> Note that one possible argument for upholding the California statute is that it does not single out arbitration agreements—it applies to court selection clauses as well. The Ninth Circuit rejected this argument in *Bradley*,<sup>211</sup> and it properly is considered under step one (not step four) of this analytical framework.

A court applying the *Keystone* Theory would uphold the California statute at issue in *Bradley* (as the Montana Supreme Court did in *Keystone* itself) because even under the statute the parties’ dispute will be resolved in arbitration, not in court. The statute would be upheld under the RUA Theory because the location of the proceeding does not seem to be an “essential dimension” of the arbitration process.<sup>212</sup> Under the Anti-FAA Theory, the statute likely would be upheld as well because it does not conflict with anything in the FAA or in general arbitration law—the FAA does not address where the arbitration proceeding is to take place.<sup>213</sup> Under the Pro-Contract Theory, however, the statute would be struck down, assuming that the parties specified in their arbitration agreement that the arbitration would take place out-of-state. The statute also would be preempted under the FAA Exclusivity Theory because the FAA would preempt all state arbitration law.

206. 275 F.3d 884 (9th Cir. 2001).

207. *Id.* at 888 n.4 (quoting CAL. BUS. & PROF. CODE § 20040.5 (West 2003)) (“A provision in a franchise agreement restricting venue to a forum outside this state is void with respect to any claim arising under or relating to a franchise agreement involving a franchise business operating within this state.”).

208. 275 F.3d at 890.

209. *See, e.g.*, *OPE Int’l LP v. Chet Morrison Contractors, Inc.*, 258 F.3d 443, 447 (5th Cir. 2001); *KKW Enters., Inc. v. Gloria Jean’s Gourmet Coffees Franchising Corp.*, 184 F.3d 42, 50-52 (1st Cir. 1999); *Doctor’s Assocs., Inc. v. Hamilton*, 150 F.3d 157, 163 (2d Cir. 1998); *Mgmt. Recruiters Int’l, Inc. v. Bloor*, 129 F.3d 851, 856 (6th Cir. 1997) (dictum). Some, if not all of these cases, however, involve state laws that invalidate the arbitration clause altogether when an out-of-state forum is selected, which would be preempted under step three as noted in the text.

210. *Keystone, Inc. v. Triad Sys. Corp.*, 971 P.2d 1240 (Mont. 1998).

211. 275 F.3d at 890.

212. *See* Hayford, *supra* note 17, at 75.

213. *See* 9 U.S.C. §§ 1-16 (2000). Section 4 provides that when a federal court compels arbitration, “[t]he hearing and proceedings . . . shall be within the district in which the petition for an order directing such arbitration is filed.” 9 U.S.C. § 4 (2000). That provision limits the authority of federal courts to compel arbitration, but does not restrict where the parties can agree to hold the arbitration proceeding.

*B. Classwide Arbitration: Bazzle v. Green Tree Financial Corp.*

In *Bazzle v. Green Tree Financial Corp.*,<sup>214</sup> the South Carolina Supreme Court held that a court can order classwide arbitration when the parties' arbitration agreement is silent on the matter. As discussed above, the United States Supreme Court in *Bazzle* considered but did not decide whether the FAA preempts the South Carolina rule.<sup>215</sup> A key consideration may be whether the South Carolina rule applies only when the parties' arbitration agreement is silent or whether it also applies even if the agreement by its terms precludes classwide arbitration.<sup>216</sup> The majority in *Bazzle* held that interpreting the contract provision was a question for the arbitrator and not the court, and so did not reach the preemption issue. Three dissenting justices, as noted previously, would have held that the contract precluded classwide arbitration and that the state rule was preempted by the FAA.<sup>217</sup>

Under the *Keystone* Theory, the South Carolina rule would not be preempted regardless of whether the parties' arbitration clause precludes classwide arbitration. The result under the RUAA and Anti-FAA theories is less clear. Arguably, ordering classwide arbitration would affect an essential dimension of arbitration: Arbitration conducted by class representatives may differ significantly from ordinary arbitration, and proceeding on a classwide basis may restrict the parties' choice of arbitrator (as the dissent in *Bazzle* argued).<sup>218</sup> On the other hand, the parties still have their dispute finally resolved by a private judge of their own choosing, and the RUAA drafters classified consolidation as a "'procedural' issue" unlikely to be preempted by the FAA.<sup>219</sup> Although the FAA does not expressly address classwide arbitration or even consolidation of arbitration proceedings, the federal courts unanimously have construed the FAA's silence as precluding consolidation and classwide arbitration unless the parties agree otherwise.<sup>220</sup> Under

214. 569 S.E.2d 349 (S.C. 2002), *vacated*, 123 S. Ct. 2402 (2003); *see also* *Blue Cross of California v. Superior Court*, 78 Cal. Rptr. 779 (Cal. Ct. App. 1998) (rejecting preemption challenge to California rule permitting court to order class-wide arbitration).

215. *See supra* text accompanying notes 86-93.

216. *Green Tree Fin. Corp. v. Bazzle*, 123 S. Ct. 2402, 2408 (2003).

217. *See supra* text accompanying notes 91-93.

218. *Bazzle*, 123 S. Ct. at 2409-11 (Rehnquist, J., dissenting); *see also* *Discover Bank v. Superior Court*, 129 Cal. Rptr. 2d 393 (Ct. App. 2003), *review granted*, 132 Cal. Rptr. 2d 526 (Cal. 2003).

219. *See* *Hayford*, *supra* note 17, at 76 ("[P]rocedural' issues . . . are of less substantive importance to the nature and integrity of the arbitration process than are the 'borderline' issues positioned at the center of the preemption continuum.").

220. *E.g.*, *Iowa Grain Co. v. Brown*, 171 F.3d 504, 510 (7th Cir. 1999) (no classwide arbitration); *Champ v. Siegel Trading Co.*, 55 F.3d 269, 274-77 (7th Cir. 1995) (same); *Gov't of the United Kingdom v. Boeing Co.*, 998 F.2d 68, 74 (2d Cir. 1993) (no consolidation); *Am. Centennial Ins. Co. v. Nat'l Cas. Co.*, 951 F.2d 107, 107-08 (6th Cir. 1991) (same); *Baessler v. Cont'l Grain Co.*, 900 F.2d 1193, 1195 (8th Cir. 1990) (same); *Protective Life Ins. Corp. v. Lincoln Nat'l Life Ins. Corp.*, 873 F.2d 281, 282 (11th Cir. 1989) (*per curiam*) (same); *Del E. Webb Constr. v. Richardson Hosp. Auth.*, 823 F.2d 145, 150 (5th Cir. 1987) (same); *Weyerhaeuser Co. v. W. Seas Shipping Co.*, 743 F.2d 635, 637 (9th Cir. 1984) (same). In *Pedcor Mgmt. Co. v. Nations Personnel of Texas, Inc.*, 343 F.3d 355 (5th Cir. 2003), the Fifth Circuit concluded that "[t]o the extent that the issue of consolidation in arbitration is analogous to class arbitration, *Green Tree's* holding that

those cases, the Anti-FAA Theory might hold the South Carolina rule preempted. The result under the Pro-Contract Theory turns on whether the parties precluded classwide arbitration (or agreed to have arbitration proceed on an individual basis) in their arbitration agreement. If so, the state rule is preempted. If not, the state rule is not preempted. Again, the South Carolina rule providing for classwide arbitration would be preempted under the FAA exclusivity theory.

*C. Arbitrator Disclosure: Mayo v. Dean Witter Reynolds, Inc.*

At issue in *Mayo v. Dean Witter Reynolds, Inc.*<sup>221</sup> was the validity of ethics standards promulgated by the California Judicial Council to govern neutral arbitrators.<sup>222</sup> A central component of the ethics standards is a requirement that neutral arbitrators make detailed disclosures of possible conflicts of interest.<sup>223</sup> The disclosure requirement is reinforced by making the failure to disclose a ground for automatically vacating the arbitration award.<sup>224</sup> The disclosures appear to be broader and certainly are more detailed than those required to avoid vacatur of an award under the FAA.<sup>225</sup> In *Mayo*, a federal district court held the ethics standards preempted as applied to securities arbitrations, in part on the ground that the ethics standards conflicted with the parties' arbitration agreement, which provided that the arbitration rules of the New York Stock Exchange would govern the arbitration.<sup>226</sup>

The ethics standards would not be preempted under the *Keystone* theory. They probably would not be preempted under the RUAA Theory or the Anti-FAA Theory, except to the extent a party sought to vacate the award because of the arbitrator's failure to disclose required information. State rules governing vacatur of arbitration awards may well go to an essential dimension of the arbitration process<sup>227</sup> and would conflict with section IO of the FAA, which includes its own

arbitrators, not courts, decide whether an agreement provides for class arbitration would appear to overrule *Del E. Webb's* holding to the contrary." *Id.* at 363.

221. 258 F. Supp. 2d 1097 (N.D. Cal. 2003). *But see* *Jevne v. Superior Court*, 6 Cal. Rptr. 3d 542, 552 & n.8 (Ct. App. 2003) (holding that ethics standards "are not preempted by the FAA as a matter of law," but not deciding whether standards "are preempted by the FAA as applied in this case").

222. Judicial Council of California, *supra* note 7. For a discussion of the history of the California ethics rules, see Note, *A New Era of Disclosure: California Enacts Arbitrator Ethics Standards*, 2003 J. DISP. RESOL. 271, 280-83. An earlier preemption challenge to the California ethics standards was dismissed on the basis of the Eleventh Amendment. *NASD Dispute Resolution, Inc. v. Judicial Council of Cal.*, 232 F. Supp. 2d 1055, 1063-65 (N.D. Cal. 2002).

223. *See* Judicial Council of California, *supra* note 7, at 7-8 (2003). For a discussion of the history of the California ethics rules, see Keisha I. Patrick, *A New Era of Disclosure: California Judicial Council Enacts Arbitrator Ethics Standards*, 2003 J. DISP. RESOL. 271, 280-83.

224. CAL. CIV. PROC. CODE § 1286.2(a)(6)(A) (2003).

225. *See* Michael A. Perino, *Report to the Securities and Exchange Commission Regarding Arbitrator Conflict Disclosure Requirements in NASD and NYSE Securities Arbitrations* 41-44 (Nov. 4, 2002), available at [http://www.nasdaq.com/pdf-text/perino\\_report.pdf](http://www.nasdaq.com/pdf-text/perino_report.pdf). For a detailed analysis of when failure to disclose is a ground for vacating an award under the FAA, see 3 MACNEIL ET AL., *supra* note 17, § 28.2.

226. *Mayo*, 258 F. Supp. 2d at 1104-05.

227. The RUAA drafters classified arbitrator disclosure as a "'borderline' issue" that "do[es] not go to the essence of the agreement to arbitrate or the effectuation of the results of

grounds for vacating awards.<sup>228</sup> To the extent parties agreed on arbitration rules that addressed arbitrator disclosure (as in *Mayo*), the California ethics standards would be preempted under the Pro-Contract Theory. Indeed, the federal court's analysis in *Mayo* is very much consistent with the Pro-Contract Theory.<sup>229</sup> Finally, the ethics standards also would be preempted under the FAA Exclusivity Theory.

#### *D. Appealability of Orders Compelling Arbitration: Wells v. Chevy Chase Bank*

*Wells v. Chevy Chase Bank, F.S.B.*<sup>230</sup> involved a Maryland law governing when a party can appeal a court order compelling the parties to arbitrate. Some states, like Maryland, permit a party to appeal immediately from an order compelling arbitration.<sup>231</sup> Section 16 of the FAA, by contrast, does not permit an immediate appeal.<sup>232</sup> The Maryland Court of Appeals held that the FAA does not preempt the Maryland rule,<sup>233</sup> joining the "near unanimity of opinion on the matter" in the state courts.<sup>234</sup> The court justified its decision on the grounds that section 16 by its terms applies only in federal court and that Maryland's contrary rule does not "undermine the goals and principles of the FAA."<sup>235</sup>

The state rule at issue in *Wells* is different from the other state rules considered here because it deals with the procedure in state court rather than the procedure in arbitration.<sup>236</sup> Nonetheless, it should be possible to apply the alternative preemption theories with some degree of confidence.<sup>237</sup> As with the other state rules, the Maryland rule would not be preempted under the *Keystone* Theory and would be preempted under the FAA Exclusivity Theory. The timing of appellate review of orders compelling arbitration does not go to the essence of the arbitration

the process." See Hayford, *supra* note 17, at 75, 79 (explaining that, with respect to arbitrator disclosure, the "Drafting Committee fashioned statutory language intended to track the federal law"); see also Hayford & Palmiter, *supra* note 17, at 220-21 ("The FAA addresses, but only obliquely, disclosure of arbitrator conflicts of interest," and so RUAA drafters "acted boldly in addressing arbitrator disclosure.").

228. 9 U.S.C. § 10 (2000); see 1 MACNEIL ET AL., *supra* note 17, § 10.8.3.2, at 10:97 ("One thing remains clear, however: state law may not contravene FAA provisions. Thus, for example, a state court vacating an award on grounds other than those allowed under the FAA would be violating the principles of *Perry v. Thomas* (U.S. 1987).") (footnote omitted).

229. *Mayo*, 258 F. Supp. 2d at 1105.

230. 768 A.2d 620 (Md. 2001).

231. *Id.* at 624.

232. 9 U.S.C. § 16(b)(2) (2000).

233. *Wells*, 768 A.2d at 629.

234. See Pierre H. Bergeron, *District Courts as Gatekeepers? A New Vision of Appellate Jurisdiction over Orders Compelling Arbitration*, 51 EMORY L.J. 1365, 1387 (2002).

235. *Wells*, 768 A.2d at 627.

236. See Rau, *supra* note 17, at 20-21.

237. The case is similar to *Johnson v. Fankell*, 520 U.S. 911 (1997), in which the Supreme Court upheld against a preemption challenge a state rule that precluded immediate appeal of an order rejecting a qualified immunity defense in a federal civil rights action. One difference is that in *Johnson*, the Supreme Court characterized the dispute as involving a conflict between competing state interests (rather than state and federal interests): a conflict between the state appealability rule and qualified immunity protection for state officials. *Id.* at 919-20. In the arbitration context, a federal interest is at stake: the enforceability of arbitration agreements under the FAA.



agreement,<sup>238</sup> nor are parties likely to address it in their arbitration agreement. Thus, the Maryland rule likely would not be preempted under the RUAA theory and the Pro-Contract theory. However, the Maryland rule may be deemed “anti-FAA” because it rejects the FAA approach (in a manner less favorable to arbitration as well), and so arguably it would be preempted under the Anti-FAA theory.<sup>239</sup>

### CONCLUSION

It has now been twenty years since the Supreme Court decided *Southland Corp. v. Keating*,<sup>240</sup> in which it first held that the Federal Arbitration Act applies in state court and preempts state law. This is a good time to take stock of the legal doctrine that has developed. Some fundamental principles of FAA preemption are resolved: State laws that single out arbitration are preempted when they invalidate arbitration agreements; general contract law defenses, even when applied to invalidate arbitration agreements, ordinarily are not preempted; and parties can incorporate by reference state arbitration laws into their contracts and avoid FAA preemption.

As the analytical framework developed here illustrates, however, a number of issues remain unsettled, even after twenty years. The lower courts are divided on whether the FAA preempts state laws that apply to arbitration agreements and to some other contract clauses, but not to contracts generally. Questions remain to be answered as to when general contract law defenses, while ordinarily saved from preemption, may nonetheless single out arbitration agreements and be preempted after all. Perhaps most importantly, the Supreme Court still has to decide how to deal with “second generation” FAA preemption cases—cases involving state laws that regulate the arbitration process rather than invalidating the parties’ arbitration agreement. This Article identifies and categorizes five alternative theories for deciding such cases. One might expect the Court to favor one of the narrower theories (i.e., one that preempts fewer state laws), as contract law is an area traditionally occupied by the states and so the presumption against preemption would apply.<sup>241</sup> But given the notable absence of the presumption in the Court’s FAA preemption decisions to date,<sup>242</sup> that may be an unrealistic expectation.

238. It may be that the RUAA drafters viewed appealability standards as presenting a “front-end” issue,” as the standards arguably involve “questions raised when a party attempts to evade an otherwise valid arbitration contract,” Hayford, *supra* note 17, at 74, but I have found no clear indication to that effect in their published writings. The closest is a statement in Hayford & Palmiter, *supra* note 17, at 181, describing appealability standards as “[a]t the back end” of the FAA, but not mentioning RUAA.

239. See 1 MACNEIL ET AL., *supra* note 17, § 10.8.2.4, at 10:95-10:96 (concluding that state court decision, which applied state law time limit for vacatur action instead of shorter FAA time limit, was “wrong but, fortunately, rare”; and that because state “allows a longer period its act should have been recognized as limiting the FAA improperly”).

240. 465 U.S. 1 (1984).

241. See *supra* text accompanying notes 37-39.

242. Except, of course, in the dissents.

