

ALLIED-BRUCE TERMINIX COS. V. DOBSON: HOW THE FEDERAL ARBITRATION ACT WILL KEEP CONSUMERS AND CORPORATIONS OUT OF THE COURTROOM

In *Allied-Bruce Terminix Cos. v. Dobson*, the United States Supreme Court closed the door on state attempts to regulate arbitration agreements by holding that Congress intended to exercise its commerce power in full when it enacted the Federal Arbitration Act ("FAA" or "the Act")¹ in 1925.² In so holding, the Court has eviscerated numerous state statutes, including statutes designed to protect consumers, and expanded the FAA to cover transactions for which it was never designed.³ The Court, however, has also ensured that the FAA will serve effectively its intended purpose of providing businesses with a less expensive, faster method of resolving their disputes.⁴

Since its enactment in 1925, the scope of the Federal Arbitration Act has been in doubt.⁵ A murky legislative history has spawned questions as to when the Act governs an arbitration agreement.⁶ Constitutional concerns about applicability in state court proceedings as well as statutory construction issues have complicated this determination.⁷ Seventy years after the FAA's enactment, the United States Supreme Court finally settled these issues in *Allied-Bruce Terminix Cos. v. Dobson*.⁸

This Note examines the decision and its probable impact on commercial and consumer contracts.⁹ Part I provides a brief discussion of arbitration and its advantages and disadvantages.¹⁰ Part II examines the history of arbitration law in the United States and the enactment of the FAA.¹¹ Part III then reviews the series of decisions interpreting

¹ 9 U.S.C. §§ 1-14 (1988 & Supp. V. 1994).

² 115 S. Ct. 834, 838-39, 841 (1995).

³ *Id.* at 843, 844 (O'Connor, J., concurring).

⁴ *See id.* at 838, 840, 842-43.

⁵ *See, e.g., id.* at 836; *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198 (1956).

⁶ *See Terminix*, 115 S. Ct. at 839.

⁷ *See id.* at 838-39.

⁸ *Id.* at 839-40.

⁹ *See infra* sections V-VI reviewing and analyzing the decision and its impact.

¹⁰ *See infra* notes 16-32 and accompanying text.

¹¹ *See infra* notes 33-77 and accompanying text.

the scope of the FAA that provide the necessary background for *Terminix*.¹² Part IV reviews the majority concurring and dissenting opinions in *Terminix*.¹³ Part V analyzes the *Terminix* decision.¹⁴ Finally, Part VI examines the impact the Court's decision in *Terminix* will have on both commercial and consumer transactions.¹⁵

I. ARBITRATION AND ITS ADVANTAGES AND DISADVANTAGES

Arbitration is a private mechanism for dispute resolution that uses neutral third parties to review claims and make binding decisions.¹⁶ Arbitration is generally seen as an alternative to litigation and is meant to serve as a faster, less formal and less expensive way to resolve controversies.¹⁷ Parties in arbitration may have attorneys or other representation; they also may choose to represent themselves.¹⁸ Often a sponsoring organization, such as the American Arbitration Association, appoints the arbitrator and the parties pay the arbitrator a per diem fee.¹⁹ While processes differ, arbitration is often characterized by limited discovery, hearings that do not follow formal rules of evidence, and written awards that do not need to state the reasons or findings that support the decisions.²⁰ Generally, arbitrators, unlike courts, are not bound to follow the law and may consider a variety of factors when making their decision.²¹ Judicial review of arbitration awards is very circumscribed.²² In general, courts will only review awards upon a showing of actual misconduct by the arbitrator or a "manifest disregard of the law."²³ The arbitrator's overall goal is to determine a fair award that comports with the parties' original agreement.²⁴

Arbitration tends to earn high marks for speed, fairness and cost-effectiveness.²⁵ The business sector, in particular, has resorted to arbi-

¹² See *infra* notes 78–158 and accompanying text.

¹³ See *infra* notes 159–223 and accompanying text.

¹⁴ See *infra* notes 224–36 and accompanying text.

¹⁵ See *infra* notes 237–50 and accompanying text.

¹⁶ G. Richard Shell, *Res Judicata and Collateral Estoppel Effects of Commercial Arbitration*, 35 UCLA L. REV. 623, 628–29 (1988).

¹⁷ Thomas J. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 429–30 (1988).

¹⁸ *Id.* at 433–34.

¹⁹ Shell, *supra* note 16, at 630–31.

²⁰ *Id.* at 632; Stipanowich, *supra* note 17, at 438.

²¹ Shell, *supra* note 16, at 633.

²² Stipanowich, *supra* note 17, at 439.

²³ 1 MARTIN DOMKE, DOMKE ON COMMERCIAL ARBITRATION § 34:00, at 475–76 (Gabriel M. Wilner ed., 1994).

²⁴ Shell, *supra* note 16, at 633.

²⁵ Stipanowich, *supra* note 17, at 457, 460, 461.

tration to try to settle disputes more quickly and cheaply.²⁶ The use of arbitration as administered by business organizations has helped to develop uniform definitions of contract terms and conditions.²⁷ Arbitration also can allow parties in ongoing relationships to avoid the acrimony of litigation.²⁸ Additionally, arbitration allows experts in particular markets or industries, rather than judges, to decide claims.²⁹

Arbitration does, however, have some disadvantages. Some research has shown a tendency for arbitrators to "split the difference" between the parties in order to preserve the parties' relationship, to spawn repeat business from the parties or to enhance the arbitrator's reputation as a moderate decision maker.³⁰ Additionally, limited discovery in arbitration can lead to "trial by surprise" which leads to longer arbitration hearings and increased attorney preparation time for the hearings.³¹ This can both increase costs and lead to uninformed awards.³²

II. AMERICAN ARBITRATION LAW AND THE FEDERAL ARBITRATION ACT

Early American courts adopted a hostile stance towards arbitration agreements from English courts.³³ Courts and commentators conjecture that the English courts developed a negative posture towards arbitration because the agreements attempted to deprive them of jurisdiction and bypass the courts.³⁴ This hostility translated into a refusal to enforce arbitration agreements by considering them revocable until an award was returned.³⁵ American courts may have followed this rule simply because it was well-settled, not because of its merits.³⁶

²⁶ Domke, *supra* note 23, § 2:01, at 13.

²⁷ *Id.*

²⁸ Shell, *supra* note 16, at 629.

²⁹ *Id.*

³⁰ *Id.* at 633-34.

³¹ Súpanowich, *supra* note 17, at 443-44, 452.

³² *Id.* at 444, 452.

³³ See *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 838 (1995); see also Linda R. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1309-11 (1985); Henry C. Strickland, *The Federal Arbitration Act's Interstate Commerce Requirement: What's Left for State Arbitration Law*, 21 HOFSTRA L. REV. 385, 389 (1992).

³⁴ *Terminix*, 115 S. Ct. at 838; *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 211 n.5 (1956); Harry Baum & Leon Pressman, *The Enforcement of Commercial Arbitration Agreements in the Federal Courts*, 8 N.Y.U. L.Q. REV. 238, 240 (1931); Julius Henry Cohen & Kenneth Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 282 (1926).

³⁵ Strickland, *supra* note 33, at 389.

³⁶ *Bernhardt*, 350 U.S. at 211 n.5 (Frankfurter, J., concurring).

In the 1920's, however, the business community began to pressure legislatures to enact laws altering the common law rule.³⁷ In 1920, New York adopted the first statute that declared arbitration agreements enforceable.³⁸ Other states soon followed.³⁹ Federal courts, however, did not follow these statutes because they were seen primarily as procedural and because federal courts at that time were not bound by state common law.⁴⁰ Accordingly, in 1925, the United States Congress enacted the Federal Arbitration Act.⁴¹ Although the legislative history is not entirely clear, it appears that the Act was intended simply to complement state laws and make commercial arbitration agreements enforceable in federal courts.⁴²

The FAA's cardinal provision, section 2, provides that courts will enforce written arbitration agreements in connection with either maritime transactions or contracts involving commerce whether entered into before or after the dispute arises, unless grounds for revocation of the agreement exist.⁴³ The other sections of the act provide definitions⁴⁴ and procedures for enforcing arbitration agreements.⁴⁵ These include methods of obtaining a stay of proceedings in United States courts,⁴⁶ a court order to compel arbitration,⁴⁷ the appointment of arbitrators,⁴⁸ subpoenas,⁴⁹ and judicial enforcement,⁵⁰ revision,⁵¹ and annulment of awards.⁵² After passage of the Act, federal courts began

³⁷ Hirshman, *supra* note 33, at 1311-12.

³⁸ *Id.* at 1312.

³⁹ *Id.* at 1312 & n.33; Strickland, *supra* note 33, at 389-90.

⁴⁰ *Southland Corp. v. Keating*, 465 U.S. 1, 34 (1984) (O'Connor, J., dissenting); *Atlantic Fruit Co. v. Red Cross Line*, 5 F.2d 218, 219 (2d Cir. 1924).

⁴¹ *Southland*, 465 U.S. at 34 (O'Connor, J., dissenting).

⁴² *Southland*, 465 U.S. at 12; *id.* at 34-35 (O'Connor, J., dissenting).

⁴³ 9 U.S.C. § 2 (1988). The text of the statute states:

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

Id.

⁴⁴ 9 U.S.C. § 1 (1988).

⁴⁵ 9 U.S.C. §§ 3-10 (1988 & Supp. V 1993).

⁴⁶ 9 U.S.C. § 3 (1988).

⁴⁷ 9 U.S.C. § 4 (1988).

⁴⁸ 9 U.S.C. § 5 (1988).

⁴⁹ 9 U.S.C. § 7 (1988).

⁵⁰ 9 U.S.C. § 9 (1988).

⁵¹ 9 U.S.C. § 11 (1988).

⁵² 9 U.S.C. § 10 (1988 & Supp. V 1993).

enforcing arbitration agreements. Thirteen years later, however, a United States Supreme Court decision threatened the constitutionality of the Act.⁵³

In the landmark 1938 decision, *Erie Railroad Co. v. Tompkins*,⁵⁴ the United States Supreme Court held that federal courts did not have the power to fashion substantive common law and implied that Congress could not do so in diversity cases.⁵⁵ *Erie* involved the now famous story of a Pennsylvania resident injured in his home state by a freight train owned by the Erie Railroad Company, a New York corporation.⁵⁶ The resident, Tompkins, sued the railroad in the United States District Court for the Southern District of New York on the basis of diversity jurisdiction.⁵⁷ Applying the federal common law of torts, the district court found for the plaintiff despite Pennsylvania common law to the contrary.⁵⁸ In contrast, the United States Supreme Court reasoned that the application of a general federal common law invaded the rights of the states and encouraged forum-shopping by establishing the availability of different outcomes depending on whether parties filed the case in state or federal court.⁵⁹ The Court, therefore, reversed the United States Court of Appeals for the Second Circuit, which had affirmed the district court's judgment.⁶⁰ Thus, the *Erie* Court held that there is no federal general common law and further stated that Congress lacked the power to declare any such substantive rules of common law.⁶¹

After *Erie*, the FAA faced a number of challenges to its constitutionality.⁶² Most of the cases involving arbitration agreements landed in federal courts on the basis of diversity jurisdiction because disputes over the agreements generally arose out of contracts.⁶³ Contract interpretation is mainly an area of state common law.⁶⁴ It thus became important to determine Congress's authority to enact the FAA.

The legislative history shed little light on whether Congress intended the Act to replace general federal common law or whether

⁵³ See *infra* notes 62-64 and accompanying text.

⁵⁴ 304 U.S. 64 (1938).

⁵⁵ *Id.* at 72, 78-79; Hirshman, *supra* note 33, at 1316.

⁵⁶ *Erie*, 304 U.S. at 69.

⁵⁷ See *id.*

⁵⁸ *Id.* at 70.

⁵⁹ *Id.* at 76, 78-80.

⁶⁰ *Id.* at 70, 80.

⁶¹ *Erie*, 304 U.S. at 78.

⁶² Hirshman, *supra* note 33, at 1313-14; Strickland, *supra* note 33, at 392.

⁶³ *E.g.*, *American Guar. Co. v. Caldwell*, 72 F.2d 209, 210-11 (9th Cir. 1934).

⁶⁴ See *Erie*, 304 U.S. at 78.

Congress enacted the FAA under its Article III power to regulate procedure in federal courts or under its Article I commerce and admiralty powers.⁶⁵ If Congress meant the Act as a substantive federal rule of decision, *Erie* suggested that Congress lacked the power to enact it.⁶⁶ Moreover, between *Erie* and the 1965 United States Supreme Court decision in *Hanna v. Plumer*,⁶⁷ it was uncertain whether federalism concerns would render the FAA inapplicable in diversity cases if enacted as a procedural rule under Article III.⁶⁸ As arbitration does tend to lead to differing outcomes, the potential for forum shopping existed.⁶⁹ Parties to the agreement may have chosen between differing federal and state rules regarding enforceability of arbitration agreements depending on their assessments of the chances of a favorable or unfavorable arbitration award.⁷⁰ If Congress enacted the FAA under its Article I powers, however, *Erie* would not invalidate the FAA because Congress clearly had the power to enact substantive laws in the areas of commerce.⁷¹ Although Congress usually provided for federal question jurisdiction when enacting legislation under Article I, it did not do so in the FAA.⁷² Moreover, the Act was not considered binding on state proceedings,⁷³ and the legislative history, although murky, indicated that Congress saw arbitration and the FAA as procedural or

⁶⁵ Hirshman, *supra* note 33, at 1314–15.

⁶⁶ *Erie*, 304 U.S. at 78.

⁶⁷ 380 U.S. 460 (1965). In *Hanna*, the United States Supreme Court held that the Constitution gives Congress the power to regulate practice and procedure in federal courts, including ambiguous issues that rationally could be considered either substantive or procedural. *Id.* at 472. In *Hanna*, a defendant in a diversity case was served process in accordance with Fed. R. Civ. P. 4. *Id.* at 461. The United States District Court for the District of Massachusetts granted the defendant's motion for summary judgment because the service did not comply with a state law. *Id.* at 461–62. The Supreme Court reasoned, in contrast, that *Erie* involved more than whether the outcome differed under state or federal law; *Erie* also involved concerns with forum-shopping, equal protection due to "substantial" differences between state and federal law, and federalism. *See id.* at 466–67, 471. Furthermore, the Court noted that every procedural difference could be outcome-determinative, that it was unlikely that different methods of service would guide a litigant's choice of forum, and that *Erie* involved a substantive rule of negligence, not a "house-keeping" rule that Congress had the constitutional authority to enact. *See id.* at 468–69, 472–73. Thus, the Court held that arguably procedural rules prescribed by Congress can constitutionally be applied in diversity cases. *Id.* at 472, 474.

⁶⁸ Strickland, *supra* note 33, at 392.

⁶⁹ *Southland Corp. v. Keating*, 465 U.S. 1, 15 (1984); *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 202–03 (1956).

⁷⁰ *See Bernhardt*, 350 U.S. at 203–04.

⁷¹ Hirshman, *supra* note 33, at 1317; Strickland, *supra* note 33, at 392.

⁷² 9 U.S.C. § 4 (1988); Hirshman, *supra* note 33, at 1317–18.

⁷³ *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 845–46 (1995) (Thomas, J., dissenting); Strickland, *supra* note 33, at 391.

remedial in nature and intended the Act to complement, not preempt, state law.⁷⁴

Thus, the issue of whether the FAA mandated the enforcement of an arbitration agreement contained two components.⁷⁵ First, did Congress intend the FAA to apply in state proceedings and was that application constitutional?⁷⁶ Second, did the Act, as a matter of statutory construction, cover the arbitration agreement in question?⁷⁷ State and federal courts have grappled with these issues since *Erie*.

III. JUDICIAL INTERPRETATION OF THE SCOPE OF THE FEDERAL ARBITRATION ACT

In 1956, in *Bernhardt v. Polygraphic Co. of America*,⁷⁸ the United States Supreme Court avoided the constitutional issue created by *Erie* by holding that the contract in question did not evidence "a transaction involving commerce," which meant that the FAA, by its own terms, did not apply.⁷⁹ The case arose from an employment contract which provided that, in the event of a dispute, the parties would submit the matter to arbitration under New York law.⁸⁰ At the time the parties entered into the contract, the employee was a resident of New York and the employer was a New York corporation.⁸¹ The contract, made in New York, called for the employee to move to Vermont to perform his duties.⁸² The employee was subsequently discharged, and when he sued the company in Vermont state court, Polygraphic removed the action to federal district court under diversity jurisdiction.⁸³ Polygraphic then sought a stay of proceedings under section 3 of the FAA so that arbitration could occur in New York.⁸⁴

The United States District Court for the District of Vermont denied the stay, ruling that *Erie* required the court to apply Vermont law, which made arbitration agreements revocable at any time prior to the actual award.⁸⁵ The United States Court of Appeals for the Second

⁷⁴ *Southland*, 465 U.S. at 25, 29, 34-35 (O'Connor, J., dissenting).

⁷⁵ *Terminix*, 115 S. Ct. at 838-39.

⁷⁶ *Id.*

⁷⁷ *Id.* at 839.

⁷⁸ 350 U.S. 198 (1956).

⁷⁹ *Id.* at 200-01, 202.

⁸⁰ *Id.* at 199.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Bernhardt*, 350 U.S. at 199.

⁸⁴ *Id.* at 199-200.

⁸⁵ *Id.* at 200.

Circuit reversed, holding that section 3 could be invoked independently of section 2 and covered all contracts, even those that do not involve maritime transactions or transactions in commerce.⁸⁶ The United States Supreme Court reversed the Second Circuit, reasoning that sections 1 through 3 were all part of the same regulatory scheme and covered the same field—maritime transactions or transactions “in commerce.”⁸⁷ Thus, as the employment transaction did not “involve commerce,” the Court held that section 3 did not apply and left the *Erie* question unresolved.⁸⁸

In 1967, in *Prima Paint Corp. v. Flood & Conklin Manufacturing*,⁸⁹ the United States Supreme Court finally addressed the *Erie* question by holding that Congress enacted the FAA under its Article I interstate commerce power.⁹⁰ The Court further held that the FAA governed the agreement in question because the transaction involved commerce.⁹¹ Finally, the Court also held that an arbitration agreement is separable from the contract in which it is found.⁹² Thus, the Court held that a claim of fraud in the inducement of the entire contract was an arbitrable issue.⁹³

The *Prima Paint* controversy arose out of a consulting agreement between Prima Paint, a Maryland corporation, and Flood & Conklin (“F&C”), a New Jersey corporation, that followed the sale of F&C’s paint business to Prima Paint.⁹⁴ Shortly after the parties signed the six-year agreement, F&C filed for bankruptcy.⁹⁵ Prima Paint sued for rescission of the contract on the ground of fraudulent inducement.⁹⁶ F&C moved to stay the court action pending arbitration, as provided in the agreement.⁹⁷ The United States District Court for the Southern District of New York granted the stay.⁹⁸ The United States Court of Appeals for the Second Circuit and, later, the United States Supreme Court affirmed the stay.⁹⁹

⁸⁶ *Id.* at 200, 201.

⁸⁷ *Id.* at 201.

⁸⁸ *Bernhardt*, 350 U.S. at 201, 202.

⁸⁹ 388 U.S. 395 (1967).

⁹⁰ *Id.* at 404–05.

⁹¹ *Id.* at 401.

⁹² *Id.* at 402, 404.

⁹³ *Id.* Therefore, only claims for rescission or revocation that are directed specifically at the agreement to arbitrate will be heard by a court. *Id.* at 404. All others are decided via arbitration. *Id.*

⁹⁴ *Prima Paint*, 388 U.S. at 397.

⁹⁵ *Id.* at 398.

⁹⁶ *Id.* at 398 & n.2.

⁹⁷ *Id.* at 399.

⁹⁸ *Id.*

⁹⁹ *Prima Paint*, 388 U.S. at 399–400.

In affirming the decision, the Court first declared the consulting agreement a contract that evidenced a transaction in commerce.¹⁰⁰ The Court reasoned that three facts made this a clear case of interstate commerce.¹⁰¹ First, the agreement involved corporations from two different states.¹⁰² Second, the paint business served wholesale clients in a number of states.¹⁰³ Finally, the transaction involved the transfer of the business from New Jersey to Maryland.¹⁰⁴

The Court next held that the arbitrator should decide the claim of fraudulent inducement while the federal court could only consider issues specifically related to the agreement to arbitrate.¹⁰⁵ The Court reasoned that section 3's remedy of a stay should be available in the same situations as section 4's remedy of compelling arbitration.¹⁰⁶ Section 4 instructed federal courts to order arbitration once they were satisfied that the actual making of, or failure to comply with, the agreement to arbitrate was not at issue.¹⁰⁷

Finally, the Court summarily held that Congress enacted the FAA on the basis of its commerce and admiralty powers.¹⁰⁸ In a footnote, the Court supported its conclusion by citing brief legislative statements suggesting that the bill was intended to cover the fields of maritime transactions and foreign and interstate commerce.¹⁰⁹ Thus, the Court eliminated the *Erie* question and provided an example of a contract evidencing a transaction in interstate commerce while affirming the Second Circuit's dismissal of an appeal from the grant of a stay of proceedings in the District Court.¹¹⁰

The dissent, written by Justice Black and joined by Justices Douglas and Stewart, disagreed with all three holdings.¹¹¹ Justice Black reasoned that the FAA did not apply to the consulting agreement both because the main supporters of the Act were those involved in producing, buying, selling and transporting commodities across state lines and because Congress did not use the term "affecting commerce," which

¹⁰⁰ *Id.* at 401.

¹⁰¹ *Id.* at 397, 401.

¹⁰² *Id.*

¹⁰³ *Id.* at 401.

¹⁰⁴ *Prima Paint*, 388 U.S. at 401.

¹⁰⁵ *Id.* at 403-04.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* 9 U.S.C. § 4 states, "The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration . . ." 9 U.S.C. § 4 (1988).

¹⁰⁸ *Prima Paint*, 388 U.S. at 404-05.

¹⁰⁹ *Id.* at 405 n.13.

¹¹⁰ *Id.* at 399, 401, 405, 407.

¹¹¹ *Id.* at 409-11 (Black, J., dissenting).

usually indicates Congress's desire for an expansive reach.¹¹² The dissent further reasoned that the language of section 4 did not mandate severability, it simply posited the further question of what claims would put the making of an agreement to arbitrate in issue.¹¹³ Additionally, Justice Black reasoned that Congress did not intend the Act to be substantive law enacted under the commerce power because the legislative history contained assurances that the new law was procedural in nature and granted no new rights other than enforcement remedies.¹¹⁴ Finally, the dissent cited indications in the legislative history that the Act did not apply to state proceedings and the Act lacked independent federal question jurisdiction, both of which were inconsistent with the idea that Congress was enacting substantive law.¹¹⁵

In sum, the *Prima Paint* Court held that Congress enacted the FAA under its Article I powers, that the FAA governed the consulting agreement because the underlying transaction involved commerce, and that an arbitration clause is severable from the rest of a contract.¹¹⁶ Therefore, a claim of fraudulent inducement of the entire contract needed to be decided via arbitration.¹¹⁷ Despite the dissenting opinion that disagreed with these holdings,¹¹⁸ *Prima Paint* seemed to settle the question of whether the FAA applied in state courts, as well as in federal courts by implication.¹¹⁹ Some state courts, however, narrowly read *Prima Paint* as only applying to cases over which federal courts could have had jurisdiction.¹²⁰

In 1984, in *Southland Corp. v. Keating*, the United States Supreme Court reversed the California Supreme Court by holding that section 2 of the FAA preempts state laws that withdraw the power to enforce arbitration agreements.¹²¹ Thus, the Court established the FAA as the generally applicable substantive law of arbitration in state and federal courts.¹²²

The dispute in *Southland* arose out of franchise agreements, which included arbitration clauses, between Southland Corporation, the

¹¹² *Id.* at 409-10 & n.2 (Black, J., dissenting).

¹¹³ *Prima Paint*, 388 U.S. at 410 (Black, J., dissenting).

¹¹⁴ *Id.* at 418-19 (Black, J., dissenting).

¹¹⁵ *Id.* at 420 (Black, J., dissenting).

¹¹⁶ *Id.* at 401, 402, 404-05.

¹¹⁷ *Id.* at 406-07.

¹¹⁸ *Prima Paint*, 388 U.S. at 409-11 (Black, J., dissenting).

¹¹⁹ *Southland Corp. v. Keating*, 465 U.S. 1, 11-12 (1984); *Prima Paint*, 388 U.S. at 422 (Black, J., dissenting).

¹²⁰ See, e.g., *Keating v. Superior Court of Alameda Cty.*, 645 P.2d 1192, 1203-04 (Cal. 1982); Hirshman, *supra* note 33, 1326-27 & n.125.

¹²¹ 465 U.S. 1, 16-17 (1984).

¹²² Strickland, *supra* note 33, at 396.

owner and franchiser of 7-Eleven convenience stores, and its franchisees.¹²³ Several of the franchisees filed suits against Southland alleging various claims, including violations of the California Franchise Investment Law.¹²⁴ Southland's answer to almost all of these suits included the affirmative defense of failure to arbitrate.¹²⁵ Upon consolidation of the claims into a class action suit, Southland petitioned to compel arbitration of all claims.¹²⁶ The California Superior Court compelled arbitration on all of the claims, except those based on the Franchise Investment Law, because the statute did not allow any waivers of its terms.¹²⁷ The California Supreme Court agreed, holding that the claims under the California statute were not arbitrable and that the Franchise Investment Act did not contravene the FAA.¹²⁸

The Supreme Court reversed,¹²⁹ reasoning that in enacting section 2 "Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration."¹³⁰ The Court relied on the legislative history to support its position, reasoning that it was unlikely that Congress would only address the Act's impact in federal courts in light of the widespread problem.¹³¹ According to the Court, this problem encompassed both common law hostility to arbitration and the lack of state statutes to override it and order enforcement of arbitration agreements.¹³² Moreover, the Court reasoned, a contrary interpretation of Congress's intent would lead to forum shopping and have little effect because most civil litigation occurs in state courts.¹³³ Therefore, the *Southland* Court concluded that the California Franchise Investment Law, as construed by the California Supreme Court, violated the Supremacy Clause and was preempted by the FAA.¹³⁴

After *Southland* cleared away the last of the constitutional concerns involving Congress's authority, only two limitations to the scope of the FAA and its broad policy favoring arbitration remained.¹³⁵ The

¹²³ *Southland*, 465 U.S. at 3-4.

¹²⁴ *Id.* at 4.

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.* at 4, 5 n.1.

¹²⁸ *Southland*, 465 U.S. at 5.

¹²⁹ *Id.* at 6.

¹³⁰ *Id.* at 10.

¹³¹ *Id.* at 12-13.

¹³² *Id.* at 14.

¹³³ *Southland*, 465 U.S. at 15-16.

¹³⁴ *Id.* at 16-17.

¹³⁵ *Id.* at 10-11.

first, the savings clause in section 2 states that arbitration agreements are valid except upon "grounds as exist at law or in equity for the revocation of any contract."¹³⁶ The Court's ruling in *Prima Paint* that these grounds must be aimed at the arbitration agreement specifically and not at the contract in general, however, lessened its impact.¹³⁷ Thus, the debate shifted to focus on the second limitation, also contained in the statute itself.¹³⁸ This limitation, a threshold requirement in section 2 mandates that the arbitration agreement be "in a written maritime contract transaction or a contract 'evidencing a transaction involving commerce.'"¹³⁹

The issue of whether a contract "involved" commerce became increasingly important because federal courts have developed their own arbitration common law that tends to resolve any ambiguities in favor of arbitration.¹⁴⁰ The choice of federal versus state law was based on whether the FAA, by its own terms, applied to the contract, which turned on whether it involved commerce.¹⁴¹ State and lower federal courts developed numerous standards for interpreting this requirement.¹⁴² The two most widely used standards were the "affecting" commerce and the "contemplation of substantial interstate activity" tests.¹⁴³

The "affecting" commerce standard broadly construed the "involving commerce" language in section 2 of the FAA to show Congress's intent for the reach of the Act to "be coextensive with congressional power to regulate under the Commerce Clause."¹⁴⁴ Thus, courts adopting this standard found the FAA applicable to all contracts evidencing transactions that Congress could constitutionally regulate.¹⁴⁵ Under this standard, almost all contracts fell within the FAA because courts have interpreted the Commerce Clause in a manner that gives Congress the power to reach even local activities, provided those activities could possibly affect interstate commerce in the aggregate.¹⁴⁶

¹³⁶ *Id.* (quoting 9 U.S.C. § 2 (1988)).

¹³⁷ See 388 U.S. 395, 404 (1967).

¹³⁸ See, e.g., *Snyder v. Smith*, 736 F.2d 409, 417 (7th Cir. 1984); *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 384 (2d Cir. 1961).

¹³⁹ *Southland*, 465 U.S. at 10-11 (9 U.S.C. § 2 (1988)).

¹⁴⁰ *Metro Indus.*, 287 F.2d at 386 (Lumbard, J., concurring). See also Strickland, *supra* note 33, at 400-10 for a full discussion of the differences between state and federal arbitration law.

¹⁴¹ See *Southland*, 465 U.S. at 10; Strickland, *supra* note 33, at 410.

¹⁴² See, e.g., *Snyder*, 736 F.2d at 418 ("affecting commerce" test); *Metro Indus.*, 287 F.2d at 384 (interstate elements test); *Ex parte Costa*, 486 So. 2d 1272, 1275 (Ala. 1986) ("slightest nexus" test); *Downing v. Allstate Ins. Co.*, 335 N.W.2d 139, 141 (Mich. App. 1983) (location of events test).

¹⁴³ *Snyder*, 736 F.2d at 418; *Metro Indus.*, 287 F.2d at 387 (Lumbard, J., concurring).

¹⁴⁴ *Foster v. Turley*, 808 F.2d 38, 40 (10th Cir. 1986).

¹⁴⁵ See, e.g., *id.*; *Snyder*, 736 F.2d at 418.

¹⁴⁶ See *Wickard v. Filburn*, 317 U.S. 111, 128 (1942).

The "contemplation of substantial interstate activity" standard, on the other hand, did not ascribe to the view that Congress intended to reach all contracts within its constitutional limits when it enacted the FAA.¹⁴⁷ Chief Judge Lumbard first articulated this view in a concurring opinion in *Metro Industrial Painting Corp. v. Terminal Construction Co.*¹⁴⁸ According to Judge Lumbard, the standard should be whether the parties thought the transaction involved substantial interstate activity at the time they agreed to the arbitration clause, not simply whether the transaction crossed state lines.¹⁴⁹ Whether the parties contemplated substantial interstate activity rested, in turn, on their state of mind, determined by looking at: contract terms, how the parties thought the contract would be carried out and how the contract was performed.¹⁵⁰ Lumbard justified his standard by looking at Congress's intent in passing the FAA.¹⁵¹ He stated, "In enacting the Arbitration Act, unlike various other statutes invoking the interstate commerce power, Congress was not seeking to regulate and control activity affecting commerce, but was providing for those engaged in interstate transactions an expeditious extra-judicial process for settling disputes."¹⁵² Noting that people involved in interstate commerce can avoid the Act by not including such clauses in their contracts, Lumbard believed the purpose of the FAA was to uphold the expectations of the parties to an arbitration agreement.¹⁵³ He argued that a broader standard which invoked the FAA upon the crossing of state lines would impose on the parties a dispute resolution system to which they had not agreed.¹⁵⁴

¹⁴⁷ See *Metro Indus.*, 287 F.2d at 387 (Lumbard, J., concurring).

¹⁴⁸ *Id.* at 385-88 (Lumbard, J., concurring).

¹⁴⁹ *Id.* at 387 (Lumbard, J., concurring).

¹⁵⁰ *Id.* (Lumbard, J., concurring).

¹⁵¹ *Id.* (Lumbard, J., concurring).

¹⁵² *Metro Indus.*, 287 F.2d at 387 (Lumbard, J., concurring).

¹⁵³ *Id.* (Lumbard, J., concurring).

¹⁵⁴ *Id.* (Lumbard, J., concurring). Judge Lumbard's oft-quoted opinion stated:

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

The significant question, therefore, is not whether, in carrying out the terms of the contract, the parties *did* cross state lines, but whether, at the time they entered into it and accepted the arbitration clause, they *contemplated* substantial interstate

Therefore, his standard sought to determine whether the parties thought they were agreeing to state or federal arbitration law when they entered into the contract.¹⁵⁵

Under this and other even narrower standards, courts have found the FAA inapplicable to certain consumer purchases of services and goods, as well as some real estate transactions—transactions that probably are included in the FAA's reach under the "affecting" commerce standard.¹⁵⁶ In the absence of the FAA, these courts have applied state statutory and common law.¹⁵⁷ In order to resolve this interpretive split, the United States Supreme Court granted certiorari to an Alabama case that turned on which standard was appropriate.¹⁵⁸

IV. *ALLIED-BRUCE TERMINIX COMPANIES V. DOBSON*

In 1995, in *Allied-Bruce Terminix Co. v. Dobson*, the United States Supreme Court held that the proper test to employ when determining the applicability of the FAA is whether the transaction, in fact, involved interstate commerce "even if the parties did not contemplate an interstate commerce connection."¹⁵⁹ Writing for a seven member majority, Justice Breyer reaffirmed *Southland*, which had established the FAA's applicability in state courts, and then went on to rule that the phrase "involving commerce" is equivalent to the words "affecting commerce" in terms of signaling Congressional intent to fully exert its commerce power.¹⁶⁰ Moreover, he reasoned, the phrase "evidencing a transaction" means that the transaction must actually involve interstate commerce.¹⁶¹ In so holding, the Court reversed the Alabama Supreme Court, which had held that a transaction between a homeowner and the local office of a multi-state pest control company did not "involve commerce," and thus did not implicate the FAA because the parties did not contemplate substantial interstate activity when they agreed to the contract and its arbitration provision.¹⁶² The Supreme Court held

activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract, . . . evidence as to how the parties expected the contract to be performed and how it was performed is relevant to whether substantial interstate activity was contemplated.

Id. (Lumbard, J., concurring) (emphasis in original) (citations omitted).

¹⁵⁵ See *id.* at 386, 387 (Lumbard, J., concurring).

¹⁵⁶ See, e.g., *Riess v. Murchison*, 329 F.2d 635, 644 (9th Cir. 1964); *Ex parte Williams*, 555 So. 2d 146, 147, 148 (Ala. 1989); *Strickland*, *supra* note 33, at 431, 442-43.

¹⁵⁷ See, e.g., *Allied-Bruce Terminix Cos. v. Dobson*, 628 So. 2d 354, 355-56 (Ala. 1993).

¹⁵⁸ *Allied-Bruce Terminix Cos. v. Dobson*, 114 S. Ct. 1292 (1994).

¹⁵⁹ 115 S. Ct. 834, 843 (1995).

¹⁶⁰ *Id.* at 839, 841.

¹⁶¹ *Id.* at 841.

¹⁶² *Id.* at 837, 843.

that the transaction did, in fact, involve interstate commerce and remanded the case.¹⁶³ The Court concluded that interstate commerce was involved because Terminix International Co. ("Terminix") and its franchisee, Allied-Bruce Terminix Companies ("Allied-Bruce") operated in more than one state and used materials from outside of Alabama to perform the contract in question.¹⁶⁴

In 1987, Steven Gwin purchased a lifetime "Termite Protection Plan" (the "Plan") from the local office of Allied-Bruce.¹⁶⁵ Under the Plan covering Gwin's Birmingham, Alabama house, Terminix promised to protect it against termites, to reinspect periodically, to provide necessary treatment, and to repair damage caused by new termite infestations.¹⁶⁶ Terminix guaranteed the Plan and the contract provided exclusively for arbitration to settle any controversies arising out of it.¹⁶⁷ In 1991, the Gwins had Allied-Bruce reinspect the house prior to its sale to Mr. and Mrs. Dobson.¹⁶⁸ After Allied-Bruce gave the house a clean bill of health, the Gwins sold the house and the Plan to the Dobsons.¹⁶⁹ Shortly after moving in, the Dobsons "found the house swarming with termites."¹⁷⁰

After Allied-Bruce attempted to treat and repair the problem, the Dobsons sued the Gwins, Allied-Bruce and Terminix in state court.¹⁷¹ Allied-Bruce and Terminix immediately asked the court for a stay of proceedings under section 2 of the FAA.¹⁷² The state trial court denied the stay.¹⁷³ The Supreme Court of Alabama affirmed the trial court's decision, holding that the FAA did not preempt an Alabama statute, which made executory arbitration agreements invalid and unenforceable, because the Act did not apply.¹⁷⁴ The Supreme Court of Alabama interpreted the FAA's "involving commerce" requirement narrowly, using Judge Lumbard's *Metro Industrial* "contemplation of substantial interstate activity" test.¹⁷⁵

¹⁶³ *Id.* at 843.

¹⁶⁴ *Terminix*, 115 S. Ct. at 843.

¹⁶⁵ *Id.* at 837.

¹⁶⁶ *Id.*

¹⁶⁷ *Id.*

¹⁶⁸ *Id.*

¹⁶⁹ *Terminix*, 115 S. Ct. at 837.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Id.* Allied-Bruce and Terminix asked for the stay under § 2 of the FAA and not § 3 because § 3 expressly allows for stays in cases brought in federal courts. *See id.* at 849 (Thomas, J., dissenting).

¹⁷³ *Id.* at 837.

¹⁷⁴ *Terminix*, 115 S. Ct. at 837.

¹⁷⁵ *See id.*

Before reaching the statutory "involving commerce" issue, the United States Supreme Court declined to overrule *Southland* as requested by the Dobsons and twenty state attorneys general.¹⁷⁶ Conceding that the issue was not fully briefed when previously argued, the Court found it inappropriate to reconsider its holding in *Southland* in the absence of significant changes in the law or practical problems spawned by the decision.¹⁷⁷ Moreover, the Court reasoned, private parties had probably relied on *Southland* when drafting contracts and Congress had since enacted legislation that further expanded the scope of arbitration.¹⁷⁸

Next, the Court addressed the statutory construction issue.¹⁷⁹ In holding that "involving commerce" meant "affecting commerce," the phrase used to signal Congress's intent to exercise fully its commerce power, the United States Supreme Court looked at the statute's wording, its background and its structure in light of the Act's overriding purpose of eliminating judicial hostility towards arbitration.¹⁸⁰ First, the Court noted that its interpretation was linguistically possible because a dictionary showed that the two words "sometimes can mean about the same thing."¹⁸¹ The Court then looked at the FAA's legislative history and dicta in prior Supreme Court decisions that indicated congressional intent to provide enforcement of arbitration agreements to the fullest extent of its commerce power.¹⁸² Further, the Court concluded that a broad reading of the phrase "involving commerce" served the Act's basic purpose, putting arbitration agreements on an equal footing with other contract terms.¹⁸³

Finally, the Court addressed contrary arguments, the most important of which involved its ruling in *Bernhardt*.¹⁸⁴ The *Bernhardt* Court had ruled that an employment contract between a New York corporation and a New York resident who became a Vermont resident in order to perform the contract did not "involve commerce."¹⁸⁵ The *Terminix* Court responded to the argument that these facts would trigger application of the FAA under an "affecting commerce" standard by stating that the language used by the *Bernhardt* Court to describe the "involv-

¹⁷⁶ *Id.* at 838-39.

¹⁷⁷ *Id.* at 839.

¹⁷⁸ *Id.*

¹⁷⁹ *Terminix*, 115 S. Ct. at 839.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.* at 839-40.

¹⁸³ *Id.* at 840.

¹⁸⁴ *Terminix*, 115 S. Ct. at 840-41.

¹⁸⁵ *Id.*

ing commerce" requirement was very broad and its opinion did not "discuss the implications of the 'interstate' facts to which the respondents now point."¹⁸⁶ Thus, according to the *Terminix* Court, *Bernhardt* did not require a narrower interpretation of the word "involving."¹⁸⁷

After holding that "involving commerce" meant the same thing as "affecting commerce," the Court went on to examine the effect of the clause "evidencing a transaction" in section 2's language, "a contract evidencing a transaction involving commerce."¹⁸⁸ The Court framed the issue as whether it meant the transaction must actually involve interstate commerce or whether it meant "more."¹⁸⁹ The "more" in this question referred to the "contemplation of the parties" interpretation.¹⁹⁰ The majority reasoned that the "contemplation" test would invite litigation about what the parties contemplated, which would undercut the FAA's goal of helping people avoid litigation, and make enforceability dependent on the happenstance of a reference by one of the parties to interstate commerce in the contract or during negotiations.¹⁹¹ The Court, therefore, concluded that the "commerce in fact" standard was the better interpretation.¹⁹² The Court posited that section 2 also covered agreements to arbitrate existing claims, which should be enforced regardless of what the parties thought at the time they contracted with each other.¹⁹³ Additionally, the Court reasoned that the word "evidencing" may have been added simply because of concerns Congress may have had of exceeding its constitutional authority, and not because of a desire to limit the Act's scope.¹⁹⁴

The *Terminix* Court then summarily dealt with the argument that the FAA should not preempt state law without a clear mandate from Congress by opining that the argument had little weight, because Supreme Court decisions since the enactment of the FAA had already displaced state law.¹⁹⁵ Finally, the *Terminix* Court did not agree that a "contemplation" test would provide better protection for consumers, because individuals also want faster, less costly alternatives to litigation.¹⁹⁶ Moreover, the Court reasoned, the Act allows a consumer to

¹⁸⁶ See *id.* at 841.

¹⁸⁷ *Id.*

¹⁸⁸ *Id.*

¹⁸⁹ *Terminix*, 115 S. Ct. at 841.

¹⁹⁰ See *id.*

¹⁹¹ *Id.* at 841-42.

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ *Terminix*, 115 S. Ct. at 842.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.* at 842-43.

force a business to arbitrate a small claim not worth pursuing in court.¹⁹⁷ Therefore, the majority declared the "commerce in fact" interpretation the correct standard for determining whether or not the FAA applied to a written arbitration agreement.¹⁹⁸

In her separate concurrence, Justice O'Connor expressed agreement with the majority's construction of section 2 of the FAA.¹⁹⁹ O'Connor disagreed, however, with the majority view that Congress intended the FAA to apply in state courts.²⁰⁰ Although she believed that the Court had "abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act" and was concerned about its preemption of state statutes designed to protect consumers, she felt compelled to join the majority opinion because of stare decisis.²⁰¹

In contrast to Justice O'Connor's adherence to *Southland* due to stare decisis, Justice Scalia, in a separate dissenting opinion, argued to overrule *Southland*.²⁰² He felt that *Southland's* extensive preemptive effect outweighed the principles of stare decisis because he believed that primary behavior was not affected by *Southland* and that any impaired reliance interests could be remedied via rescission for mistake of law.²⁰³ Expressing his willingness to overrule *Southland* in the future, Justice Scalia dissented from the majority opinion.²⁰⁴

Justice Thomas, in a dissent joined by Justice Scalia, primarily attacked the majority's adherence to *Southland* and did not reach the statutory construction issue.²⁰⁵ Specifically, Justice Thomas argued that the FAA does not apply in state courts.²⁰⁶ He also argued that even if the FAA does apply in state courts, the states may enforce an arbitration agreement by providing different remedies than those called for by the FAA.²⁰⁷

In concluding that the FAA does not apply in state courts, Justice Thomas cited a thirty-five year gap between enactment of the FAA and any attempt to apply it in state courts.²⁰⁸ He reasoned that the delay was caused by the general understanding during that period that

¹⁹⁷ See *id.* at 843.

¹⁹⁸ *Id.*

¹⁹⁹ *Terminix*, 115 S. Ct. at 843 (O'Connor, J., concurring).

²⁰⁰ *Id.* at 843-44 (O'Connor, J., concurring).

²⁰¹ *Id.* at 843, 844 (O'Connor, J., concurring).

²⁰² *Id.* at 844-45 (Scalia, J., dissenting).

²⁰³ *Id.* at 845 (Scalia, J., dissenting).

²⁰⁴ See *Terminix*, 115 S. Ct. at 845 (Scalia, J., dissenting).

²⁰⁵ See *id.* (Thomas, J., dissenting).

²⁰⁶ *Id.* at 845 (Thomas, J., dissenting).

²⁰⁷ *Id.* at 849 (Thomas, J., dissenting).

²⁰⁸ *Id.* at 845 (Thomas, J., dissenting).

arbitration was a form of procedure.²⁰⁹ Thus, state courts did not apply the FAA and federal courts did not apply state arbitration statutes when they determined the FAA inapplicable.²¹⁰ Justice Thomas also characterized arbitration agreements as a type of forum-selection clause, which are arguably procedural in nature.²¹¹ He found additional support in the language of other provisions of the FAA, which explicitly limited themselves to federal courts, and argued that the lack of federal question jurisdiction showed Congress's intent to enact a procedural measure for use in federal courts.²¹² Finally, he argued that any ambiguity surrounding the original design of the statute should be interpreted in light of federalism concerns, which weigh against the displacement of state law.²¹³

Even if section 2 of the FAA does preempt state law, Justice Thomas argued, no textual basis exists for requiring state courts to enforce arbitration agreements through specific enforcement, as sections 3 and 4 require federal courts to do.²¹⁴ Reasoning that damages could satisfy section 2's mandate to enforce arbitration agreements, Justice Thomas argued that section 2 of the FAA did not itself require state and federal courts to grant a stay.²¹⁵ If it did, he reasoned, section 3's mandate to federal courts to grant stays would be superfluous.²¹⁶

Finally, in accord with Justice Scalia's dissent, Justice Thomas found the doctrine of stare decisis inadequate to justify affirming *Southland's* holding that the FAA applies to state courts.²¹⁷ Furthermore, he found stare decisis inapplicable to the question of whether state courts must grant stays.²¹⁸ He argued that the grant of a stay was not actually at issue in *Southland* because the California statute in question there declared the agreement void, and underlying state law would have required a stay had the agreement been enforceable.²¹⁹

In sum, the Court reaffirmed *Southland's* holding that the FAA applies in state courts and further held that the FAA governs an arbitration agreement if the underlying transaction affects interstate commerce, regardless of the level, if any, of interstate commerce the

²⁰⁹ *Terminix*, 115 S. Ct. at 845-46 (Thomas, J., dissenting).

²¹⁰ *Id.* at 846-47 (Thomas, J., dissenting).

²¹¹ *Id.* at 847 (Thomas, J., dissenting).

²¹² *Id.* at 847-48 (Thomas, J., dissenting).

²¹³ *Id.* at 848 (Thomas, J., dissenting).

²¹⁴ *Terminix*, 115 S. Ct. at 849 (Thomas, J., dissenting).

²¹⁵ *Id.* (Thomas, J., dissenting).

²¹⁶ *Id.* (Thomas, J., dissenting).

²¹⁷ *Id.* at 849-50 (Thomas, J., dissenting).

²¹⁸ *Id.* at 850 (Thomas, J., dissenting).

²¹⁹ *Terminix*, 115 S. Ct. at 850 (Thomas, J., dissenting).

parties foresaw when drafting the arbitration agreement.²²⁰ Although disagreeing with the Court's interpretation of legislative intent, Justice O'Connor concurred on the basis of stare decisis principles.²²¹ Justice Scalia dissented because he reasoned that stare decisis should not stop the Court from overruling *Southland*.²²² Finally, Justice Thomas argued in dissent that *Southland* should be overruled and, therefore, did not address the statutory construction issue.²²³

V. ANALYSIS OF *TERMINIX* ON COMMERCIAL AND CONSUMER TRANSACTIONS

Analytically speaking, the Court's opinion in *Terminix* raises some difficulties. Both the concurring and dissenting opinions presented strong arguments, based in large part on the legislative history of the Act, that the Court had decided *Southland* incorrectly.²²⁴ As noted by Justice Black in his *Prima Paint* dissent, the legislative history is replete with assurances that the FAA was to be procedural, not substantive law.²²⁵ Congress designed the Act in 1925 to complement the burgeoning body of state statutes that made arbitration agreements enforceable.²²⁶

The major difference between Justice O'Connor's concurrence and the dissents by Justices Scalia and Thomas was whether stare decisis dictated that *Southland* stand.²²⁷ Like Justices Scalia and Thomas, this commentator finds it difficult to believe that *Southland's* preemption of state law should be reaffirmed.²²⁸ Moreover, the scope of this preemption was pushed even further in *Terminix* via statutory construction. Justice Thomas also argued that even while following *Southland*, Alabama could still withhold a stay of proceedings, compulsion of arbitration or both as remedies, because the Court had never previously held that state courts must enforce arbitration agreements using the measures provided by the FAA for use in federal courts.²²⁹ Sections 3 and 4 of the FAA, which provide for stays and orders

²²⁰ *Id.* at 843.

²²¹ *Id.* at 843-44 (O'Connor, J., concurring).

²²² *Id.* at 845 (Scalia, J., dissenting).

²²³ *Id.* at 845 (Thomas, J., dissenting).

²²⁴ *Terminix*, 115 S. Ct. at 844 (O'Connor, J., concurring); *id.* at 845-46 (Thomas, J., dissenting).

²²⁵ *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 418-19 (1967) (Black, J., dissenting).

²²⁶ See *Southland Corp. v. Keating*, 465 U.S. 1, 26-27 (1984) (O'Connor, J., dissenting).

²²⁷ *Terminix*, 115 S. Ct. at 844 (O'Connor, J., concurring); *id.* at 845 (Scalia, J., dissenting); *id.* at 849-50 (Thomas, J., dissenting).

²²⁸ See *id.* at 845 (Scalia, J., dissenting); *id.* at 849-50 (Thomas, J., dissenting).

²²⁹ *Id.* at 850 (Thomas, J., dissenting).

compelling arbitration, explicitly refer to their use in federal courts alone.²³⁰

Moreover, the Court's attempt to distinguish *Bernhardt* with a "do as we say, not as we do" argument is not terribly convincing.²³¹ While the language in *Bernhardt* was broad, the actual holding pointed to a narrower standard. *Bernhardt* involved a contract between a New York resident and a New York corporation that called for the employee to relocate to Vermont to work for the company there.²³² Under the "commerce in fact" standard adopted by the *Terminix* Court, this transaction would clearly involve commerce. The *Bernhardt* Court, however, held that the transaction did not involve commerce. The actual holding should signify more than the dicta that accompanied it.

Finally, as both Justices O'Connor and Thomas point out, while Congress may regulate areas traditionally within the sphere of the states' powers under the Commerce Clause, the Court has generally refused to give federal statutes wide ranging preemptive effect in the absence of a clear congressional mandate to that effect.²³³ The legislative history of the FAA does not contain such a mandate.²³⁴ As noted above, the legislative history indicates a desire to supplement, not preempt, state laws.²³⁵ The precepts of federalism should not be lightly abandoned. Regardless of these infirmities, however, the majority's holding in *Terminix* that the FAA applies whenever a transaction, in fact, involves commerce, is now the law.²³⁶ This creates several practical implications for consumers and commercial entities alike.

VI. IMPACT OF *TERMINIX* ON COMMERCIAL AND CONSUMER TRANSACTIONS

Allied-Bruce Terminix Companies v. Dobson will have a profound impact on both commercial organizations and individuals. Under the Supreme Court's "commerce in fact" test, virtually every written arbitration agreement is subject both to the FAA and to the burgeoning pro-arbitration common law that federal courts have developed under the Act.²³⁷ Moreover, the Court's treatment of arbitration agreements as on an equal footing with other contract terms is a death knell for

²³⁰ 9 U.S.C. §§ 3-4 (1988).

²³¹ See *Terminix*, 115 S. Ct. at 840-41.

²³² *Bernhardt v. Polygraphic Co. of Am.*, 350 U.S. 198, 199 (1956).

²³³ *Terminix*, 115 S. Ct. at 844 (O'Connor, J., concurring); *id.* at 848-49 (Thomas, J., dissenting).

²³⁴ See *id.* at 848-49 (Thomas, J., dissenting).

²³⁵ See *supra* notes 225-26 and accompanying text.

²³⁶ *Terminix*, 115 S. Ct. at 843.

²³⁷ See *id.* at 844 (O'Connor, J., concurring).

state statutes designed to protect consumers or to ensure knowledgeable and voluntary consent.²³⁸ The FAA, which does not provide similar protections, now preempts these statutes.

The "commerce in fact" test will subject almost every commercial contract containing an arbitration agreement to the FAA and eliminate most prearbitration litigation.²³⁹ While the test does seem to require a fact-based inquiry, parties apparently can satisfy the test by showing the presence of any interstate element—an interstate firm, diversity of citizenship, or even the use of any supplies or materials that come from a different state.²⁴⁰ One recent decision has gone so far as to indicate that use of the United States Postal Service satisfies this "commerce in fact" test.²⁴¹ Businesses should evaluate and negotiate commercial contracts on the assumption that the FAA and the federal common law generated under it will apply unless the arbitration clause explicitly chooses state law or is clearly linked to a choice of law provision.²⁴² Additionally, the FAA will govern existing commercial contracts regardless of the parties' understanding at the time of contract if one party simply incorporates some element of interstate commerce into its performance.²⁴³ Thus, the "commerce in fact" test will provide protection for the companies who have relied on *Southland* and allow those who prefer the FAA's terms to invoke it with unilateral action. Businesses must battle over the meaning of an arbitration agreement at the time of contracting; otherwise, federal common law will provide it.

More importantly, whether the transaction's connection to interstate commerce is clear or fairly indirect, *Terminix* indicates that courts will enforce boilerplate arbitration provisions against consumers. The FAA provides no special protections for consumers, and any doubts as to its application are resolved in favor of arbitration. The FAA now preempts state laws that have attempted to ensure notice of what is essentially a waiver of the constitutional right to a jury trial. Moreover, while the Court has not ruled directly on the question of contracts of adhesion, the Court did rule in *Prima Paint*, that arbitrators must decide claims such as fraudulent inducement unless they are specifically aimed at the arbitration clause itself.²⁴⁴ This makes it difficult

²³⁸ See *id.* at 843 (O'Connor, J., concurring).

²³⁹ See *id.* at 840.

²⁴⁰ See Strickland, *supra* note 33, at 458.

²⁴¹ See *Mr. Mudd, Inc. v. Petra Tech, Inc.*, 892 S.W.2d 389, 392 (Mo. App. 1995).

²⁴² See *Volt Info. Servs. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989).

²⁴³ See *Metro Indus. Painting Corp. v. Terminal Constr. Co.*, 287 F.2d 382, 388 (2d Cir. 1961) (Lumbard, J., concurring); see also Strickland, *supra* note 33, at 457-58.

²⁴⁴ 388 U.S. 395, 403-04 (1967).

to challenge the fairness of the contract, especially since arbitrators are not as familiar as courts with complex areas of the law.²⁴⁵

Although the Court correctly noted that consumers can also force businesses to submit to arbitration when their claims are too small to justify the time and expense of litigation, it seems unlikely that a company would find it financially preferable to litigate in such situations.²⁴⁶ Under the Court's holding, the FAA displaces state statutes designed to protect consumers, or at least ensure they are aware that they are agreeing to arbitration.²⁴⁷ Companies who market their products and services to consumers will find it much easier to obtain and enforce predispute arbitration agreements.

While this ease may reduce costs and, possibly, prices to consumers, the disadvantages of arbitration may well outweigh these advantages as the disadvantages increase. Arbitration is known for its limited discovery and less formal proceedings.²⁴⁸ Without full discovery, however, actions such as personal injury or product liability claims will be very difficult to establish. Although many states' laws exempt these kinds of claims from arbitration,²⁴⁹ these statutes are now preempted by the FAA, which does not differentiate based on the underlying transaction.

Furthermore, arbitrators who tend to "split the difference" are likely to make awards that favor businesses because their relationship to and reputation among the businesses is much more likely to spawn demand for their services. Unlike judges, arbitrators are paid directly by the parties involved for their services in resolving disputes.²⁵⁰ Enhanced reputation translates into increased referrals and proportionately higher income. Arbitrators are not likely to see individual consumers as sources of repeat business or reference. Unequal bargaining power at the inception of a contract may well be followed by nonneutral disposition of disputes arising under it.

CONCLUSION

In conclusion, the United States Supreme Court's decision in *Allied-Bruce Terminix Companies v. Dobson* has expanded the reach of the FAA to cover virtually all written agreements to arbitrate.²⁵¹ Despite

²⁴⁵ *Id.* at 415-16 (Black, J., dissenting).

²⁴⁶ See *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834, 842-43 (1995).

²⁴⁷ *Id.* at 843 (O'Connor, J., concurring).

²⁴⁸ Shell, *supra* note 16, at 632; Stipanowich, *supra* note 17, at 438.

²⁴⁹ See, e.g., N.Y. GEN. BUS. LAW § 399-c (McKinney 1988).

²⁵⁰ Shell, *supra* note 16, at 630-31.

²⁵¹ See *Terminix*, 115 S. Ct. at 841, 843.

an ambiguous legislative history, the Court reaffirmed its holding in *Southland* that made the FAA applicable in state courts and further held that the FAA, by its own terms, covers all written arbitration agreements provided that the underlying transaction in fact involved commerce.²⁵² While this ruling serves the Act's basic purpose of overcoming common law hostility to arbitration by preempting state law, the Court's interpretation has given the FAA a significance and impact that Congress never envisioned or intended.²⁵³ After *Terminix*, virtually all agreements to arbitrate between commercial entities will be enforced under the FAA and interpreted in a pro-arbitration manner under federal common law. Finally, companies will find it easier to obtain such agreements from consumers and enforce them if disputes arise. While only mentioning state interests, Justice O'Connor's assessment of the situation applies equally to consumer interests: "It remains now for Congress to correct this interpretation if it wishes to preserve state autonomy in state courts."²⁵⁴

JANET M. GROSSNICKLE

²⁵² *Id.* at 838-39, 843.

²⁵³ *See id.* at 843; *id.* at 844 (O'Connor, J., concurring).

²⁵⁴ *Id.* at 844 (O'Connor, J., concurring).