# FEDERAL JURISDICTION

The mere presence of an arbitration clause in a contract does not necessarily bring a dispute pertaining to that contract within the purview of the Federal Arbitration Act ("FAA") or federal courts. Disputes governed by the FAA must at times be litigated in state courts. This article describes the analysis required to consider these issues.

## When Does the FAA Apply to a Dispute?

The FAA enjoys broad application and "creates a strong federal policy in favor of arbitration." *Picard v. Credit Sols., Inc.*, 564 F.3d 1249, 1253 (11th Cir. 2009). The FAA applies to any contract "evidencing a transaction involving commerce" that is subject to a written agreement to arbitrate. *See* 9 U.S.C. § 2. The Supreme Court has held the phrase "involving commerce" in the FAA is the "functional equivalent of the more familiar term 'affecting commerce,'" which signals the broadest permissible exercise of Congress' Commerce Clause power. *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52, 56 (2003) (citing *Allied-Bruce Terminix Cos.*, 513 U.S. 265, 273–74 (1995)); *see also Circuit City Stores, Inc. v. Adams*, 532 U.S. 105, 115 (2001) ("The phrase 'affecting commerce' indicates Congress' intent to regulate to the outer limits of its authority under the Commerce Clause."); *Perry v. Thomas*, 482 U.S. 483, 490 (1987) ("[T]he Federal Arbitration Act . . . embodies Congress' intent to provide for the enforcement of arbitration agreements within the full reach of the Commerce Clause."). Parties to a contract need not anticipate that the transaction will involve interstate commerce in order to bring it within the scope of the FAA, as the term "evidencing a transaction" in § 2 "requires only that the transaction in fact involved interstate commerce, not that the parties contemplated it as such at the time of the agreement." *Rota-McLarty v. Santander Consumer USA, Inc.*, 700 F.3d 690, 697 (4th Cir. 2012) (citing *Allied-Bruce*, 513 U.S. at 281).

The substantial breadth of the Commerce Clause, and thus the FAA, is demonstrated by the Court's decision in *Citizens Bank*, which held that a dispute fell within the scope of the FAA because "[the defendant] engaged in business throughout the southeastern United States" and its debt "was secured by all of [its] business assets, including . . . goods assembled from out-of-state parts and raw materials." 539 U.S. at 57. Importantly, without those interstate connections, the Court noted the dispute would still come within the scope of the FAA, because the "general practice" of commercial lending that underpinned the dispute had a broad impact on the national economy. *Id.* at 57–58; *see also Krantz & Berman LLP v. Dalal*, 472 F. App'x 76, 77 (2d Cir. 2012) ("[A] New York law firm[] provided services to . . . a resident of Washington, D.C.[] related to litigation involving a New Jersey corporation. We need go no further [to find the agreement enforceable under the FAA].").

The reach of the Commerce Clause is not unlimited, however, and courts have occasionally held the FAA inapplicable to contracts that did not implicate interstate commerce. *See, e.g.*, *Adams v. Ogden Newspapers, Inc.*, No. 09-CV-160, 2009 WL 10702626, at *5 (D. Haw. Oct. 28, 2009) ("Unlike *Alafabco*, there is nothing before this Court that indicates the transactions between Plaintiff and Island Pages occurred or were related to commerce beyond the State of Hawaii. Nor does the subject Agreement involve an aggregate impact on the national economy such as the practice of commercial lending. . . . Accordingly, the Agreement between Plaintiff and Island Pages does not evidence a transaction involving interstate commerce and thus the FAA is not applicable to this case."); *SI V, LLC v. FMC Corp.*, 223 F. Supp. 2d 1059, 1062 (N.D. Cal. 2002) ("An agreement to sell real property between an in-state buyer and an out-of-state seller does not involve interstate commerce as defined in the FAA. . . . Therefore, the FAA is not applicable to this dispute . . . ."). Nonetheless, parties to contracts with arbitration

provisions should be mindful of the broad scope of the FAA and its applicability to a vast universe of commercial transactions.

**When Does the FAA Preempt State Law?**

When the FAA applies, another fundamental question arises as to whether and when it preempts state laws affecting enforcement of arbitration agreements. Under § 2 of the FAA, agreements to arbitrate are "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). The FAA therefore "requires courts to place arbitration agreements 'on equal footing with all other contracts.'" *Kindred Nursing Centers Ltd. P'ship v. Clark*, 137 S. Ct. 1421, 1424 (2017) (quoting *DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463, 468 (2015)); *see also Volt Info. Scis., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 478 (1989) (state laws are preempted if they "undermine the goals and policies of the FAA"). Accordingly, a state law limiting arbitration is only permissible if "that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally," *Perry*, 482 U.S. at 492, and "generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2," *Doctor's Assocs., Inc. v. Casarotto*, 517 U.S. 681, 686–87 (1996).

Where a state law discriminates specifically against arbitration, however, that law may be rendered void. For example, in *Doctor's Associates*, the Supreme Court considered the validity of a Montana law that declared an arbitration clause unenforceable unless "[n]otice that [the] contract is subject to arbitration" was "typed in underlined capital letters on the first page of the contract." *Doctor's Assocs.*, 517 U.S. at 683 (alterations in original) (quoting Mont. Code Ann.

§ 27-5-114(4) (1995)). Because the law applied only to contracts "subject to arbitration" and "condition[ed] the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally," the Court held that the law conflicted with the FAA and was preempted. *Id.* at 687; *see also Perry*, 482 U.S. at 490 (state statute that rendered unenforceable private agreements to arbitrate certain wage collection claims was preempted by FAA).

But a state law need not expressly discriminate against arbitration to run afoul of § 2's requirements, and ostensibly general contract rules that in effect undermine arbitration may similarly be preempted by the FAA. In *Kindred Nursing*, the Supreme Court heard an appeal from the Kentucky Supreme Court, which had found two arbitration agreements invalid on the grounds that the powers of attorney pursuant to which they had been executed did not specifically authorize the representatives to enter into arbitration agreements. 137 S. Ct. at 1426. The Kentucky Supreme Court reasoned that such an express authorization requirement was proper because the Kentucky Constitution "protects the rights of access to the courts and trial by jury; indeed, the jury guarantee is the sole right the Constitution declares 'sacred' and 'inviolate.'" *Id.*

Even though the Kentucky law did not expressly implicate arbitration provisions, the Court reversed the Kentucky Supreme Court and held that the law's emphasis on "access to the courts and trial by jury" necessarily "single[d] out arbitration agreements for disfavored treatment," contravening the FAA. *Id.* at 1421. As the Court explained, the Kentucky law was a "legal rule hinging on the primary characteristic of an arbitration agreement—namely, a waiver of the right to go to court and receive a jury trial." *Id.* at 1427. It therefore exemplified an improper rule that "covertly accomplishes the [] objective [of discriminating against arbitration]

by disfavoring contracts that (oh so coincidentally) have the defining features of arbitration agreements." *Id.* at 1426; *see also Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984) (holding that California Supreme Court's refusal to enforce parties' contract to arbitrate because California Franchise Investment Law required judicial consideration of claims conflicted with FAA).

The FAA, however, does necessarily preempt every state law pertaining to arbitration. For example, the Supreme Court held in *Volt* that a provision of the California Arbitration Act that permitted a court to stay arbitration pending resolution of related litigation was not preempted by the FAA, notwithstanding that the FAA contained no such stay provision. 489 U.S. at 470. At the core of the Court's decision was its crediting of the state court's holding that a choice-of-law clause in the parties' contract meant the parties had incorporated the California rules of arbitration into their arbitration agreement. *Id.* at 474. As the Court explained, "[a]rbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit," *id.* at 479, and"[t]here is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate." *Id.* at 476. The Court held that the California law was not preempted by the FAA because where "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." *Id.* at 479.

Additionally, state courts often depart from the FAA and apply state procedural rules when they find those rules are not in substantive conflict with the FAA. *See, e.g.*, *Joseph v. Advest, Inc.*, 2006 PA Super 213, ¶ 12 (2006) (gathering cases) ("State rules governing the

'conduct of arbitration' will not run afoul of the FAA even when the FAA does not contain a procedural provision that is coextensive with an applicable state procedural rule as long as the state procedural rule does not undermine the goal of the FAA.") (quoting *Volt* 489 U.S. at 476). For example, in *Sultar*, the Superior Court of Connecticut dismissed a petition to vacate an arbitration award that had been filed after the thirty-day deadline provided by the state arbitration statute. *Sultar v. Merrill Lynch, Pierce, Fenner & Smith*, No. 04-CV-527411S, 2004 WL 2595840, at *2 (Conn. Super. Ct. Oct. 13, 2004). In so holding, the court rejected the petitioners' argument that they should have been afforded the three-month period allowed under § 12 of the FAA. *Id.* The court explained that the thirty-day time limit was a procedural provision applicable to the state proceeding, and that requiring a party to contest an arbitration award within thirty days was not hostile to the FAA's goal of encouraging arbitration. *Id.* ("Requiring the movant to file within thirty days does not conflict with the primary purpose of the FAA, which is to encourage arbitration to the fullest scope of the parties' agreement to arbitrate.").

**When Does a Federal District Court Have Jurisdiction over an FAA Dispute?**

Enforcement of the FAA is not limited to federal courts. *See Vaden v. Discover Bank*, 556 U.S. 49, 71 (2009) ("Under the FAA, state courts as well as federal courts are obliged to honor and enforce agreements to arbitrate."). In order to bring an action under the FAA in federal court, the FAA requires an independent basis for federal jurisdiction; mere invocation of the FAA is insufficient. *Id.* at 59 ("The Act is 'something of an anomaly' in the realm of federal legislation: It 'bestows no federal jurisdiction but rather requires for access to a federal forum an independent jurisdictional basis' over the parties' dispute.") (quoting *Hall Street Assocs., L.L.C.*

*v. Mattel, Inc.*, 552 U.S. 576, 581–82 (2008)) (alterations omitted). That requisite independent basis is generally either federal question or diversity jurisdiction. *Hermes of Paris, Inc. v. Swain*, 867 F.3d 321, 323 n.1 (2d Cir. 2017) (citing *Northport Health Servs. of Ark., LLC v. Rutherford*, 605 F.3d 483, 486 (8th Cir. 2010)). Needless to say, parties cannot stipulate to federal jurisdiction. *See Harris v. Sycuan Band of Diegueno Mission Indians*, No. 08-CV-2111, 2009 WL 5184077, at *5 (S.D. Cal. Dec. 18, 2009) (holding that contract provision stipulating to enforcement in federal court under the FAA was insufficient to confer federal question jurisdiction and noting "[i]t is . . . axiomatic that no court may decide a case without subject matter jurisdiction, and neither the parties nor their lawyers may stipulate to jurisdiction or waive arguments that the court lacks jurisdiction") (quoting *In Wisconsin v. Ho–Chunk Nation*, 463 F.3d 655, 661 (7th Cir. 2006)).

Where a party seeks to invoke federal question jurisdiction, a district court's assessment may depend on whether the matter is a petition to compel under § 4 or a petition to confirm or vacate under §§ 9 or 10, respectively. This is because § 4 of the FAA allows a party to petition to compel arbitration in federal district court if "save for [the arbitration] agreement" the court would have jurisdiction. 9 U.S.C. § 4. The Supreme Court has interpreted the "save for" language of § 4 to mean that district courts should "assume the absence" of the arbitration agreement when assessing jurisdiction and "'look through' a § 4 petition [to the facts of the underlying dispute] to determine whether it is predicated on an action that 'arises under' federal law." *Vaden*, 556 U.S. at 62. As the Court explained, this allows a petitioner to avoid "seeking federal adjudication of the very questions it wants to arbitrate rather than litigate." *Id.* at 65.

Sections 9 and 10 of the FAA, however, which pertain to petitions to confirm and vacate arbitration awards, do not contain the "save for" language of § 4 that formed the basis of the

Supreme Court's decision in *Vaden*. *See* 9 U.S.C. §§ 9–10. This has given rise to a circuit split on whether district courts should similarly "look through" a petition to confirm or vacate an arbitration award in order to assess federal question jurisdiction. For example, noting that "Section 10 lacks the critical 'save for such agreement' language," the Third Circuit held in *Goldman* that "a district court may not look through a § 10 motion to vacate to the underlying subject matter of the arbitration in order to establish federal question jurisdiction. Instead, the traditional well-pleaded complaint rule applies so that the motion to vacate must, on its face, necessarily raise a stated federal issue." *Goldman v. Citigroup Glob. Markets Inc.*, 834 F.3d 242, 255 (3d Cir. 2016) (internal quotation marks omitted); *see also Magruder v. Fid. Brokerage Servs. LLC*, 818 F.3d 285, 288 (7th Cir. 2016) ("[A] federal issue resolved by the arbitrator does not supply subject-matter jurisdiction for review or enforcement of the award.").

On the other hand, the First and Second Circuits have held that the look through approach is not limited to motions to compel under § 4. *See Ortiz-Espinosa v. BBVA Sec. of Puerto Rico, Inc.*, 852 F.3d 36, 47 (1st Cir. 2017) (noting circuit split and holding that look through approach applies to §§ 9, 10, and 11 of the FAA); *Doscher v. Sea Port Grp. Sec., LLC*, 832 F.3d 372, 388 (2d Cir. 2016) ("[A] federal district court faced with a § 10 petition may 'look through' the petition to the underlying dispute, applying to it the ordinary rules of federal-question jurisdiction and the principles laid out by the majority in *Vaden*."). Accordingly, for a petition to confirm or vacate an arbitration award, the venue may affect the standard under which the court determines federal question jurisdiction.

It should be noted that the Supreme Court's decision in *Vaden* was limited to federal question jurisdiction, and courts have consistently rejected attempts to extend the look-through approach to the question of diversity jurisdiction. For example, in *Swain*, the Second Circuit

rejected the argument that it was required to look through the arbitration petition to the underlying dispute in order to assess diversity jurisdiction. 867 F.3d at 323–24. The court reasoned that "§ 4 of the FAA provides for jurisdiction over a suit arising out of a controversy between 'the parties,' which most sensibly refers to those persons who are parties to the arbitration agreement—and who therefore can be named in the petition to compel arbitration," *id.* at 324 (internal quotation marks omitted), and concluded that complete diversity is therefore measured only "by reference to the parties to the petition to compel arbitration," *id.* at 326. As the court noted, its decision was consistent with all other Circuits that had considered the issue. *Id.* at 325 ("All of our sister Circuits to have addressed the issue have likewise rejected a look-through approach to assessing complete diversity for the purposes of evaluating whether a district court has diversity jurisdiction over an FAA petition.").

*This publication is being provided for informational and educational purposes only. No legal advice is being given, and no attorney-client relationship is created by the use of the publication. While the publication is intended to provide information about dispute resolution generally, you should not act or rely on the information contained in this publication without first seeking the advice of an attorney. The views set forth herein are the personal views of the authors and do not necessarily reflect those of the American Arbitration Association.*