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FAA AND ARBITRATION CLAUSES - HOW FAR CAN IT REACH? THE EFFECT OF
ALLIED-BRUCE TERMINIX, INC. v. DOBSON

I. INTRODUCTION

In response to the powerful current of animosity in English and American common law courts toward prospective agreements to arbitrate disputes, the 1925 Congress enacted the Federal Arbitration Act (hereinafter “FAA”). The FAA established that “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract itself or an allegation of waiver, delay, or a like defense to arbitrability.” However, the FAA did not become an effective tool for avoiding litigation until the 1980s, when the Supreme Court systematically removed most of the barriers to binding pre-dispute arbitration.

This note discusses Allied-Bruce Terminix, Inc. v. Dobson, which solidified the Supreme Court’s rationale in favor of arbitration. The Court specifically held that the FAA governs all arbitration provisions in contracts “affecting commerce and that the phrase ”affecting commerce signals a Congressional intent to exercise its Commerce Clause powers in full.” This note will first provide a short background of the interpretation of the FAA in connection with the enforceability of the arbitration clauses, and then discuss Allied-Bruce and its potential effect on the future of arbitration clauses.

II. THE CASE

In August 1987, Steven Gwin, who owned a house in Birmingham, Alabama, purchased a lifetime "Termite Protection Plan" from the local office of Allied-Bruce Terminix Companies, a franchise of Terminix International Company. The contract document, provided in writing that "any controversy or claim arising out of or relating to the interpretation, performance or breach of any provision of this agreement shall be settled exclusively by arbitration."

In the spring of 1991, the Gwins, wishing to sell their house to the Dobsons, had Allied-Bruce re-inspect the house and issue them a clean bill of health. Upon purchase of the house (with the plan included), the Dobsons found the house swarming with termites. Allied-Bruce's efforts to cure the problem were inadequate. Hence, the Dobsons sued the Gwins and (along with the Gwins who cross-claimed) also sued Allied-Bruce and Terminix in Alabama state court. Allied-Bruce and Terminix, pointing to the Plan's arbitration clause and 2 of the FAA, immediately asked the court for a stay, to allow arbitration to proceed. The court denied the stay. Allied-Bruce and Terminix appealed.

The Supreme Court of Alabama upheld the denial of the stay on the basis of a state statute, making written, pre-dispute arbitration agreements invalid and unenforceable. The Alabama court reached this conclusion by finding that the FAA, which preempts conflicting state law, did not apply to the termite contract. It considered the FAA inapplicable because the connection

4. In the Plan, Allied-Bruce promised "to protect" Gwin's house "against attack of subterranean termites," to reinspect periodically, to provide any "further treatment found necessary" and to repair up to $100,000 damage caused by new termite infestations. Terminix International "guaranteed the fulfillment of the terms" of the plan. Id. (citing App. at 70).
5. Id. at 837.
6. Id.
7. Id.
8. Id.
9. Id.
10. Id.
11. Id.
12. Id.
14. Allied Bruce Terminix, 115 S. Ct. at 837 (citing Allied-Bruce Terminix, Inc. v. Dobson, 628 So. 2d 354 (Ala. 1993)).
15. Id.
between the termite contract and interstate commerce was too slight.\textsuperscript{16} According to the court, the FAA applied to a contract only if "at the time [the parties entered into the contract] and accepted the arbitration clause, they contemplated substantial interstate activity."\textsuperscript{17} Other state and federal courts had offered similar interpretations.\textsuperscript{18} However, several federal appellate courts had interpreted the same language, as reaching to the limits of Congress's Commerce Clause power.\textsuperscript{19} The Supreme Court granted certiorari to resolve this conflict.\textsuperscript{20}

Despite the Alabama Supreme Court's strong showing of public policy in favor of its decision,\textsuperscript{21} the Supreme Court reversed and held that the statutory language, "involving commerce, is the functional equivalent of the traditional "affecting commerce, and represents congressional intent that the statute embrace the full limit of legislative power under the Commerce Clause of the Constitution.\textsuperscript{22}

In a separate concurrence,\textsuperscript{23} Justice O'Connor expressed her view that the Court "laid a faulty foundation"\textsuperscript{24} in \textit{Southland Corp. v. Keating},\textsuperscript{25} but she found no "special justification" to overrule it. Justices Scalia and Thomas dissented. Justice Scalia found that \textit{Southland} "clearly misconstrued the Federal Arbitration Act,"\textsuperscript{26} and said that he would be willing to join four other justices in overruling it.\textsuperscript{27} Justice Thomas, in a lengthy dissent joined by Justice Scalia,\textsuperscript{28} wrote that \textit{Southland} was wrongly

\begin{itemize}
\item \textsuperscript{16} \textit{Id.}
\item \textsuperscript{17} Allied-Bruce Terminix, Inc. v. Dobson, 628 So. 2d 354 (Ala. 1993) (quoting \textit{Warren v. Jim Skinner Ford}, 548 So. 2d 157, 160 (Ala. 1989)).
\item \textsuperscript{19} \textit{Id.} (citing \textit{Foster v. Turley}, 808 F.2d 38 (10th Cir. 1986); \textit{Lawrence Co. v. Devonshire Fabrics, Inc.}, 271 F.2d 402 (2d Cir. 1959); \textit{Snyder v. Smith}, 736 F.2d 409 (7th Cir. 1984), \textit{cert. denied}, 469 U.S. 1037 (1984)).
\item \textsuperscript{20} \textit{Id.}
\item \textsuperscript{21} \textit{See Allied-Bruce Terminix}, 628 So. 2d 354.
\item \textsuperscript{22} \textit{Allied Bruce Terminix}, 115 S.Ct. at 836.
\item \textsuperscript{23} \textit{Id.} at 843.
\item \textsuperscript{24} \textit{Id.} at 844.
\item \textsuperscript{25} 465 U.S. 1 (1984) (this case made the FAA applicable in state courts).
\item \textsuperscript{26} \textit{Allied-Bruce Terminix}, 115 S.Ct. at 845 (Scalia, J., dissenting).
\item \textsuperscript{27} \textit{Id.}
\item \textsuperscript{28} \textit{Id.}
\end{itemize}
decided. He argued that the arbitration agreements are procedural, and "it would have been extraordinary for congress to prescribe procedural rules for state courts." Justice Thomas stated that the FAA applies only in the federal courts.

III. THE BACKGROUND

Historically, agreements to arbitrate have not been favorably considered by the courts, which feared that they were being ousted of their jurisdiction. Therefore, in order to overcome this "anachronism of the American law," the U.S. Congress enacted the Federal Arbitration Act. One of the purposes of the enactment was to eliminate judicial hostility toward arbitration agreements.

29. Id.
30. Id. at 846.
31. Id. (Thomas, J., dissenting).
32. Id. at 838; see also Mastrobuono v. Shearson Lehman Hutton, 115 S. Ct. 1212 (1995) (holding that arbitrators can award punitive damages notwithstanding the fact that state law prohibits them); Volt Information Sciences v. Board of Trustees, 489 U.S. 468 (1989) (both majority and dissent mention the historical reluctance of courts to enforce arbitration agreements); Bernhardt v. Polygraphic Co. of Am., Inc., 350 U.S. 198 (1956) (stating that the origins of these refusals to enforce arbitration lie in ancient times, when the English courts fought for extension of jurisdiction - all of them being opposed to anything that would altogether deprive every one of them of jurisdiction); Southland Corp. v. Keating, 465 U.S. 1 (1984) (dealing briefly with courts' reluctance to enforce arbitration agreements and holding the FAA applicable in state courts).
33. The need for the law arises from an anachronism of our American law. Some centuries ago, because of the jealousy of the English courts for their own jurisdiction, they refused to enforce specific agreements to arbitrate upon the ground that the courts were thereby ousted from their jurisdiction. This jealousy survived for so long a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts. The courts have felt that the precedent was too strongly fixed to be overturned without legislative enactment, although they have frequently criticized the rule and recognized its illogical nature and the injustice which results from it. This bill declares simply that such agreements for arbitration shall be enforced, and provides a procedure in Federal courts for their enforcement.

35. The legislative history of the Act establishes that the purpose behind its passage was to ensure judicial enforcement of privately made
The FAA § 2 provides that any 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 shall be valid, irrevocable and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.36

Despite clear congressional intent regarding the enforcement of arbitration clauses in contracts, several questions have arisen and have been litigated over the years.

One of the questions was whether the FAA represented an exercise of Congress' Article III power to "ordain and establish" federal courts.37 In Prima Paint Corp. v. Flood & Conklin Mfg. Co.,38 the Court rejected this view and held that the FAA "is based upon and confined to the incontestible federal foundations of control over interstate commerce and over admiralty."39 Therefore, the power of the FAA is derived from the Commerce Clause. Intrinsically related to the question of whether the FAA represented the exercise of Congressional power under Article III, was the issue of the FAA's applicability in diversity cases.40 Agreeing that the FAA sets forth substantive law, the Prima Paint Court nonetheless concluded that the act applied in diversity cases because Congress had so intended.41

agreements to arbitrate. We therefore reject the suggestion that the overriding goal of the Arbitration Act was to promote the expeditious resolution of claims. The Act, after all, does not mandate the arbitration of all claims, but merely the enforcement—upon the motion of one of the parties—of privately negotiated arbitration agreements.


36. 9 U.S.C.S. § 2 (1987). The FAA also provides procedures for enforcing valid arbitration agreements. Section 3 provides for a stay of proceedings "in any of the courts of the United States" on an issue that is subject to a valid arbitration agreement. Section 4 provides procedures for obtaining a court order to compel a recalcitrant party to proceed with arbitration as agreed. The FAA further provides procedures for appointing arbitrators (§ 5), and issuing subpoenas to witnesses (§ 7), grounds for judicial enforcement (§ 9), modification (§ 11) and annulment of arbitration awards (§ 10).


39. Id. at 405 (quoting H.R. Rep. No. 96, 68th Cong., 1st sess., 1 (1924)).

40. Erie R.R. Co. v. Tompkins, 304 U.S. 64, 71-80 (1938) (made clear that federal courts must apply state substantive law in diversity cases).

41. "Congress may prescribe how federal courts are to conduct themselves with respect to subject matter over which Congress plainly has power to
The holding in *Prima Paint* led to the question whether Congress intended the Act also to apply in state courts. In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, the Supreme Court held that the FAA created a body of federal substantive law that is applicable in both state and federal courts. This ruling was confirmed in *Southland Corp. v. Keating*, which held that the FAA pre-empts state law and that state courts cannot apply state statutes that invalidate arbitration agreements. The court emphasized that the FAA had created a body of federal substantive law, based on Congress' commerce clause power, regarding the enforceability of arbitration clauses.

The holdings in *Prima Paint* and *Southland* "federalized the law of arbitration by establishing the FAA as the generally applicable substantive law of arbitration in the United States." With these cases the Supreme Court laid the basis for a policy in favor of arbitration as a means of dispute resolution. However, prior to *Allied-Bruce* a conflict had arisen as to the interpretation of the FAA in federal appellate courts and state courts.

At least three federal circuit courts addressing the reach of the FAA had held that the act's reach is coextensive with Congress' broad power to regulate interstate commerce. In other words, the FAA applies to transactions which relate in any way, or affect to interstate commerce. In *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, the Second Circuit stated that, when Congress enacted the FAA, it "intended to exercise as much of the constitutional power as it could in order to make the Act as widely effective as possible." Later, in *Foster v. Turley*, the Tenth Circuit held that the requirement that the underlying transaction "involve commerce" must be broadly construed "so as to be co-extensive with congressional power to regulate under the Commerce Clause." Finally, in *Snyder v. Smith*, the Seventh Cir-legislate." *Prima Paint Corp. v. Flood & Conklin Mfg. Co.* 388 U.S. 395, 405 (1967). 42. 460 U.S. 1 (1983). 43. *Id.* at 23-26. 44. 465 U.S. 1 (1984). 45. *Id.* at 15-16. 46. *See* Strickland, supra note 1, at 396. 47. *See supra* note 19. 48. 271 F.2d 402 (2d Cir. 1959). 49. *Id.* at 406. 50. 808 F.2d 38 (10th Cir. 1986). 51. *Id.* at 40.
cuit similarly concluded that Congress intended the FAA to reach the fullest extent of the commerce clause.53

Nevertheless, a number of state courts, trying to escape the effect of Southland, which conflicted with a number of state anti-arbitration statutes, went on to interpret the FAA's language narrowly as requiring the parties to a contract to have "contemplated" an interstate commerce connection.54

IV. Analysis

Against this background the Supreme Court decided whether the Dobsons were entitled to a jury trial or whether they had to arbitrate. The first argument presented by the Dobsons was that Southland should be overruled because Congress had never intended the FAA to apply in state proceedings.55 The Dobsons were joined by the attorneys general of 20 states, who submitted an amicus curiae brief urging the Supreme Court to overrule Southland. The gist of their argument was that the FAA does not contain a pre-emption clause expressly displacing state law.56

In his first opinion on the bench, Justice Breyer, writing for the majority, explained that nothing had occurred in the ten years since Southland to justify overruling that decision and that, in the interim, private parties and courts had relied upon Southland and structured their affairs and decisions accordingly.57 Having declined the invitation to overrule Southland, the Supreme Court proceeded to address the FAA's reach. The major issue of the case


53. Snyder, 736 F.2d at 417.


57. Allied-Bruce Terminix, 115 S.Ct. at 839.
was whether the FAA’s language, “transaction involving commerce,” was to be read broadly, as the federal appellate courts had done, or narrowly, as the Alabama Supreme Court did in the case under discussion. A broad interpretation of these words would make them equivalent to “affecting commerce”—a phrase which usually signals full exercise of congressional power over interstate commerce, as long as the activity being regulated has substantial effect on interstate commerce.

The Court offered several reasons for concluding that the word “involving”, like “affecting”, signals an intent to exercise Congress’ commerce power to the full. First, it relied on linguistic interpretation, according to which “involved” and “affect” sometimes can “mean about the same thing.” Second, the Court stated that legislative history “indicates an expansive congressional intent.” Third, the Court referred to the broad interpretations of the FAA set forth in prior Supreme Court decisions.

58. The Dobsons argued that the express wording of the FAA compels an inquiry into the parties’ intentions at the time they entered into their arbitration agreement rather than an inquiry into whether the parties’ transaction in fact involved interstate commerce. Hence, the substantial “contemplation” test applied by the Alabama Supreme Court is consistent with the wording of the statute. Brief for Respondent, Allied Bruce Terminix Corp. v. Dobson, 115 S. Ct. 834 (1995) (No. 93-1001).


60. See NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937) (Congress could regulate labor relations in the industry since they had a substantial effect on interstate commerce); Wickard v. Filburn, 317 U.S. 111 (1942) (If an activity as a class has a substantial effect on interstate commerce, Congress can regulate such particular activity, regardless of the fact that it may be intrastate); U.S. v. Lopez, 115 S. Ct. 1624 (1995) (where the Court again upheld the substantial effect rationale).

61. Allied-Bruce Terminix, 115 S.Ct. at 841.

62. OXFORD ENGLISH DICTIONARY 466 (1st ed. 1933) (where the semantic structure of the word “involve” included also the meaning “include or affect in... operation.”).

63. Allied-Bruce Terminix, 115 S.Ct. at 839.

64. See H.R. Rep. No.96, 68th Cong., 1st Sess. 1 (1924) (the FAA's "control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce"); 65 CONG. REC. 1931 (1924) (the FAA "affects contracts relating to interstate subjects and contracts in admiralty").

which unquestionably support an expansive reading of the FAA. Finally, the Court concluded that a broad interpretation of “involving commerce” is consistent with the FAA’s basic purpose to put arbitration provisions on the “same footing as all other contractual clauses.”

After discussing three cases relied upon by the respondent and stating that they did not affect the above conclusion regarding the broad interpretation of “involving commerce” phrase, the Court proceeded to discuss the second question, namely whether the interstate connection of the transaction had to have been “contemplated by the parties” or whether a “commerce in fact” test would be sufficient to decide the applicability of the FAA.

The Court noted that the Supreme Court of Alabama and several other courts had followed the “contemplation of the parties” test. However, such a test had been proven anomalous and not fitting with the purpose of the Act. Instead of a summary and speedy disposition of petitions to enforce arbitration clauses, the “contemplation” test would breed more litigation and incur costs and delays, which Congress had sought to avoid. Such interpretation would lead to unrealistic approaches, since the application of the FAA would depend merely on the state of mind of the parties - whether they had in mind interstate commerce contacts when they entered into the contract. The Court went on to say that by rejecting the “contemplation of the parties” test and adopting the “commerce in fact” test, there was no justified concern that the Act would excessively encroach upon the powers reserved to the states by the Constitution or by statute.


68. Allied-Bruce Terminix, 115 S.Ct. at 841.

69. Id.

70. Id. 841-42.

71. Id.

72. Id. at 842.

73. Id.
Finally the court rejected the argument of *amicus curiae* for an objective version of the "contemplation of the parties" test. This objective version would allegedly give more protection to consumers asked to sign form contracts with businesses.\(^7\text{4}\) The court noted that the ability to disavow an arbitration clause might benefit a consumer with a potentially large damage claim who wants to present his case to the jury, but it may equally harm small claim consumers, who cannot justify the costs of proceeding in court.\(^7\text{5}\)

The best way to ensure consumer protection was for the states to apply general contract law principles and to invalidate an arbitration clause, as permitted by the FAA § 2, "upon such grounds as exist at law or in equity for the revocation of any contract."\(^7\text{6}\) However, the FAA prohibits the states to consider a contract fair and enforceable as to other terms but not as to the arbitration clause, just because it calls for arbitration.\(^7\text{7}\) After all, the purpose of the FAA had been to place arbitration clauses on the same footing as any other contractual provision.\(^7\text{8}\)

V. EFFECT OF THE DECISION

The holding in *Allied-Bruce* rejects any notion that the FAA does not apply in state courts. In addition, it conclusively rejects the substantial contemplation test for determining whether the FAA or state law applies to arbitration clauses. Finally, it set forth the "commerce in fact" test for determining FAA applicability. Under *Allied-Bruce* the FAA applies to any transaction which in fact involves or affects commerce, even if the parties did not contemplate interstate commerce at all.

The applicability of the FAA will now apparently hinge on the FAA's interstate commerce requirement. Long-standing tradition and many Supreme Court decisions construing the commerce power indicate that such power is almost limitless. It extends to any activity or transaction that "affects interstate commerce."\(^7\text{9}\) When applying this pervasive standard, the Supreme Court has held that even intrastate activities of a very small scale may be federally regulated if they might affect commerce when combined

\(^7\text{4}\) Id.
\(^7\text{5}\) Id. at 843.
\(^7\text{6}\) Id. (quoting 9 U.S.C. § 2 (1987)).
\(^7\text{7}\) Id.
\(^7\text{8}\) Id.
\(^7\text{9}\) Hodel v. Virginia Surface Mining & Reclamation Ass'n, 452 U.S. 264, 276-77 (1981) (citations omitted).
with similar small-scale activities. In Wickard v. Filburn,\textsuperscript{80} for example, the Court held that Congress could use its commerce power to regulate a farmer's production of grain on his own farm for his own consumption. Therefore, the reach of Congress' commerce power seems to be far-reaching. Accordingly, unless the transaction is purely local, the FAA should govern the enforceability of arbitration provisions in future arbitrability disputes.

However, a subsequent recent Supreme Court decision, United States v. Lopez,\textsuperscript{81} suggests some limitations to this all-powerful commerce clause. For the first time in 60 years the Court invalidated a federal statute\textsuperscript{82} on the grounds that the regulation attempted by the statute was beyond Congress' commerce power. While the Lopez decision may be limited to its facts and, according to the Court, would not disturb the "substantial effect on interstate commerce" rationale for activities commercial in character,\textsuperscript{83} it may indicate a renewed initiative by the Court to narrow Congress' commerce power.\textsuperscript{84} In any event, the inference may be drawn that while the scope of the FAA's applicability is all-embracing, it is not limitless.

Notwithstanding the Lopez decision, Allied-Bruce will have a far-reaching effect on the laws of many states, Alabama included, whose arbitration statutes will not have a prayer under the "commerce in fact" test. As of now, it appears that only Alabama, Mississippi and Nebraska still hold that arbitration agreements are unenforceable absent application of the FAA.\textsuperscript{85}

\begin{itemize}
\item \textsuperscript{80} 317 U.S. 111 (1942).
\item \textsuperscript{81} 115 S. Ct. 1624 (1995).
\item \textsuperscript{82} 18 U.S.C § 922 (g)(A) (1988) (The Gun-Free School Zone Act made it a federal crime "for any individual to possess a firearm at a place that the individual knows, or has reasonable cause to believe, is a school zone.").
\item \textsuperscript{83} United States v. Lopez, 115 S. Ct. 1624, 1675 (1995).
\item \textsuperscript{84} Recall Pre-New Deal decisions such as: Hammer v. Dagenhart, 247 U.S. 251 (1918) (Court struck down a federal statute which prohibited the interstate transport of articles produced by companies which employed under-age children, overruled by United States v. Darby, 312 U.S. 100 (1941)); Carter v. Carter Coal Co., 298 U.S. 238 (1936) (holding unconstitutional and beyond commerce power a federal statute which set maximum hours and minimum wages for workers in coal mines).
\item \textsuperscript{85} ALA. CODE. § 8-1-41(3) (1984); see also Ex Parte Clemens, 587 So. 2d 317, 319 (Ala. 1991) ("Unless the FAA is applicable, pre-dispute arbitration agreements are void in Alabama as against public policy"); MISS. CODE ANN. § 11-15-101 (Supp. 1992) (Mississippi takes the same view, except for disputes arising from construction contracts); NEB. REV. STAT. §§ 25-2601 to 25-2622 (1989) adopting the Uniform Arbitration Act, was held by Nebraska Supreme
\end{itemize}
Several other states, though enforcing pre-dispute arbitration clauses, have codified certain exceptions to their arbitration statutes. For example, the Georgia Arbitration Code liberally provides for the enforcement of "a written agreement to submit any existing controversy to arbitration."\(^{66}\) However, the Code does not enforce arbitration agreements in insurance contracts, contracts related to consumer transactions, agreements to arbitrate future personal injury or wrongful death tort claims and some loan agreements and financing agreements.\(^{67}\) A few other states have codified similar exceptions in their arbitration statutes: Arkansas, Indiana, Kansas, Ohio, South Carolina.\(^{68}\)

Since contractual arbitration clauses will now be routinely enforced, a consideration of certain advantages or disadvantages of these clauses is necessary before submitting to arbitration as a means of dispute resolution. The advantages of arbitration will depend on the circumstances. First, arbitration is usually time-saving and less expensive than jury trials; but the speed of this process may oftentimes be detrimental to someone who has an interest in delaying resolution of the dispute. Second, arbitration procedures are less formal and technical than court procedures. However, arbitration may still result in unfavorable, irrational and arbitrary results. In these circumstances judicial recourse to overturn an unfavorable reward is very difficult. Third, arbitration provides a greater measure of finality than litigation. Fourth, arbitration is more flexible and the parties usually have more control over it and over the selection of the arbitrators than in a court procedure. Fifth, arbitration offers more privacy than the litigation of a dispute. Finally, while litigation is prone to produce winners and losers who harbor bitter feelings towards each other,
arbitration can be used as a tool to find solutions to maintain relationships. Considering all these advantages and the assurance that nearly all arbitration clauses will be enforced under the FAA, it seems that arbitration as a means of dispute resolution will be more widely utilized.

VI. EFFECT ON THE NORTH CAROLINA LAW

A. North Carolina and the “Contemplation of the Parties” Test

Like many other states, North Carolina used to conform to the old common law rule which made all agreements to arbitrate future disputes unenforceable. However, in August 1973 with the policy favoring arbitration growing stronger, the North Carolina legislature amended the arbitration law. The amendment provided that agreements to arbitrate future disputes are binding and irrevocable. Several later decisions have upheld this strong public policy in favor of arbitration as a means of dispute resolution.

Agreements to arbitrate. Two or more parties may agree in writing to submit to arbitration, in conformity with the provisions of this article, any controversy existing between them at the time of the agreement to submit. Such an agreement shall be valid and enforceable, and neither party shall have the power to revoke the submission without the consent of the other party or parties to the submission save upon such grounds as exist in law or equity for the rescission or revocation of any contract. The interpretation of this provision had been that agreements to arbitrate could not oust the courts of their jurisdiction. See, e.g., Skinner v. Gaither Corp., 234 N.C. 385, 67 S.E.2d 267 (1951).

90. N.C. GEN. STAT. § 1-567.2 (1973).

91. N.C. GEN STAT. 1-567.2 (1973) provides:
Two or more parties may agree in writing to submit to arbitration any controversy existing between them at the time of the agreement, or they may include in a written contract a provision for the settlement by arbitration of any controversy thereafter arising between them relating to such contract or the failure or refusal to perform the whole or any part thereof. Such agreement or provision shall be valid, enforceable, and irrevocable except with the consent of all parties, without regard to the justiciable character of the controversy.

The landmark case in North Carolina regarding arbitration is *Burke County Pub. Sch. Bd. of Educ. v. Shaver Partnership.*93 *Burke* involved a service contract between a multi-state architectural firm and a local Indiana school board for the designing of two school buildings. Upon completion of one of the buildings, the plaintiff discovered a roof leak which would require extensive repairs. Alleging a design defect, plaintiff brought action for $150,000 in damages for breach of contract. The defendant moved to stay the proceedings filing a demand for arbitration of the dispute with the American Arbitration Association in accordance with the provisions of the contract.94 The Court of Appeals denied the stay, concluding that the contract between the parties was not a transaction involving interstate commerce within the meaning of the FAA.95 Therefore the plaintiff had the right to disregard the agreement to arbitrate future disputes and institute litigation.96

The North Carolina Supreme Court reversed and held that a contract need not contemplate the interstate shipment of goods in order to evidence a transaction involving commerce within the meaning of Section 2 of the FAA. "Where, however, performance of the contract itself, including a personal service contract, necessarily involves, so that the parties to the agreement must have contemplated, substantial interstate activity the contract evidences a transaction involving commerce within the meaning of the FAA."97 Therefore, the FAA would pre-empt any conflicting state law and the arbitration provision would be enforced.

The Court adopted Judge Lumbard's widely-held approach—known as "contemplation of the parties" test—according to which:

> [T]he significant question 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 arbitra-  

94. Article Eleven of the contract provided: "All claims, disputes and other matters in question arising out of . . . his Agreement or the breach shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Association then obtaining. This agreement so to arbitrate shall be specifically enforceable under the prevailing arbitration law." *Id.* at 409, 279 S.E.2d at 817.
95. *Id.* at 410-410, 279 S.E.2d at 818.
96. *Id.* at 410, 279 S.E.2d at 817. (The Court of Appeals found that the dispute was governed by the former N.C. GEN. STAT. § 1-544 since the contract had been entered into in 1969, prior to the amended arbitration law of 1973.).
tion clause, they contemplated substantial interstate activity. Cogent evidence regarding their state of mind at the time would be the terms of the contract, and if it, on its face, evidences interstate traffic the contract should come within - 2.98

Later cases confirmed the adoption of the “contemplation of the parties” test. In In the Matter of Arbitration Between Cohoon and Ziman,99 the North Carolina Court of Appeals held that evidence presented in trial “was sufficient to support conclusion that interstate activity was contemplated by the parties to a partnership agreement, and therefore such agreement was covered by the FAA.100 In Bennish v. North Carolina Theater, Inc.,101 the Court of Appeals held that the contract between the dance theater and the dancer which contained an arbitration clause under which either party could demand arbitration was within the FAA, “because there is sufficient evidence that the contract contemplated substantial interstate activity.”102 Both these decisions relied on Burke and on Judge Lumbard’s “contemplation of the parties” test.

Thus, North Carolina, like Alabama, has been committed to a narrow interpretation of the FAA language “involving commerce, making the interstate commerce connection dependant on the contemplation of the parties, on their state of mind, when they entered into the contract.

B. Allied-Bruce Terminix “Terminates” North Carolina’s “Contemplation of the Parties” Test

It appears that after the Allied-Bruce decision the North Carolina courts’ narrow interpretation of the FAA language “involving commerce” and the endorsement of the “contemplation of the parties” test will no longer be valid.103 Under the new broad interpretation of the language, as a functional equivalent of “affecting commerce,” and the far-reaching “commerce in fact

100. Id. at 229, 298 S.E.2d at 731.
102. Id. at 45, 422 S.E.2d at 337.
103. The Allied-Bruce opinion made specific reference to Burke County Public Schools Bd. of Ed. v. Shaver Partnership, 303 N.C. 408, 279 S.E.2d 816 (1981), criticizing it along with other state courts for having adopted a narrow interpretation of the FAA language and resorted to the “contemplation of the parties” test. Allied-Bruce Terminix, 115 S.Ct. at 841.
test, any remote connection with interstate commerce will make arbitration agreements enforceable under the FAA. Furthermore, the new sweeping "commerce in fact" test may displace some of the North Carolina arbitration law. For example, the provision that excludes employer-employee disputes from arbitration agreements may fall under the challenge of the new test. The FAA will be almost always applicable since the burden of showing a connection between the dispute at issue and the interstate commerce connection will not be hard to carry.

The uncertainty of the potential ramifications of *Allied-Bruce* is demonstrated by the North Carolina legislature's recent amendment to the forum selection clause statute. The statute still provides that "any provision in a contract entered into in North Carolina that requires the prosecution of any action or the arbitration of any dispute that arises from a contract to be instituted or heard in another state is against public policy and is void and enforceable." After *Allied-Bruce*, if the contract will affect or involve interstate commerce (for which very little is needed), arbitration will be enforceable under the FAA. Consequently, the North Carolina law will be pre-empted by the federal law.

It is interesting to note that while arbitration provisions will be enforceable, other contract provisions which require the contract to be governed by the law and forum of another state, will not enjoy the same preferential treatment. Under North Carolina law such terms will still be void and unenforceable. Hence, arbitration provisions in this context are placed not "on the same footing" but on better footing than other contract terms.

VI. CONCLUSION

*Allied-Bruce* appears to be a major victory for supporters of arbitration. It guarantees that if a contract involves or affects interstate commerce, the pro-arbitration standards contained in the FAA will govern the enforcement of an arbitration provision in

104. *N.C. Gen. Stat.* § 1-567.2 (b) (1996) ("This section shall not apply to (b) Arbitration agreements between employers and employees or between their respective representatives, unless the agreement provides that this Article shall apply.").

105. See supra pp. 13-14.


107. Id. However, this section specifically provides that "this prohibition will not apply to non-consumer loan transactions".

108. See supra note 66.
the contract. Parties submitting to arbitration will no longer face the legislative barriers of differing state standards or the judicial hostility against the enforcement of arbitration clauses. It's still too early to see how courts around the country will react to this decision. Naturally, courts and attorneys may still resort to creative ways to void arbitration clauses "upon such grounds as exist at law or in equity for the revocation of a contract." However, the odds of invalidating arbitration clauses in contracts affecting commerce seem to be very slim, if not impossible.

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109. This possibility was left open in Allied-Bruce which expressly provided that "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.'" Allied-Bruce Terminix, 115 S.Ct. at 843 (citing 9 U.S.C. § 2 (1987)).

110. Mastrobuono, 115 S.Ct. 1212, one of the latest incursions of the Supreme Court into the arbitration area, accomplished a further expansion of the FAA, by upholding arbitrator's power to award punitive damages notwithstanding state law that prohibits such an award.