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Allied-Bruce Terminix Companies v. Dobson: The Implementation of the Purposes of the Federal Arbitration Act or an Unjustified Intrusion into State Sovereignty?

In Allied-Bruce Terminix Companies v. Dobson, the United States Supreme Court held that section 2 of the Federal Arbitration Act ("FAA") was applicable to contract actions which were brought in state court. The controversy began with a house originally owned by Mr. and Mrs. Gwin in Fairhope, Alabama. In 1987, the Gwins purchased a lifetime termite protection plan from the local Allied-Bruce Terminix office, a franchise of Terminix International. The termite protection plan was to protect the house "against the attack of subterranean termites," to reinspect the house periodically, to provide any 'further treatment found necessary,' and to repair, up to $100,000, damage caused by new termite infestations. The contract also contained an arbitration clause which indicated "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 1991, the Gwins had Allied-Bruce reinspect the house because the Dobsons were interested in purchasing the house. The house was given a clean bill of health. As soon as the Dobsons bought the house, they discovered that it was swarming with termites. Allied-Bruce was not able to adequately remedy the infestations. The Dobsons sued the Gwins, Allied-Bruce, and Terminix International in an Alabama state court, claiming breach of contract, fraud and negligence. The Gwins cross-claimed against Allied-Bruce and Terminix International. Allied-Bruce and Terminix requested a stay, pending arbitration, as indicated in the plan's contract.

3. 115 S. Ct. at 837.
4. Id.
5. Id.
6. Id.
7. Id.
and by application of section 2 of the FAA. The state court denied the stay by applying the restrictive "substantial contemplation" test to determine if the FAA was applicable. That test only allows the application of the FAA where "at the time [the parties entered into the contract] and accepted the arbitration clause, they contemplated substantial interstate activity." The court found that the FAA did not apply to this contract and instead applied the Alabama law which makes "written, predispute arbitration agreements invalid and 'unenforceable.'" Allied-Bruce and Terminix appealed to the Alabama Supreme Court which upheld the denial of the stay, finding that the FAA was inapplicable to this contract "because the connection between the termite contract and interstate commerce was too slight." The court applied the substantial contemplation test, which Allied-Bruce and Terminix appealed to the Supreme Court, which reversed both decisions of the lower courts.

The Federal Arbitration Act was passed in 1925 in an attempt to limit the common law restrictions in the use of arbitration. The scope of the FAA was not clearly defined at the time of its passage, so the evolution of its application must be outlined in order to understand the history behind the decision in Allied-Bruce Terminix Companies v. Dobson. In 1956, the Supreme Court decided Bernhardt v. Polygraphic Co., where the issue before the Court involved the applicability of the FAA in state courts. The case revolved around a labor dispute which involved an arbitration clause in an employment contract. The decision in Bernhardt avoided the issue of the applicability of the FAA in a state court by holding that the contract in dispute did not involve interstate commerce and thus was not covered by the FAA. The Court gave no rationale as to why this contract did not "evidence commerce," but merely made the broad statement, "Nor does this contract evidence 'a transaction in interstate commerce' within the meaning of section 2 of the Act." Over a decade later, the Supreme Court again faced the question of the FAA's applicability in Prima Paint
This controversy was not originally filed in state court but instead in the United States District Court for the Southern District of New York. The dispute was based on a breach of a consulting agreement containing an arbitration clause with federal subject matter jurisdiction based on diversity. The Supreme Court held that this contract did evidence interstate commerce, and therefore the FAA was controlling in this controversy. This case expanded the prior application of the FAA, which was formerly limited to federal question cases only, to all cases brought in federal court regardless of whether federal jurisdiction was based on a federal question or diversity jurisdiction. This expansion made it clear that the Supreme Court found that the FAA was not passed under the Article III power of the Constitution (which would limit its application to only federal question cases), but instead the FAA was passed pursuant to the Commerce Clause (which makes the FAA federal substantive law). The Court in Prima Paint indicated that the agreement clearly involved interstate commerce. Like the decision in Bernhardt, the Court gave no reasoning for the conclusion, but merely stated "There could not be a clearer case of a contract evidencing a transaction in interstate commerce." In 1983, the Supreme Court decided Moses H. Cone Memorial Hospital v. Mercury Construction Corp., reaffirming that the FAA created a body of federal substantive law and, therefore, should be applicable in both federal and state courts. The following year, the Supreme Court reinforced the applicability of the FAA in state courts in Southland Corp. v. Keating. The Court reversed the California Supreme Court, which enforced a California statute prohibiting the enforcement of arbitration clauses. The Supreme Court held that state courts could not refuse to apply the FAA when the contract containing the arbitration clauses evidence a

19. Id. at 398.
20. Id.
21. Id. at 401.
27. 388 U.S. at 401. See also Bynum et al., supra, note 22, at 9.
29. Id. See also Bynum et al., supra note 22, at 9.
31. Id. at 16.
Thus, the Supreme Court clearly established that the FAA created federal substantive law, pursuant to the Commerce Clause power, which is applicable in both federal and state courts. The FAA applies to any contract which evidences commerce and pre-empts any contravening state law. The phrase "evidencing commerce" of section 2 has not had a clear or consistent application since the passage of the FAA. The two Supreme Court cases prior to Terminix which discussed that phrase, Bernhardt and Prima Paint, provided little to no analysis of the phrase. Both cases merely drew conclusions about whether a contract did or did not evidence commerce, with no further explanation. Until Terminix, two distinct interpretations of the phrase "evidencing commerce" existed: 1) A broad test which encompassed any contract which "affects interstate commerce" and; 2) A more restrictive test which would include any contract which contemplated substantial interstate commerce at the time the contract was entered into. The existence of these two tests created a great disparity in the enforceability of the arbitration clause by the varying applicability of the FAA in each state court.

Allied-Bruce Terminix Companies v. Dobson has two holdings which are significant to the development of arbitration in the United States and, specifically, section 2 of the FAA. The Court held: (1) The phrase "evidencing a transaction in interstate commerce" means that interstate commerce in fact must be proven before the FAA is applicable

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32. Id.
34. Bynum et al., supra note 22, at 10.
37. 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, C.J., concurring). In his concurrence in Metro Indus. Painting Corp. v. Terminal Constr. Co., Judge Lumbard argued that his test balances the interests implicit in the Supremacy Clause: state sovereignty and federal interest in consistent application of the law. Id. at 386. The FAA did not provide a clear mandate, so Judge Lumbard encouraged the use of a cautious approach. Id. Judge Lumbard also argued that his test would closely meet the expectations of the parties. Id. The fact that it is necessary for one party to cross state lines in order to fulfill obligations arising out of the contract should not by itself bring the arbitration clause within the reach of the federal statute. The Arbitration Act should apply only when the parties know or have reason to believe that the performance of the contract will require substantial interstate movement.

Id. at 388.
38. 115 S. Ct. at 838.
to the contract at issue; and (2) section 2 of the FAA is applicable in state courts and pre-empts any contravening state law, so long as the contract at issue involves or affects interstate commerce "in fact." Considering the first holding, this was the first time the Supreme Court interpreted the phrase, "evidencing a transaction in interstate commerce," and conclusively resolved the dispute between the prior two approaches to that phrase of section 2 of the FAA. The Court resolved the dispute, crystallizing the effect of the FAA on state rights. The Court found that a "commerce in fact" test would be the superior approach, reasoning that this test implements the intent of the enacting Congress. In 1925, Congress passed the FAA, specifically section 2, pursuant to the power of the Commerce Clause; it would be inconsistent for the application of the FAA not to extend as far as the commerce clause power reaches. The Court held that the commerce in fact test would provide for universal enforcement of arbitration clauses wherever Congress' jurisdiction extends. The commerce in fact test prevents the FAA from extending beyond the reach of the Commerce Clause. Arbitration clauses will not be enforced in contracts that do not in fact involve interstate commerce. The Court concluded that the application of the commerce in fact test will put arbitration clauses in those contracts on equal footing with other contract provisions, thus meeting the goals of the FAA. The Court established a clear test which would clearly define and limit the encroachment on state rights. The Court expressly rejected the application of the "substantial contemplation of the parties at the time of the contract," which the Alabama courts used as the relevant test in the prior rulings on the Terminix dispute.

41. 115 S. Ct. at 843.
42. Id. See also Bynum et al., supra note 22, at 9.
43. The two tests are: 1) A broad test which encompassed any contract which affects interstate commerce (Bynum et al., supra note 22, at 10) and; 2) A more restrictive test which would include any contract which contemplated substantial interstate commerce at the time the contract was entered into. 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, CJ, concurring).
44. 115 S. Ct. at 842.
45. U.S. Const. art I, § 3, cl. 8. The fact that the FAA was passed pursuant to the Commerce Clause is seen through the case law development.
46. The question remains: what is the significance of the word "involving"? Commerce Clause jurisprudence had developed "affecting" as the appropriate term of art. This inconsistency could be explained because the FAA was passed before "affecting" became an established term of art.
47. 115 S. Ct. at 842.
48. Id.
49. Id. at 840.
50. Id. at 837.
Supreme Court explained that the test the Alabama courts applied was unrealistic. The test relied on what the parties included at the time the contract was finalized. If a reference to interstate commerce was found, the arbitration clause in the contract would be enforceable under section 2 of the FAA. On the other hand, the parties would be prevented from utilizing an arbitration clause in their contract merely because they did not contemplate interstate commerce at the time of contracting. The Court continued to explain that the substantial contemplation test would only invite litigation about what was and what was not contemplated at the time of the contract. The Court could not reconcile the test with the literal language of section 2 of the FAA. It found no language in the section which required the parties to contemplate interstate commerce at the time of the contract; the section merely required a transaction involving interstate commerce. The second holding in *Terminix* reinforced the applicability of the FAA in state courts as established in *Southland Corp. v. Keating*. The Court reiterated the reasoning of the decision in *Southland*; that the FAA was not passed under the power of Article III of the United States Constitution, but instead under the power of the Commerce Clause. The Court in *Dobson* explained that *Southland* is well established law and there have been no intervening reasons to overrule *Southland*. Overruling *Southland* would disturb the expectations of parties who have relied on that decision in drafting their own contracts and arbitration clauses. Congress could have taken action in the thirteen years since *Southland* if they did not agree with the Court’s decision. However, this was not the case. The decision in *Terminix* reinforced that section 2 of the FAA was applicable to

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51. *Id.* at 842.
52. *Id.*
54. 115 S. Ct. at 840.
56. 115 S. Ct. at 841 (referring to U.S. CONST. art. I, § 3, cl. 8). Although the Supreme Court holds clearly in *Southland* that the FAA was enacted pursuant to the Commerce Clause, the Act’s legislative history is ambiguous on where the power to enact came from. Jon R. Schumacher, *The Reach of the Federal Arbitration Act: Implications on State Procedural Law*, 70 N.D. L. REV. 459 (1994). Congress felt its authority to enact such a law was “ample.” *Id.* at 461. An argument can be made that the procedural sections of the FAA refer specifically to the federal courts and thus the conclusion can be drawn that the entire Act was pursuant to Article III of the Constitution. However, it would be inconsistent to believe that certain sections would be passed pursuant to different congressional powers.
57. 115 S. Ct. at 839.
58. *Id.*
contract actions in state court, where the contract contains an arbitration clause and in fact involves interstate commerce.

The decision in \textit{Allied-Bruce Terminix Companies v. Dobson} is likely to increase the use of arbitration as a form of alternative dispute resolution. The major criticism of the decision in \textit{Terminix} is that the FAA preempts state substantive law. Contracts, and the remedies associated with breach, have typically been subject to state substantive law. Since this decision, an arbitration clause in a contract will be removed from state jurisdiction and subjected to federal substantive law. A broad application of the FAA will infringe on areas which state legislatures have felt should not be submitted to arbitration. This will impact states with anti-arbitration statutes most heavily, but the decision will have ramifications for all states. The FAA will have a stronger effect in those states which continue to resist arbitration. However, this effect is consistent with a federal law designed to displace state judicial hostility towards arbitration agreements. Some proponents of this criticism argue that Congress did not express a clear intention, at the time of enactment, to preempt existing state law. If Congressional intent was clear at the time of enactment, critics may wonder why it has taken seventy years to make this intent clear. The legislative history on the passage of the FAA is limited, and the history that does exist shows no express intent to preempt state law. The legislative history shows an intent to overcome the common law presumption to enforce arbitration awards but not agreements to

\footnotesize{59. 115 S. Ct. 834 (1995).}
\footnotesize{60. Bynum et al., \textit{supra} note 22, at 13. In arguments before the United States Supreme Court, 20 state attorneys general submitted amici curiae briefs requesting the Court to overrule \textit{Southland} and not to apply the FAA in state courts. Westlaw Lawprac Index, \textit{High Court Decision Striking State Rule, Could Boost the Use of Arbitration Clauses}, 13 \textit{ALTERNATIVES TO HIGH COST LITIG.} 31 (March 1995).}
\footnotesize{61. Strickland, \textit{supra} note 35, at 420. \textit{See also} Bynum et al., \textit{supra} note 22, at 15.}
\footnotesize{62. Strickland, \textit{supra} note 35, at 420.}
\footnotesize{65. Baum & Pressman, \textit{supra} note 64, at 240-42.}
arbitrate. The House Committee on the Judiciary report indicates that the congressional power for the bill came from both Article III and the Commerce Clause. The remainder of the report, though, refers to the Act as only being applied in federal courts. There is evidence that the FAA was passed pursuant to the Commerce Clause, but there is no support found in the limited legislative history that the FAA was to apply in both state and federal courts. There may be a concern that since contracts are historically governed by state law, parties to a contract contemplate the enforcement of that contract under state law. The application of the FAA would not be expected by the parties to such a contract. This criticism was foreseen by the enacting legislature. Congressional intent at that time was to eliminate the resistance to the enforcement of an arbitration clause. The goal of the FAA, as described in the legislative history, obviously involves the preemption of some state law. Additionally, Allied-Bruce Terminix Companies v.

67. H.R. Rep. No. 96, 68th Cong., 1st Sess. (1924); S. Rep. No. 536, 68th Cong., 1st Sess. (1924). The issue was not even raised in law review articles at the time of passage of the FAA. One article said,

Conflicts between the federal and state laws will undoubtedly arise in the future. If interstate commerce is involved, then of course arbitration must take place in accordance with the Federal Act. Difficulty will often arise in solving this question of jurisdiction. Very many contacts are on the border line between intra- and inter-state transactions.


The purpose of this bill is to make valid and enforceable agreements for arbitration contained in contracts involving interstate commerce or within the jurisdiction or admiralty, or which may be the subject of litigation in the Federal Courts. The bill declares that such agreements shall be recognized and enforced by the courts of the United States. The remedy is founded also upon the Federal control over interstate commerce reaches not only the actual physical interstate shipment of goods but also contracts relating to interstate commerce.

69. Id. Additionally, commentators cannot agree on which power Congress relied on for the passage of the FAA. See supra note 45 (FAA was passed pursuant to the Commerce Clause). Julius H. Cohen & Kenneth Drayton, The New Federal Arbitration Law, 12 Va. L. Rev. 265 (1926) (FAA was passed pursuant to Article III power).

70. Id.

71. 115 S. Ct. at 838.

72. Id.
Dobson is not the first case in which the FAA has been applied to state courts. Over a decade ago, the Court decided Southland, which held that the FAA created a body of federal substantive law which would preempt contravening state law. The decision in Allied-Bruce Terminix Companies v. Dobson has now defined how far the FAA will preempt state law and clarified the Southland holding. The commerce in fact test will now be the standard applied in all courts. No longer will the applicable test vary from jurisdiction to jurisdiction, and thus the preemption of state law will be consistent. The FAA will not significantly affect state sovereignty, because the FAA only preempts a small, closely defined area of state law: the enforceability of arbitration clauses. State contract law still regulates all other aspects of contracts, including fraud, duress, and unconscionability. Additionally, concerned parties could agree not to arbitrate or to have state law apply to all provisions of the contract and thus protect their desire not to have the FAA applied to the transaction. Another criticism of the FAA is that widespread application of the FAA will serve to limit individuals' right to a jury trial as well as the right to appeal. This criticism may be true, but the individual has notice that arbitration will be used for any dispute. The individual signed the contract which contained the arbitration clause. If the individual was unaware of the arbitration clause, the contract could be held unenforceable for a variety of reasons: fraud, if one party did not disclose the existence of the clause; unconscionability, if the contract is one of adhesion; an individual does not waive constitutional rights without clear knowledge, as well as other theories which would depend upon the facts of each individual case. Parties can also easily agree to exclude issues from arbitration. Therefore, the FAA does not impose arbitration where the parties have not contemplated it. The FAA will only apply when the parties have included an arbitration clause in the contract. The FAA only makes arbitration enforceable as the parties desired, overcoming any state law barriers. The decision in Terminix could increase the use of arbitration clauses and thus increase the use of arbitration since parties know the FAA will mandate enforceability. Arbitration clauses will be presumptively valid

73. Id.
75. 115 S. Ct. 834.
76. Bynum et al., supra note 22, at 14.
77. ROBERT R. RODMAN, COMMERCIAL ARBITRATION WITH FORMS, Ch. 3 Common Law and Statutory Arbitration, § 3.9 Nature and Purpose of United States Arbitration Act (1995 Supp.).
78. Bynum et al., supra note 22, at 14.
79. RODMAN, supra note 77.
Arbitration will become more widespread as an alternative to litigation due to this presumption. A broader application of the FAA will make enforcement of such clauses more consistent. Therefore, arbitration clauses will be less likely to be thrown out during a battle of the forms. There are many benefits to increased arbitration over litigation, especially in small contract disputes. For example, arbitration is cheaper, faster, and more flexible than litigation. Arbitration can give small consumers a more accessible way to challenge a big corporation. Arbitration also allows the parties to choose knowledgeable decision makers for their controversies. Not only will arbitration become more prevalent as a form of dispute resolution, but the decision in Terminix will decrease litigation over the applicability of the FAA. The test is now clearly defined, so lower courts can apply the test, thus decreasing appeals. Basing the test on the Commerce Clause allows parties to rely on established Commerce Clause jurisprudence. Additionally, the test will be clear for lawyers to use when drafting documents and when disputes arise. As the litigation over the FAA decreases, the benefits of arbitration will be reinforced. Contract disputes will now be resolved in a more efficient manner. The benefits of increased arbitration due to the decision in Terminix outweigh any minimal intrusion upon state sovereignty, especially since the intent of the FAA was to decrease common law hostility toward arbitration agreements.

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81. Bynum et al., supra note 22, at 8.
82. Id. at 14.
86. Strickland, supra note 35, at 455.