New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
ALM.
WWW.NYLJ.COM
VOLUME 268—NO. 91
WEDNESDAY, NOVEMBER 9, 2022

INTERNATIONAL ARBITRATION

Expert Analysis

SCOTUS's Ill-Advised Recasting of the Federal Policy in Favor of Arbitration

By **John Fellas**

In *Morgan v. Sundance*, 142 S.Ct. 1708 (2022), the US Supreme Court addressed a common issue that arises in arbitration—whether by pursuing litigation instead of invoking an arbitration agreement to which it is a party, that party might waive its right to arbitrate. In *Morgan*, the court resolved a circuit split on the proper test for waiver in the arbitration context. Some circuit courts had held that there was a higher standard to establish the waiver of a contractual right to arbitrate than that applicable to other contractual rights.

When it comes to all other contractual rights, the law focuses solely on the party alleged to have waived its right, asking whether it had intentionally relinquished that right. In the arbitration context, by contrast, some circuit courts also focused on the other party, asking whether it had been prejudiced by the actions of the waiving party. This heighted standard makes it harder to establish a waiver of the right to arbitrate. Circuit courts adopting this standard justified it by reference to the federal policy in favor of arbitration; if it is harder to establish waiver, more cases end up in arbitration.

In an opinion by Justice Elena Kagan, a unanimous court resolved the circuit split, holding that the question of whether a party has waived its right to arbitrate should be "[s]tripped of its prejudice requirement." The court based this decision on recasting the federal policy in favor of arbitration to prohibit federal courts from "invent[ing] special, arbitration-preferring procedural rules," and to require them, instead, "to place such agreements upon the same footing as other contracts… . Or in another formulation: The policy is to make 'arbitration agreements as enforceable as other contracts, but not more so.' … The federal policy is about treating arbitration contracts like all others, not about fostering arbitration. "

Because the federal policy in favor of arbitration has been invoked to justify numerous decisions in the field of arbitration law, this sweeping declaration could have far-reaching consequences, potentially calling into question many important arbitration doctrines that rest on that policy.

In this article, I argue that the court's broad declaration is misguided. The notion that an arbitration agreement should be treated just like every other contract—the equal footing principle—is an inadequate ideal for arbitration. Some "arbitration-preferring procedural rules," as Justice Kagan calls them, are essential to the efficacy of arbitration precisely because "arbitration contracts" are *not* "like all others."

The Federal Policy in Favor of Arbitration

While the equal footing principle underlay the Federal Arbitration Act (FAA) at the time of its enactment in 1925, (H.R. Rep. No. 96, 68th Cong., 1st Sess., 1, 2 (1924)), almost 60 years later, in *Moses H. Cone Memo-*

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rial Hospital v. Mercury Construction Corporation, 460 U.S. 1 (1983), the Supreme Court announced the federal policy in favor of arbitration for the first time. Since then, that policy has been routinely invoked by courts to justify decisions throughout the field of arbitration law.

However, no definitive judicial consensus has ever emerged as to what that policy is or its underlying rationale. At the heart of the federal policy in favor of arbitration lies a normative vacuum. The result is that that policy is often unmoored from any clear rationale that might guide its application, and that it has sometimes been applied crudely to "foster arbitration," meaning, essentially, that more arbitration is good, less arbitration bad. It is that type of rudimentary approach that underlies certain decisions in the field, such as those adopting the prejudice-requirement for waiver. And it understandable that the Supreme Court might wish to proscribe such a simplistic approach. But in rejecting all arbitration-favoring rules in favor of the equal footing principle, the court threatens the efficacy of arbitration.

In asserting that "[t]he federal policy is about treating arbitration contracts like all others, not about fostering arbitration," the *Morgan* court advanced a false dichotomy: either the federal policy is a crude one—"about fostering arbitration"—or it is "about treating arbitration contracts like all others." Since, according to the court, the former view must be rejected, only the latter can remain.

While there is no clear consensus on the meaning of the federal policy, many courts, including the Supreme Court, have advanced a conception of that policy that is not captured by the *Morgan* dichotomy. Such courts have relied upon the federal policy to justify specific arbitration-favoring rules, which conflict with the equal footing principle, in order to secure the efficacy of arbitration. Indeed, this conception of the federal policy found expression in *Moses* itself. Before discussing this conception in any detail,

> Without these and other arbitration-preferring doctrines that courts have justified on the basis of the federal policy in favor of arbitration, arbitration would be unworkable. The Supreme Court is ill-advised to jettison them.

I turn to consider why the equal footing principle is an inadequate ideal for arbitration.

Why the Equal Footing Principle is Insufficient

One essential feature of any contract is that a party to it has the right to seek relief from the courts if the other breaches it. Indeed, the fact that a party has such a right is an important reason why the other party is likely to comply with its contractual obligations. In this way, the ability of a party to seek relief from the courts is essential to the efficacy of contracts; it explains in large part why parties comply with their contractual obligations.

What is true of contracts in general is also true of arbitration agreements. For example, if one party refuses to comply with its obligation to arbitrate, the other can ask a court to compel it do so. But the fact that court involvement is essential to the efficacy of contracts creates a very particular predicament for arbitration agreements.

One way of understanding an arbitration clause, after all, is as an agreement by which the parties renounce in advance a right they would otherwise have to resolve a dispute in court; their intent is to resolve that dispute by arbitration *instead of* in the courts. Yet if one party does not live up to its obligations under an arbitration agreement or refuses to comply with an arbitration award, sometimes the only solution is for the other party to invoke the very judicial process it sought to avoid by agreeing to arbitrate in the first place.

It is for this reason that the equal footing principle is an insufficient ideal for arbitration. The equal footing principle demands that arbitration agreements be treated like any other contract. But arbitration agreements are not like any other contract. When it comes to any other contract, it goes without saying that I would prefer to avoid the expense and inconvenience of court proceedings to enforce it—e.g., when someone fails to deliver goods for which I have paid or when someone fails to used contractually-required best efforts to promote a product I have licensed to them. But my seeking judicial assistance in such circumstances is not fundamentally inconsistent with the bargain I struck.

By contrast, when I go to court to enforce an arbitration agreement or award, it is. And herein lies arbitration's predicament. On the one hand, I may have no choice but to go to court

to compel a party to comply with its obligations under an arbitration agreement or an award. On the other, my invocation of the judicial process to enforce my arbitration rights is fundamentally at odds with my rationale for having entered into an arbitration agreement in the first place. When parties enter into an arbitration agreement, their intent is to resolve any disputes in arbitration *instead of* in the courts. But when a party has to go to court to enforce its right to arbitrate, the precise court involvement required to give effect to the parties' intent in some fundamental sense subverts it.

The critical point is that the court involvement essential to the efficacy of all contracts, if it is too intrusive, time-consuming or costly, can undermine arbitration altogether. Who is their right minds would agree to arbitrate if full-bore litigation were an inevitable part of it? Rather than agreeing to resolve their disputes by arbitration *instead of* litigation, parties would be signing up to resolve their disputes by arbitration *in addition to* litigation.

The federal policy, properly understood, is premised on the view that if we are committed to having a workable arbitration process at all, some arbitration-favoring rules are essential in order to avoid time-consuming litigation relating to arbitration. Indeed, this understanding of the federal policy animated the Supreme Court's decision in *Moses*, where it announced that policy in the first place.

'Moses v. Cohen'

Moses involved lawsuits in two courts (state and federal) in connection with a pending arbitration. The specific question raised by *Moses* was a narrow one—whether a federal court can stay an action before it in favor of a pending state court action addressing the same objection to arbitrability. The Supreme Court held that the district court's decision to stay the action before it and thus refuse to consider Mercury Construction Corp.'s motion to compel arbitration "was plainly erroneous in view of Congress' clear intent, in the Arbitration Act*, to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible*." The court went on to note that section 3 and 4 of the FAA both "*call for an expeditious and summary hearing, with only restricted inquiry into factual issues*. . . . *The stay thus frustrated the statutory policy of rapid and unobstructed enforcement of arbitration agreements."*

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It is against this background that we should understand the Supreme Court's often-quoted declaration of the federal policy in favor of arbitration in *Moses*:

"The basic issue presented in Mercury's federal suit was the arbitrability of the dispute between Mercury and the Hospital. Section 2 [of the FAA] is a congressional declaration of *a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary*. . . . *The Arbitration Act establishes that, as a matter of federal law, 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 language* itself or an allegation of waiver, delay, or a like defense to arbitrability.*"*

The federal policy, properly understood, justifies special arbitration-favoring rules that have as their purpose minimizing court involvement in arbitration—rules that, in many circumstances, limit court involvement to an "expeditious and summary hearing, with only restricted inquiry into factual issues" with the aim of moving "the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible," thus advancing the "statutory policy of rapid and unobstructed enforcement of arbitration agreements."

Indeed, such rules abound throughout arbitration law, even though they conflict with the equal footing principle. For reasons of space, I offer only two examples: (i) the rule that ambiguities about the scope of an arbitration agreement should be construed in favor of arbitration; and (ii) the separability doctrine.

Ambiguities About Scope

One rule that rests on the federal policy in favor of arbitration provides

that ambiguities about the scope of an arbitration clause should be resolved in favor of arbitration. This principle found expression in *Moses*, and was given more explicit content in *Volt Information Sciences v. Board of Trustees,* 489 U.S. 468 (1989), where the court stated that "due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration." This core doctrine of arbitration law cannot be squared with the equal footing principle. After all, central to the equal footing principle is, as Justice Kagan put it, that "arbitration agreements are as enforceable as other contracts, but not more so."

Generally, when a contract is ambiguous, courts consider extrinsic evidence to determine the parties' intent. See, e.g., *Wells v. Shearson Lehman,* 72 N.Y.2d 11 (N.Y. 1988). If courts truly were to follow the equal footing principle, that is how they ought to approach the interpretation of an ambiguous arbitration agreement—they ought to consider extrinsic evidence in order to determine the intent of the parties. But, when it comes to arbitration agreements, courts bypass that approach, and simply put a thumb on the scale in favor of arbitration.

In a concurring opinion in *Armijo v. Prudential Ins. Co. of America*, 72 F.3d 793 (10th Cir. 1995), Judge Jenkins criticized the ambiguities rule precisely because it conflicted with the equal footing principle: "I am troubled by the direction the case law under the Arbitration Act has taken. What I believe was originally intended only to put arbitration agreements on the same footing as other contracts is now seen as a strong federal policy favoring arbitration agreements." He went on to assert that "the rule that doubts about the scope of arbitrable issues should be resolved in favor of arbitration, like other rules of construction, should be applied only as a last resort, after the court or trier of fact has considered extrinsic evidence of the parties' intent and found it inconclusive."

But it is clear that the rule that ambiguities as to scope should be construed in favor of arbitration is essential to the efficacy of the arbitration process. Without such a rule, a court faced with an ambiguous arbitration clause might have to resort to extrinsic evidence to determine its meaning. This, in turn, might require a factual inquiry into the parties' negotiating history in order to ascertain their intent when entering into the contract. Instead of an "expeditious and summary hearing, with only restricted inquiry into factual issues" undertaken in order to move the "parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible"—as contemplated in *Moses*—a party could get bogged down in an evidentiary hearing in the courts before an arbitration proceeding could even get off the ground.

The Separability Doctrine

The separability doctrine operates by shielding an arbitration clause from an attack to the validity of the underlying agreement containing that clause. Under that doctrine, defects in the underlying agreement—for example, that it is invalid because it was induced fraudulently or because it is illegal—do not necessarily impact the arbitration clause contained within it because that clause is presumed to be a separate contract.

Without the separability doctrine, every time a party claimed, whether as tactic to derail an arbitration or in good faith, that a contract containing an arbitration clause was invalid, logically, it would be putting the validity of the arbitration clause in issue, and therefore the authority of the arbitrators to resolve any dispute pursuant to it. It would follow, therefore, that no arbitration could go forward until a court ruled on whether the contract (and thus the arbitration clause within it) was valid. Thus, every case where the validity of a contract (with an arbitration clause) is challenged in court could potentially get bogged down in litigation before an arbitration can even get going, frustrating "the statutory policy of rapid and unobstructed enforcement of arbitration agreements," as the court put it in *Moses*. The separability doctrine avoids this result, and it is no surprise that it has been adopted throughout the world.

In *Prima Paint Corp. v. Flood Conklin Mfg. Co.*, 388 U.S. 395, (1967), where the Supreme Court first adopted the separability doctrine, Justice Abe Fortas, writing for the majority, offered the following rationale for doing so: "the unmistakably clear congressional purpose that the arbitration procedure, when selected by the parties to a contract, *be speedy and not subject to delay and obstruction in the courts."*

In his dissent in *Prima Paint*, Justice Hugo Black criticized the separability doctrine precisely because it conflicted with the equal footing

principle—asserting that, by adopting that doctrine, the court approved "a rule which indeed elevates arbitration provisions above all other contractual provisions." He went to stress this point in the following way:

"*The avowed purpose of the Act was to place arbitration agreements "upon the same footing as other contracts." The separability rule which the Court applies to an arbitration clause does not result in equality between it and other clauses in the contract.* I had always thought that a person who attacks a contract on the ground of fraud and seeks to rescind it has to seek rescission of the whole, not tidbits, and is not given the option of denying the existence of some clauses and affirming the existence of others."

Justice Black was correct to note that the separability doctrine conflicts with the equal footing principle. Under that doctrine, arbitration clauses are endowed with a special defense to a validity challenge to a contract that is unavailable to any other term of that contract. Thus, when it comes to contracts in general, a challenge to the validity of the contract is a challenge to every term within it. Therefore, the adoption of a special rule holding that arbitration clauses may be immune to a challenge that would impact other clauses in the contract "does not," as Justice Black stressed, "result in equality between it and other clauses in the contract."

The majority in *Prima Paint* did not explicitly invoke the federal policy in favor of arbitration. However, in adopting the separability doctrine, Justice Fortas relied on a rationale that many decisions, such as *Moses*, have since asserted animates such policy—avoiding time-consuming litigation relating to arbitration: that "the arbitration procedure, when selected by the parties to a contract, *be speedy and not subject to delay and obstruction in the courts*." Indeed, in *Moses*, the Supreme Court retrospectively explained the decision in *Prima Paint* in terms of the federal policy.

Thus, the *Moses* court noted: "the policy of the Arbitration Act requires a liberal reading of arbitration agreements…. As a result, some issues that might be thought relevant to arbitrability are themselves arbitrable—*further speeding the procedure* under §§3 and 4 [of the FAA]. See, e.g., *Prima Paint Corp*… ." And, at another point, the court in *Moses* noted: "[a]lthough our holding in *Prima Paint* extended only to the specific issue presented, the Courts of Appeals have since consistently concluded that questions of arbitrability must be addressed with a healthy regard for the federal policy favoring arbitration."

Conclusion

The equal footing principle is an insufficient ideal for arbitration because an arbitration agreement differs fundamentally from any other contract. In the case of other contracts, the court involvement necessary to ensure their efficacy—e.g., where a party seeks specific performance—is an undesirable inconvenience. In the case of arbitration agreements, that court involvement, while it may be necessary, undermines the parties' rationale for having entered into an arbitration agreement in the first place and can, if too intrusive, time-consuming or costly, threaten the efficacy of arbitration altogether.

If arbitration were typically accompanied by cumbersome litigation, parties would avoid entering into arbitration agreements entirely. The federal policy in favor of arbitration emerged as a corrective to the equal footing principle that originally animated the enactment of the FAA, and, properly understood, seeks to secure the efficacy of arbitration through the adoption of arbitration-preferring doctrines that cannot be squared with the equal footing principle, such as the rule about ambiguities as to scope or the separability doctrine. Without these and other arbitration-preferring doctrines that courts have justified on the basis of the federal policy in favor of arbitration, arbitration would be unworkable. The Supreme Court is ill-advised to jettison them.