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Commercial Arbitration in Federal Courts

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Commercial Arbitration in Federal Courts

I. INTRODUCTION

With increasing frequency attorneys are confronted with disputes arising under commercial contracts which contain arbitration agreements. Before the attorney can advise the client as to his legal position and recommend a course of conduct, he must interpret the effect of the arbitration agreement. Often the first question for the attorney is whether the client (or, in turn, the opposing party) can be forced to arbitrate. The answer depends upon whether agreements to arbitrate future disputes are enforceable under the law applicable to the transaction. Where both parties to the contract are citizens of the same state, the answer is readily found since the arbitration law of that state will govern the transaction. But in our increasingly mobile society, a growing number of commercial contracts involve parties of different states. In the disputes arising under many of these contracts, federal diversity jurisdiction will lie. The major problem faced by the attorney in such a case is whether the enforceability of the arbitration clause in the contract will be governed by federal law or state law, since in many instances the two will be diametrically opposed. Of course, if state law is found to govern the diversity case, the enforceability question cannot be answered until it is determined which of the two or more states' law applies. This raises a conflicts choice of law question, with which this paper is not directly concerned. The conflicts methods of choosing the state law applicable to a transaction involving many states will be used only as an illustration of a process which may also be useful in deciding whether federal or state law should apply to a particular enforceability problem in a diversity case.

A. *The Problem of Characterization*

In the past there has been no little disagreement in federal court diversity cases as to which law governs specific enforcement of agreements to arbitrate future disputes arising under a commercial contract. Under the arbitration law of some jurisdictions specific enforcement is possible, while under many others, it is not.[1] The determination of

1. See, *e.g.*, IND. STAT. ANN. § 3-201-226 (1946); MICH. STAT. ANN. § 27A.5001(2) (1962); OHIO REV. CODE ANN. § 2711.01 (Baldwin 1964) (providing for specific enforcement of an agreement to arbitrate); TENN. CODE ANN. § 23-501 (1955) (providing only for submission of existing disputes for arbitration).

which jurisdiction's law should be applied thus becomes all important. The answer to this choice of law question will normally depend upon whether arbitration is characterized as substantive or procedural under federal law.

Traditionally matters of arbitration have been characterized as procedural rather than substantive.[2] It was said that arbitration relates to the remedy, and as such, is one of the modes of trial.[3] Under standard conflicts rules, the law of the forum controls as to matters of procedure and thus, in federal court diversity cases, it was initially held that the federal law of arbitration governed.[4] Further justification for this application of federal arbitration law in such cases rested on the characterization of arbitration as a matter of federal "general law" under *Swift v. Tyson*.[5]

With the decisions in *Erie*[6] and *Guaranty Trust*,[7] it became apparent that arbitration could no longer be automatically characterized as procedural. It was not, however, until the decision in *Bernhardt v. Polygraphic Co. of America*[8] in 1956 that the Supreme Court finally directed that arbitration was to be characterized as substantive in federal court diversity cases. This decision would appear to require use of the arbitration law of the state wherein the federal court exercising diversity jurisdiction is located. Some federal courts, however, have utilized various methods to avoid the apparent mandate of *Bernhardt*.[9] In order to understand the reasoning and arguments behind these developments, this characterization problem must be viewed against a background of the general developments in substantive arbitration law.

B. *Developments in Substantive Arbitration Law*

At common law, agreements to arbitrate future disputes were held unenforceable, even though nominal damages could be granted for their breach.[10] The reason underlying the rule was that such an agreement ousted the courts from jurisdiction.[11] Since this was a time when courts were struggling to establish their prestige, they quite

2. See, *e.g.*, Red Cross Line v. Atlantic Fruit Co., 264 U.S. 109 (1924).

3. Heckers v. Fowler, 69 U.S. (2 Wall.) 123, 128 (1864).

4. California Prune & Apricot Growers Ass'n v. Catz Am. Co., 60 F.2d 788 (9th Cir. 1932); Lappe v. Wilcox, 14 F.2d 861 (D.C.N.Y. 1926).

5. 41 U.S. (16 Pet.) 1 (1841). See text accompanying notes 28-31 *infra*.

6. Erie R.R. v. Tompkins, 304 U.S. 64 (1938).

7. Guaranty Trust Co. v. York, 326 U.S. 99 (1945).

8. 350 U.S. 198 (1956).

9. See Part IV *infra*.

10. Red Cross Line v. Atlantic Fruit Co., *supra* note 2.

11. See, *e.g.*, STURGES, COMMERCIAL ARBITRATIONS AND AWARDS, §§ 22-23 (1930). Section 22 states in part: "Statements recur many times in common law cases to

naturally condemned the use of a practice which failed to recognize them as the final authority in the settlement of legal disputes.[12] The courts, however, have long since achieved their quest for prestige in the adjudication process. Moreover, expanded commercial activity has resulted in an increased number of disputes, leading eventually to hopelessly crowded court dockets. Recognizing that arbitration is an effective way of reducing the number of disputes requiring litigation, many states have altered the common law rule of revocability of agreements to arbitrate future disputes, and, by statute, have made such agreements specifically enforceable.[13]

Another statute, making agreements to arbitrate future disputes irrevocable, is the United States Arbitration Act,[14] enacted by Congress in 1925. At first the availabilty of the act, either specifically to enforce agreements to arbitrate under section 4,[15] or to stay legal proceedings

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the effect that revocable future disputes clauses are 'contrary to public policy,' and 'invalid'; that they are 'not binding upon the parties'; that they are 'unenforceable' or 'void.' Statements also frequently appear to the effect that a party who is aggrieved by the breach of such an agreement can maintain an action for damages. So few cases, however, have involved such an action that if there is such a rule of law it rests upon this popular acclaim."

As stated in Greason v. Keteltas, 17 N.Y. 491, 496 (1858) "It is well settled that courts of equity will never entertain a suit to compel parties specifically to perform an agreement to submit to arbitration. . . . To do so, would bring such courts in conflict with that policy of the common law which permits parties in all cases to revoke a submission to arbitration already made. This policy is founded in the obvious importance of securing fairness and impartiality in every judicial tribunal. . . ." See also Tobey v. County of Bristol, 23 Fed. Cas. 1313 (No. 14065) (C.C. Mass. 1845).

The idea that an agreement to arbitrate ousted the courts from jurisdiction dates back to dicta in Vynior's Case, 4 Coke 80 (pt. 8), 77 Eng. Rep. 595 (K.B. 1609) where Lord Coke held that an agreement to submit a dispute to arbitration could be revoked at the will of either party.

12. At the time when Coke's "ousting the courts of jurisdiction" idea was first utilized, this was indeed the case. However, this reason for denying the enforcement of agreements to arbitrate was continually used by the courts, long after it ceased to exist. It was not until Lord Campbell's decision in Scott v. Avery, 5 H.L. Cas. 811, 10 Eng. Rep. 1121 (1855), that the English courts gave effect to an agreement to refer a dispute to arbitration. This view, however, was not adopted by the American courts and it was not until statutory modification that the rule was changed. See statutes cited note 1 *supra.*

13. See statutes cited note 1 *supra.*

14. 9 U.S.C. §§ 1-14 (1947). Section 2 of the act provides: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

15. Section 4 of the act provides in part: "A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any court of the United States which, save for such agreement, would have jurisdiction under the judicial code at law, in equity, or in admiralty of the subject matter of a suit arising out of the controversy between the

on the dispute pending their arbitration under section 3,[16] was limited by the courts.[17] They soon realized the act's advantages, however, and began applying it in federal diversity cases, even though relevant state law made such agreements to arbitrate revocable.[18] The *Bernhardt* decision appeared to preclude application of the act in a large number of federal court cases when the jurisdictional basis was diversity.[19] To prevent this emasculation of the effectiveness of the act some lower federal courts have construed the act as creating federal substantive law under the commerce clause which applies to "contracts evidencing a transaction involving commerce," regardless of the *Erie* and *Guaranty Trust* requirements.[20]

The consideration of the problem at hand is threefold: (1) to review the development of arbitration in the federal courts in light of the changing federal policies toward arbitration; (2) to point out how previous characterization of arbitration as substantive or procedural has thwarted judicial consideration of the policy issues involved; and (3) to investigate the extent to which current federal policy, as expressed in the Arbitration Act, constitutionally could, and realistically should, be applied in diversity cases, and the problems raised by such application.

II. FEDERAL ARBITRATION LAW PRIOR TO ERIE

A. *Prior to the Adoption of the United States Arbitration Act*

Until 1924 the few Supreme Court decisions characterizing arbitration treated it as essentially a procedural matter. In *Heckers v. Fowler*,[21] decided in 1864, the parties before the court agreed to submit their dispute to a referee. The referee's decision was reported to the court and entered by the clerk as a judgment. This judgment was challenged on the basis that the court had no authority to settle the dispute in such a manner. The Supreme Court, nevertheless, upheld

parties, for an order directing that such arbitration proceed in the manner provided for in such agreement."

16. Section 3 of the act provides: "If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration."

17. See part IV *infra*.

18. *Infra* note 76.

19. See part IV *infra*.

20. *Infra* note 76.

21. *Supra* note 3.

the judgment, stating that "a trial by arbitrators appointed by the court, with the consent of both parties, was one of the modes of prosecuting a suit to judgment . . . ."[22]

Although at the time of the *Heckers* decision it was settled arbitration law that agreements to arbitrate future disputes were revocable, the lower federal courts were faced with a problem in applying this law to cases where jurisdiction was based upon diversity of citizenship. The Rules of Decision Act[23] required that "the laws of the several states . . . be regarded as rules of decision in civil actions in the courts of the United States in cases where they apply." Moreover, the Conformity Act,[24] in effect, further required that the procedure followed in a federal court diversity case be "as near as may be" to that followed by the state in which the federal court is located. Thus it seemed that even if the Rules of Decision Act did not require state law to govern arbitration issues in a federal court diversity suit based on a state cause of action, the Conformity Act did, since arbitration is essentially procedural. The lower federal courts were able to circumvent these problems through the use of two distinct theories.

1. *Characterization of Arbitration as Procedural.*—Application of the Rules of Decision Act could be avoided and federal arbitration law applied, by characterizing arbitration as procedural and utilizing the conflicts rule that procedural matters are governed by the law of the forum. But the problem of the requirements of the Conformity Act still existed. The courts were able to avoid the application of this act, however, since its requirements were inapplicable in equity suits[25] and specific enforcement of an arbitration agreement required an action in equity. Furthermore, the Supreme Court in *Pusey & Jones v. Hanssen*[26] held in 1923 "that a remedial right to proceed in a federal court sitting in equity cannot be enlarged by state statute . . . ."[27]

22. *Supra* note 3, at 128.

23. 28 U.S.C. § 1962 (1948).

24. 17 Stat. 197 (1872). Section 5 of that act provided: "That the practice, pleadings, and forms and modes of proceeding in other than equity and admiralty causes in the circuit and district courts of the United States shall conform, as near as may be to the practice, pleadings, and forms and modes of proceeding existing at the time in like causes in the courts of record of the State within which such circuit or district courts are held, any rule of court to the contrary notwithstanding; *Provided,* however, That nothing herein contained shall alter the rules of evidence under the laws of the United States, and as practiced in the courts thereof."

25. The act specifically provided that the provisions were inapplicable in equity and admiralty suits. 17 Stat. 197 (1872).

26. 261 U.S. 491 (1923).

27. *Id.* at 497. In California Prune & Apricot Growers Ass'n v. Catz Am. Co., *supra* note 4, the Ninth Circuit Court of Appeals reversed a district court order compelling arbitration under state law, holding that arbitration was a matter of procedure and that the law of the forum applied. Citing Pusey & Jones Co. v. Hanssen, *supra* note 26,

2. *Characterization of the Arbitration Act as Federal General Law.*— The majority of federal courts based their use of federal arbitration law on another line of reasoning. In *Swift v. Tyson*,[28] the Court interpreted the Rules of Decision Act to require federal court application of state law only when the question involved state statutory or decisional law regarding matters of purely local concern. The act did not apply to litigation on "contracts and other instruments of a commercial nature, the true interpretation and effect whereof are to be sought, not in the decisions of the local tribunals, but in the general principles and doctrines of commercial jurisprudence."[29] Several lower federal courts seized upon the language of *Swift v. Tyson* and applied federal arbitration law in diversity cases as a matter of "general law," thereby avoiding problems in application of the Rules of Decision and Conformity Acts.[30]

When in 1924 the Supreme Court reaffirmed its characterization of arbitration as essentially procedural in *Red Cross Line v. Atlantic Fruit Co.*[31] the inconsistency of the lower federal courts' logic became manifest. The Supreme Court's characterization at the same time made the lower court's characterization of arbitration as a matter of federal general law highly untenable. This, nevertheless was the confusing and incongruous situation that developed.

B. *After the Adoption of the United States Arbitration Act*

The passage of the United States Arbitration Act[32] in 1925 created additional problems in determining what the federal law of arbitration was and the extent of its application. Section 3 of the act provided for a stay of judicial proceedings pending arbitration, where the contract

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the court found the Conformity Act to be inapplicable since application of the California statute making arbitration agreements specifically enforcable would have broadened federal equity jurisdiction. See also Lappe v. Wilcox, 14 F.2d 861 (D.C.N.Y. 1926).

28. 41 U.S. (16 Pet.) 1 (1842).

29. *Id.* at 18.

30. See, *e.g.*, Haskell v. McClintic-Marshall Co., 289 Fed. 405 (9th Cir. 1923); Michell v. Dougherty, 90 Fed. 639 (3d Cir. 1898); Rae v. Luzerne, 58 F.2d 829 (D.C. Pa. 1932); Jefferson Fire Ins. Co. v. Bierce & Sage Inc., 183 Fed. 588 (E.D Mich. 1910).

31. 264 U.S. 109 (1924). This was an admiralty case where one of the parties to a charter agreement petitioned a New York state court for an order compelling arbitration pursuant to a clause in the contract. Although the New York statute provided for specific enforcement of executory agreements to arbitrate, the Court of Appeals of New York held it inapplicable since admiralty cases are governed by federal law under U.S. CONST. art. III, § 2. On certiorari, the United States Supreme Court reversed, holding that New York could constitutionally apply its arbitration law as a matter of procedure since arbitration deals only with the remedy and does not attempt to modify substantive admiralty law.

32. 9 U.S.C. §§ 1-14 (1947), quoted in note 14 *supra*.

in dispute contained an agreement to arbitrate future disputes. Section 4 provided for specific enforcement of such an agreement. These provisions reflected complete reversal of prior federal arbitration policy favoring revocability of agreements. However, it was section 2, defining the scope of application of the act, which created problems. This section extended the act to maritime contracts and "contracts evidencing a transaction involving commerce." Although there was no problem in defining the extent of the application of the act to admiralty cases, the situation was otherwise in non-admiralty commercial contract cases.[33] Did the use of the language "contract evidencing a transaction involving commerce" indicate merely the basis of congressional authority for passage of the act, or did this language require that the disputed contract constitute interstate transaction before the provisions of the act applied? If the latter were the correct interpretation, how were the courts to determine when a contract evidenced a transaction involving commerce? Was it even necessary to have interstate contract before the stay provision of section 3 could be applied, since this was essentially nothing more than a procedural rule? The only available Supreme Court decision concerning the application of the act was the Court's 1932 decision in *Marine Transit Corp. v. Dreyfus*.[34] This, however, was an admiralty case in which the Court in upholding the constitutionality of the act, declared its provisions to be procedural since the act in no way deprived the parties of their rights under federal admiralty law. This decision was of little aid in defining the scope of the act in non-admiralty cases, leaving this problem largely to the determination of the lower federal courts. The results, as will be seen, were far from uniform.

In general, it can be said that the scope of the act in non-admiralty cases was severely limited. A majority of the courts required diversity of citizenship, the proper jurisdictional amount, and a contract evidencing a transaction that involved commerce, before the provisions of the act could be applied.[35] In addition, most of these courts placed a restrictive definition on the term "contract evidencing a transaction involving commerce."[36] Some courts surmounted what they evidently

33. Section 2 of the Arbitration Act makes the act specifically applicable to "any maritime transaction." In order to apply the act to a commercial contract, however, the contract must be found to evidence a transaction involving commerce.

34. 284 U.S. 263 (1932).

35. See, *e.g.*, Krauss Bros. Lumber Co. v. Louis Bossert & Sons, Inc., 62 F.2d 1004 (2d Cir. 1933); *In re* Woerner, 31 F.2d 283 (2d Cir. 1929); Zip Mfg. Co. v. Pep Mfg. Co., 44 F.2d 184 (D. Del. 1930). See also Note, *Availability of Provisional Remedies in Arbitration Proceedings*, 17 N.Y.U.L.Q. 638 (1940); Note, *Arbitration Case Law of the Last Decade*, 26 VA. L. REV. 327, 340 (1940).

36. See, *e.g.*, *In re* Cold Metal Process Co., 9 F. Supp. 992 (W.D. Pa. 1935); The Volsinio, 32 F.2d 357 (E.D.N.Y. 1929).

felt to be constitutional problems in applying federal law to state contracts by characterizing some provisions of the act as procedural and applying them regardless of whether an interstate contract was involved.[37] Under this reasoning, in the absence of an interstate contract, a court would refuse to compel specific enforcement of an agreement to arbitrate under section 4, since to do so would be an unconstitutional application of federal law to a matter governed by the substantive contract law of the state. But, under the same theory, the court would grant a stay of judicial proceedings pending arbitration under section 3, since this was merely an application of procedure which in no way interfered with state substantive law.

It is apparent that the problem of characterization of arbitration existed in the pre-*Erie* analysis of arbitration statutes just as it did in the analysis of common law arbitration. The Supreme Court had characterized arbitration as procedural in both the *Atlantic Fruit* and *Dreyfus* cases in upholding application of the New York and United States arbitration statutes. But the approach taken by the lower federal courts seems to have relied on the premise that not all aspects of arbitration law are procedural, and that in some situations the application of federal arbitration law amounts to an unconstitutional preemption of a state's right to apply its substantive law to legal relations created by the authority of that state.

III. FEDERAL ARBITRATION LAW FROM ERIE TO BERNHARDT

The 1938 decision of the Supreme Court in *Erie R.R. v. Tompkins* did not solve the lower federal court's problems in applying federal arbitration law, but, instead, merely altered the approach to these problems. *Erie's* redefinition of the word "laws," as used in the Rules of Decision Act, precluded application of federal "general law" in diversity cases.[38] The federal courts, no longer able to apply federal arbitration law as "general law" in diversity cases, could justify its application only by characterizing arbitration as a matter of procedure, thus governed by the law of the forum. However, there had also been changes in the standard for determining what federal courts could do in the name of procedure. The Federal Rules of Civil Procedure, enacted in 1938 pursuant to a 1934 enabling act,[39] were,

37. See, *e.g.*, Shanferoke Coal & Supply Corp. v. Westchester Serv. Corp., 70 F.2d 297 (2d Cir. 1934). For a good discussion of these two views pertaining to the scope of § 3 of the act see Wilson & Co. v. Fremont Cake & Meal Co., 77 F. Supp. 364 (D.C. Neb. 1948).

38. In *Erie* the Supreme Court held that application of federal substantive law to a state cause of action in federal court on diversity jurisdiction violated both the equal protection clause and the tenth amendment of the United States Constitution.

39. 28 U.S.C. § 2072 (1964). "Be it enacted . . . that the Supreme Court of the United States shall have the power to prescribe, by general rules, for the district

in effect, held by the Supreme Court in *Sibbach v. Wilson & Co.*[40] to to repeal the Conformity Act. It thus appeared that the Rules of Decision Act, even as interpreted by *Erie*, did not preclude federal courts from applying their own procedure in diversity cases. This however, was somewhat limited by the Supreme Court's decision in *Guaranty Trust Co. v. York*[41] in 1945, which indicated that a federal court was precluded from applying its procedural rules in a diversity case when to do so would lead to an outcome different from that which would have resulted had the case been decided in a state court.[42] This led to a somewhat different application of federal arbitration law than had been the case before *Erie*. A summary of the post-*Erie* federal court arbitration decisions before the Supreme Court's decision in *Bernhardt*,[43] illustrates how, for the most part, courts continued to ignore the real issues when characterizing and applying arbitration law in federal court diversity cases.[44]

Although the basis of federal court jurisdiction in the cases arising during this period is not always discernible, for purposes of this discussion the cases will be divided into three main categories: those apparently based on diversity jurisdiction, those apparently based on federal question jurisdiction, and those based on admiralty jurisdiction.

A. *Diversity Cases*

During the period between the Supreme Court's decisions in *Erie* and *Bernhardt*, the United States Arbitration Act came into wider use in the lower federal courts. Most courts now applied the stay provisions of section 3 even when the contract did not evidence a transaction involving commerce,[45] reasoning that the section 3 stay provision, being essentially procedural, was not limited by the section 2 requirement of a contract evidencing a transaction involving commerce.[46] In contrast to this interpretation of section 3, most courts continued to require a contract evidencing a transaction involving commerce before granting specific enforcement of an agreement to arbitrate future disputes under section 4.[47] The result was that there were few

courts of the United States and for the courts of the District of Columbia, the forms of process, writs, pleadings, and motions, and the practice and procedure in civil actions at law."

40. 312 U.S. 1 (1941).

41. 326 U.S. 99 (1945).

42. *Id.* at 109.

43. 350 U.S. 198 (1956).

44. See text accompanying notes 45-52 *infra*.

45. See, *e.g.*, Donahue v. Susquehanna Collieries Co., 138 F.2d 3 (3d Cir. 1943); Wilson & Co. v. Fremont Cake & Meal Co., *supra* note 37.

46. Cases cited *supra* note 37.

47. See, *e.g.*, Fremont Cake & Meal Co. v. Wilson & Co., 86 F. Supp. 968 (D. Neb. 1949), *aff'd*, 183 F.2d 57 (8th Cir. 1950); *In re* Wisconsin Central Ry. Co., 74 F.

cases where arbitration agreements were specifically enforced under section 4. Even if the disputed contract evidenced interstate commerce, there was no guarantee of specific enforcement under section 4.[48] In *Kentucky River Mills v. Jackson*,[49] where the disputed contract was found to evidence a transaction involving commerce, the court found that the enforceability of the agreement to arbitrate was governed by the United States Arbitration Act rather than by Kentucky law. The court reasoned that Congress, in enacting the act had legislated within its constitutional domain and had declared as a matter of substantive law that such agreements were enforceable. Although previous cases had held that section 3, as opposed to section 4, was procedural, *Kentucky River Mills* was apparently the first case to distinguish the application of sections 3 and 4 on the ground that specific enforcement of an agreement to arbitrate is a matter of substantive law. Two subsequent cases, although not suits for specific enforcement under section 4, nevertheless buttressed the reasoning that, absent a contract evidencing a transaction involving commerce, Congress had no constitutional authority to regulate the enforceability of arbitration agreements. In *Tejas Development Co. v. McGough Bros.*,[50] suit was brought in the federal district court to enforce an award rendered pursuant to an arbitration agreement contained in a contract for grading of streets and building of houses. Part of the prayer was for reformation of the contract on the basis of mistake. The Fifth Circuit Court of Appeals reversed the district judge's determination that the United States Arbitration Act was controlling on the grounds that the validity of the awards and the binding effect of the agreement to arbitrate were both matters of state substantive law, and that the awards, if invalid under state substantive law, could not be enforced in federal court under authority of the United States Arbitration Act. In *United Fuel Gas Co. v. Columbian Fuel Corp.*,[51] the

Supp. 85 (D. Minn. 1947). See also Reconstruction Fin. Corp. v. Harrisons & Crosfield, 204 F.2d 366 (2d Cir. 1953) (granting motion to compel arbitration under § 4 without discussing whether the contract evidenced a transaction involving commerce). *Cf.* McElwee-Courbis Const. Co. v. Rife, 133 F. Supp. 790 (M.D. Pa. 1955) (granting motion to compel arbitration under § 4 as a matter of procedure without regard to requirement that contract involve commerce). See also Sturges & Murphy, *Some Confusing Matters Relating to Arbitration Under the United States Arbitration Act*, 17 LAW & CONTEMP. PROB. 580 (1952); Comment, *Jurisdiction of the Federal Courts Under The U.S. Arbitration Act*, 27 TEXAS L. REV. 218 (1948).

48. Before specific enforcement of an agreement to arbitrate will be compelled under § 4 the party seeking arbitration must have complied with all the "initiatory steps." Fremont Cake & Meal Co. v. Wilson & Co., *supra* note 47.

49. 65 F. Supp. 601 (E.D. Ky. 1946). This dispute again came before the Sixth Circuit Court of Appeals seven years later but the same issues were not treated by the court. See Kentucky River Mills v. Jackson, 206 F.2d 111 (6th Cir. 1953).

50. 165 F.2d 276 (5th Cir. 1947).

51. 165 F.2d 746 (4th Cir. 1948).

Fourth Circuit Court of Appeals was confronted with enforcement of an award rendered pursuant to an agreement to arbitrate disputes concerning fuel gas prices under a contract of sale. The court enforced the award, citing West Virginia decisions without discussion of the United States Arbitration Act. Although the arguments used in these two cases were far from universally accepted, they did indicate that courts were beginning to deal with the real issues involved in the application of federal arbitration law. Rather than merely declaring that it was necessary to have a contract evidencing a transaction involving commerce before section 4 of the act applied, these cases affirmatively recognized that some aspects of arbitration law were substantive and could not constitutionally be applied in diversity cases under the *Erie* doctrine absent some other element in the dispute giving Congress a right to regulate. In all fairness, it must be pointed out that the scarcity of such reasoning can be partially attributed to the lack of diversity cases where specific enforcement was sought.[52]

B. *Federal Question Jurisdiction*

1. *Generally.*—When jurisdiction is based on a federal cause of action, the constitutional problems of *Erie* are not present. Thus there is no need to characterize particular aspects of arbitration as substantive or procedural for purposes of determining the applicable law in a federal court. Two cases decided during this period seem to support this analysis. In *Reconstruction Finance Corp. v. Harrisons & Crosfield,*[53] the Second Circuit Court of Appeals granted specific enforcement of an agreement to arbitrate under section 4 without discussing whether the dispute involved a contract evidencing a transaction involving commerce. In *Wilko v. Swan,*[54] the Second Circuit, in an action under the Securities Act, granted a stay pending arbitration under section 3, referring to arbitration as a form of trial, but ignoring any procedural-substantive distinction between section 3 and section 4.

2. *Labor Cases.*—The labor law cases in federal courts during this period present a unique set of problems. Actions in which arbitration questions arose were of two types. The first involved suit by an employee for wages under the Fair Labor Standards Act.[55] Section 16(b) of that act provides for the employer's liability for failure to pay the minimum wage and authorizes an action to recover on such

52. Kochery, *The Enforcement of Arbitration Agreements in the Federal Courts: Erie v. Tompkins,* 39 CORNELL L.Q. 74 (1953).
53. *Supra* note 47.
54. 201 F.2d 439 (2d Cir. 1953).
55. 52 Stat. 1060 (1938), as amended, 29 U.S.C. §§ 201-19 (1964).

liability in any court of competent jurisdiction.[56] The second type involved actions by either the employee or the employer to enforce the provisions of a collective bargaining agreement under section 301 of the Labor Management Relations Act.[57] Another factor rendering labor law cases unique was the exception of employment contracts of workers engaged in interstate or foreign commerce from application of the United States Arbitration Act as provided for in section 1 of that act.[58]

The problems involved in analysis of the application of federal arbitration law to agreements to arbitrate in such cases were twofold: First, did section 1 of the United States Arbitration Act prevent the act's application to the particular case? Second, if section 1 did not prevent the act's application, what was the extent of this application? As to the first question, available cases during this period indicate a split of authority.[59] It is the second question however, which is of primary concern. Of the cases during this period in which federal arbitration law was applied, one was brought under the Fair Labor Standards Act[60] and two were brought under the Labor Management Relations Act.[61] In all three of these cases, the section 3 stay provision was characterized as procedural and thus applicable, even in the absence of a contract evidencing a transaction involving commerce. Language in one of these cases further indicated that the section 4 provision for specific enforcement was substantive law, thus

56. "(b) Any employer who violates the provisions of section 6 or section 7 of this Act shall be liable to the employee or employees affected in the amount of their unpaid minimum wages, or their unpaid overtime compensation, as the case may be, and in an additional amount as liquidated damages. Action to recover such liability may be maintained in any court of competent jurisdiction. . . ."

57. 61 Stat. 136 (1947), 29 U.S.C. § 141-88 (1964). "Sec. 301 (a) Suits for violation of contracts between an employer and a labor organization representing employees in an industry affecting commerce . . . may be brought in any district court of the United States having jurisdiction of the parties, or without regard to the citizenship of the parties."

58. 9 U.S.C. § 1 (1947). " § 1 . . . nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce."

59. See, *e.g.*, United Furniture Workers v. Colonial Hardwood Flooring Inc., 168 F.2d 33 (4th Cir. 1948); Boston & Maine Transp. Co. v. Amalgamated Ass'n of St. & Elec. Ry. Employees, 106 F. Supp. 334 (D. Mass. 1952) (finding the Arbitration Act inapplicable to labor disputes). *Cf.* Tenney Eng'r Inc. v. United Elec. Workers, 207 F.2d 450 (3d Cir. 1953) (finding the act applicable to the labor dispute involved despite § 1). See also Lewittes & Sons v. United Furniture Workers, 95 F. Supp. 851 (S.D.N.Y. 1951) (applying the act to a labor dispute without discussion of the applicability of § 1); Burstein, *The United States Arbitration Act-A Reevaluation*, 3 VILL. L. REV. 125 (1958).

60. Donahue v. Susquehanna Collieries Co., *supra* note 45.

61. Tenney Eng'r Inc. v. United Elec. Workers, *supra* note 59; Lewittes & Sons v. United Furniture Workers, *supra* note 59.

requiring a contract evidencing a transaction involving commerce before federal law could be applied.[62]

From the few labor cases decided during this period, it appears that even when the case involved federal question jurisdiction, the application of substantive federal arbitration law was limited to contracts which Congress would otherwise have had a right to regulate. Implicit in these decisions was the proposition that federal question jurisdiction extended only to the labor law aspects of the disputed contracts. It would appear that once there is federal regulation of the provisions of a labor contract, federal law could and should be held to govern all aspects of that contract, including its enforcement. This question appears to have been subsequently resolved by the Supreme Court's 1957 decision in *Textile Workers Union v. Lincoln Mills*[63] decided after *Bernhardt*. Interpreting section 301 of the Labor Management Relations Act, the Court held that section to be more than jurisdictional. Rather, it "authorizes federal courts to fashion a body of federal law for the enforcement of those collective bargaining agreements and includes within that federal law specific performance of promises to arbitrate grievances under collective bargaining agreements."[64] The Court further stated that "it is not uncommon for federal courts to fashion federal law where federal rights are concerned."[65] In forming this "301 law," the federal courts are to be guided by the general policies of the national labor laws. *Lincoln Mills* makes it clear that in a section 301 suit involving arbitration, federal law governs. The position of the United States Arbitration Act on this matter is, however, unclear. Is this one of the statutes to which federal courts must look as expressing the general policy of the federal labor laws?[66] A majority of courts, on the authority of *Lincoln Mills*, have decided arbitration issues in labor disputes without ref-

62. "Then the second section proceeds to lay down a rule of substantive law regarding the validity of an agreement for arbitration in case of any maritime transaction or a contract evidencing a transaction involving commerce. Congress was here making a rule concerning subject matter within its own constitutional legislative authority. It was not seeking to confer validity to arbitration agreements generally a matter outside the scope of federal powers. Instead it picked out two important classes of transactions within the federal legislative domain and declared the effect of arbitration clauses in agreements concerned therewith." Donahue v. Susquehanna Collieries Co., *supra* note 45, at 5.

63. 353 U.S. 448 (1957).

64. *Id.* at 451.

65. *Id.* at 457.

66. See Local 19, Warehouse Workers v. Buckeye Cotton Oil Co., 236 F.2d 776 (6th Cir. 1956); Local 205, United Elec. Workers v. General Elec. Co., 233 F.2d 85 (1st Cir. 1956). (Both of these 301 cases applied the Arbitration Act as substantive federal labor law). See also Note, *Federal Enforcement of Grievance Arbitration Provisions Under the Doctrine of Lincoln Mills*, 42 MINN. L. REV. 1139 (1958).

erence to the Arbitration Act.[67] Even so, it appears that there would be no constitutional problem in applying the Arbitration Act to a federal question suit under section 301.[68]

C. *Admiralty Jurisdiction*

In cases involving an admiralty claim the Constitution apparently requires federal courts to apply federal law.[69] Thus the *Erie* problems of substance and procedure are absent. Furthermore, section 2 of the United States Arbitration Act provides for application of that act to a maritime transaction, notwithstanding commerce considerations.[70] The admiralty cases decided during this period indicate no problem in granting the specific enforcement of agreements to arbitrate under section 4.[71]

An interesting problem exists however in admiralty cases litigated in state courts. Under the Constitution and the Judiciary Act, state courts have concurrent in personam jurisdiction over maritime causes of action, but must apply federal substantive admiralty law. State law, however, governs matters of procedure. If section 4 of the United States Arbitration Act is characterized as substantive, must a state court, hearing an admiralty case, grant specific enforcement of an agreement to arbitrate, when state arbitration law provides for revocability of such an agreement? In *Red Cross Line v. Atlantic Fruit Co.*,[72] decided before enactment of the Arbitration Act, the Supreme Court characterized arbitration as procedural in upholding the application of New York arbitration law to an admiralty case litigated in a New York court. At the time of the decision, the New York law provided for irrevocability of agreements to arbitrate, while federal law provided that such agreements were revocable. Whether this case would be authority today for a state court's refusal to specifically enforce an arbitration agreement in an admiralty case is open to considerable question.

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67. See, *e.g.*, John Wiley & Sons, Inc. v. Livingston, 376 U.S. 543 (1964).

68. In Scalzitti Co. v. Operating Eng'rs, 351 F.2d 576 (7th Cir. 1965), the court upheld the union's contention that the Arbitration Act applied to § 301 suits against the company's objection that such disputes are precluded from the act under § 1. The court relied on the fact that the Supreme Court had compelled arbitration in *Lincoln Mills* without mentioning § 1 of the act even though the court of appeals in *Lincoln Mills* had denied the application of the act under § 1.

69. "The judicial power shall extend to all cases . . . of admiralty and maritime jurisdiction." U.S. CONST. art. III, § 2. It has also been said that the *Erie* doctrine is irrelevant when the court is exercising admiralty jurisdiction, even when a state created right is being enforced. Levinson v. Deupree, 345 U.S. 648 (1953).

70. See statute quoted in note 14 *supra*.

71. See, *e.g.*, Albatross S.S. Co. v. Manning Bros., 95 F. Supp. 459 (S.D.N.Y. 1951); Stathatos v. Arnold Bernstein S.S. Corp., 87 Supp. 1007 (S.D.N.Y. 1950).

72. 264 U.S. 109 (1924).

IV. BERNHARDT: SUBSEQUENT DEVELOPMENTS AND PROBLEMS

A. *Bernhardt and Subsequent Developments*

In 1956 the Supreme Court in *Bernhardt v. Polygraphic Co. of America*[73] rendered its first decision concerning the scope of the application of the United States Arbitration Act in federal court diversity cases. In a damages suit for wrongful discharge under an employment contract which was removed to a Vermont federal district court, the defendant moved for a stay pending arbitration under section 3 of the act. The Second Circuit Court of Appeals reversed the district court's holding that since the disputed contract did not evidence a transaction involving commerce, the *Erie* doctrine required application of Vermont law. The court of appeals held that section 3 of the act applied as a matter of procedure even though the contract did not involve commerce. The Supreme Court reversed the court of appeals, stating the arbitration should be characterized as substantive for *Erie* purposes, since the application of federal arbitration law would lead to an outcome different from that which would be reached in a a state court on the same cause of action. The Court further stated that sections 1, 2, and 3 of the act are integral parts of the whole and that the stay provision of section 3 reaches only those contracts covered by sections 1 and 2. The majority felt that if they were to hold otherwise, a constitutional question under *Erie* might be presented. Mr. Justice Frankfurter, writing the concurring opinion, indicated that the act had no application in diversity cases, but expressed "no opinion on the constitutional question that would be presented were Congress to make the Arbitration Act applicable to such cases."[74]

The response of the lower federal courts to the Supreme Court's decision in *Bernhardt* has been anything but one of unanimous assent. Of the circuits that have interpreted the effect of the *Bernhardt* decision on the application of the Arbitration Act in diversity cases, only the First Circuit has apparently held that arbitration issues must be governed by state law.[75] Most circuits have continued to apply the act in diversity cases where the disputed contract has evidenced a transaction involving commerce, on the theory that as to these contracts, Congress intended to enact federal substantive law.[76] This

73. 350 U.S. 198 (1956).

74. *Id.* at 208.

75. Lummus Co. v. Commonwealth Oil Ref. Co., 280 F.2d 915 (1st Cir. 1960).

76. Metro Industrial Painting Co. v. Terminal Const. Co., 287 F.2d 382 (2d Cir. 1961); Robert Lawrence Co. v. Devonshire Fabrics Inc., 271 F.2d 402 (2d Cir. 1959); American Airlines Inc. v. Louisville & Jefferson County Air Bd., 269 F.2d 811 (6th Cir. 1959). See also Note, *Scope of the United States Arbitration Act in Commercial Arbitration: Problems in Federalism*, 58 NW. U. L. REV. 468 (1963).

theory views the constitutional problems referred to in *Bernhardt* as arising only if the Arbitration Act is characterized as procedural, and distinguishes *Bernhardt* on its facts, since the contract in that case did not evidence a transaction involving commerce. Perhaps the primary factor influencing the court's position is that the exclusion of diversity cases from the act's coverage significantly, if not almost totally, limits the effectuation of a policy which Congress intended to implement by the passage of the act.

B. *Problems Posed by Subsequent Developments*

By characterizing the Arbitration Act as federal substantive law, the lower federal courts have been able to avoid the *Bernhardt* limitation of the act's application. But significant problems of constitutionality, jurisdiction, and policy remain.

1. *Constitutional Problems.*—Granted that Congress has the power to regulate a transaction involving interstate commerce, to what extent can Congress constitutionally prescribe federal substantive law governing a state contract, merely because the contract involves commerce and contains an arbitration agreement? Does federal law govern the determination of which disputes are arbitrable under the particular arbitration clause? Does federal law also govern the validity and construction of other elements of the contract containing the arbitration agreement? These problems have been recognized by some courts, but no definitive solution has been forthcoming from the Supreme Court. The major issue considered by the lower federal courts has been whether federal law controls in the determination of these particular disputes that are arbitrable. Since *Bernhardt*, the First, Second, Third, Sixth and Ninth Circuits have considered the problem, with the majority of the cases arising in the Second Circuit.

The first case dealing with this question in the Second Circuit was *Robert Lawrence Co. v. Devonshire Fabrics Inc.*,[77] where the plaintiff brought suit in a diversity action seeking damages for fraudulent representation inducing it to enter into a contract to purchase a quantity of wool. The defendant, pursuant to section 3 of the Arbitration Act, moved for a stay pending arbitration under a clause in the contract. The court, treating the arbitration clause as a separable part of the contract, found that the illegality or alleged breach of the container contract did not nullify the agreement to arbitrate. The court held that federal law governed:

77. 271 F.2d 402 (2d Cir. 1959).

> questions of interpretation and construction as well as questions of validity, revocability and enforceability of arbitration agreements . . . since these two types of legal questions are inextricably intertwined.[78]

Applying federal law, the court found that the particular arbitration clause was broad enough to include the issue of fraud in the inducement and granted the stay under section 3.

Following *Lawrence,* the Second Circuit in *Metro Industrial Painting v. Terminal,*[79] a diversity case evidencing a transaction involving commerce, granted the specific enforcement of an agreement to arbitrate under section 4 of the act. Judge Lumbard, however, in his concurring opinion, expressed concern over the majority's failure to define precisely the scope of the application of federal law. The opinion indicated that a close constitutional question may arise as to whether Congress may regulate arbitration clauses in all contracts "affecting commerce" or between parties "engaged in commerce," as those phrases have been interpreted in other federal statutes. Lumbard, agreeing with the majority that the Arbitration Act should not be read so broadly, desired that the standard for determining whether a contract was governed by federal law should be sufficiently definite to permit parties to contemplate the application of federal law at the time of contracting.

Since the decision in *Metro,* the Second Circuit has been confronted with few diversity cases involving a contract evidencing commerce and containing an arbitration clause. In one the issue was whether the arbitration clause was separable from the container contract, thus authorizing arbitration of a dispute concerning alleged fraud in the inducement.[80] The issue was resolved by use of federal law without reference to constitutional problems.[81]

Two Third Circuit decisions since *Bernhardt* recognize the application of the Arbitration Act in diversity cases involving contracts

78. *Id.* at 409.

79. 287 F.2d 382 (2d Cir. 1961).

80. In El Hoss Eng'r & Transp. Co. v. American Independent Oil Co., 289 F.2d 346 (2d Cir. 1961), the contract containing the arbitration clause also incorporated a clause conditioning the seller's acceptance upon the bidders, providing guarantees covering purchase price, performance bonds and insurance protection. The court of appeals denied arbitration since the arbitration clause could not be separated from the main contract. The main contract did not provide for arbitration of disputes concerning performance until the threshold acts upon which acceptance was conditioned had been performed. The court distinguished *Lawrence* (which had held the arbitration clause to be separable) on the basis that, under the circumstances in that case, the parties had agreed to arbitrate the issue of fraud in the inducement.

81. See also World Brilliance Corp. v. Bethleham Steel Co., 342 F.2d 362 (2d Cir. 1965); *In re* Kinoshita & Co., 287 F.2d 951 (2d Cir. 1961) (issue of separability determined according to federal law).

evidencing commerce, but are of little help in defining the constitutional scope of the application of the act.[82]

The First Circuit apparently felt it was confronted with the problem of the scope of the act in *Lummus Co. v. Commonwealth Oil Refining Co.*[83] The plaintiff brought a diversity suit in the federal district court of Puerto Rico alleging that it had been fraudulently induced into a contract with the defendant, and sought to rescind the contract and to enjoin the defendant's action in a New York federal court to compel arbitration pursuant to a clause in the contract. Whether arbitration could be compelled depended upon the scope of the arbitration clause and whether it was separable from the container contract. Although both the arbitration law of New York and Puerto Rico, and the federal act provided for specific enforcement of agreements to arbitrate, the court's problem was to determine which law should be applied in determining the separability issue, which was the question that would ultimately govern the granting or denial of specific enforcement. The court indicated that the federal rule of separability, as laid down in *Lawrence*, was the better view, but felt constitutionally bound by *Bernhardt* to resolve the issue in accordance with state law. The court held New York law applicable since New York was the situs of both the execution and the intended performance of the contract, and thus was the jurisdiction with the most substantial contacts with the transaction. Under New York law the arbitration clause was not separable, but the court further found that since the plaintiff had failed to place the making of the contract in issue, it could not, under New York law, stay arbitration merely by pleading fraud in the inducement. Consequently, arbitration was compelled. This decision immediately raises the question whether the court's reasoning would have been the same had not both New York and Puerto Rican law provided for specific enforcement of agreements to arbitrate. Since the court essentially treated the case as involving a conflicts question, had New York and Puerto Rican law not provided for specific enforcement, it may well have found that the federal policy favoring arbitration was sufficiently strong to justify adoption of the Second Circuit's reasoning in *Lawrence*.

In *Ross v. Twentieth Century Fox Film Corp.*,[84] decided shortly

82. Monte v. Southern Delaware County Authority, 321 F.2d 870 (3d Cir. 1963) (holding that federal law controls interpretation of the arbitration agreement but that state law will be used since the contract specifically so directed); Kirschner v. West Co., 185 F. Supp. 317 (E.D. Pa. 1960), *aff'd*, 300 F.2d 133 (3d Cir. 1962) (holding that the Arbitration Act applied to a diversity suit concerning a contract evideneing commerce). See also Kirschner v. West Co., 247 F. Supp. 550 (E.D. Pa. 1965), *aff'd*, 353 F.2d 537 (3d Cir. 1965) (confirming award made under arbitration agreement).

83. *Supra* note 75.

84. 236 F.2d 632 (9th Cir. 1956).

after *Bernhardt,* the Ninth Circuit found section 3 of the Arbitration Act applicable in a diversity suit which involved a contract evidencing commerce. The court stated, however, that the questions of whether the contract presented an enforceable agreement to arbitrate, and so, what disputes were referable to arbitration, were governed by California law. The court held that the federal act should have no more than the procedural effect of staying suit.

In *American Airlines Inc. v. Louisville & Jefferson County Air Bd.,*[85] decided in 1959, the Sixth Circuit found that the act applied as a matter of federal substantive law, but in effect, refused to apply the separability theory to justify use of federal law in determining questions of interpretation, construction and validity, as well as revocability and enforceability. The court held that section 4 of the act did no more than make arbitration agreements irrevocable where they had previously been revocable. Furthermore, before the provisions of the act applied, both the container contracts and the arbitration clause must be valid and enforceable in accordance with standard contract principles of both state and federal law.

On the whole, the cases dealing with the constitutional scope of the Arbitration Act in diversity suits can perhaps be said to do so only in an off-hand manner. Save for the reservation of Judge Lumbard in *Metro,* which at best merely alludes to a possible constitutional issue, the Second Circuit apparently sees no constitutional restraint against the application of federal law. The First Circuit in *Lummus* merely cites *Bernhardt* as requiring use of state law, without discussion of the constitutional question. Both the Sixth and the Ninth Circuits strictly limit the application of federal law, but do so without reference to a constitutional necessity for the limitation.

It appears for the most part that the courts do not feel that the constitution offers a formidable restriction on the application of substantive federal arbitration law to contracts evidencing commerce.

2. *Jurisdictional Problems.*—Does the Arbitration Act, if it is federal substantive law, confer a basis for independent federal question jurisdiction in a federal court when an arbitration agreement is contained in a contract evidencing a transaction involving commerce? Are the state courts obligated to apply the act when confronted with such a case?

There is considerable authority that the act does not furnish a basis for federal question jurisdiction.[86] The cases have so held con-

85. *Supra* note 76.

86. See, *e.g.,* Robert Lawrence Co. v. Devonshire Fabrics Inc., *supra* note 76. See also Note, *supra* note 76.

sistently, on the basis of the language of the act. The stay provision of section 3 is available as a defense motion only in suits already "proceeding . . . in any of the courts of the United States."[87] Section 4 provides for specific enforcement of an arbitration agreement upon petition to "any court of the United States which, save for such agreement, would have jurisdiction under the judicial code, at law, in equity, or in admiralty of the subject matter of the suit arising out of the controversy between the parties."[88] Furthermore, in *Moore v. Chesapeake & Ohio Ry.*,[89] the Supreme Court held that it was indeed possible for a federal statute to create substantive rights without affording a separate basis for jurisdiction. Thus, so far as available authority indicates, the answer to this first question is settled in the affirmative.

There is little authority either way on the proposition that the state courts are obligated to apply the Arbitration Act to a contract evidencing commerce. Judge Medina, in *Lawrence*, appears to have presumed that federal law was applicable in such cases in state court.[90] There is, however, no legislative history bearing on the question. As pointed out by one commentator, application of the act in state courts would avoid the problem of forum shopping. Perhaps the best solution would be to allow the states to apply their own remedies, as long as they did not defeat the substantive rights created under section 2 of the act. This solution, however, seems to beg the question; namely, what is the scope of these substantive rights. Absent a precise determination of this scope, a considerable difference of opinion appears possible in the federal and state courts.

3. *Policy Considerations.*—To what extent do the answers to the foregoing questions depend on the policy that parties entering into a contract be able to define their respective rights and obligations at the time of contracting? Should the fact that it is often impossible to determine whether a contemplated contract will evidence a transaction involving commerce and will thus be governed by federal law, preclude application of federal law to arbitration agreements contained in contracts created under state law? To what extent should the choice of law governing a contract be decided by determining which jurisdiction has the most significant contacts with the transaction.

Implicit in the Supreme Court's holding in *Erie* was the policy of prevention of forum shopping, a practice which had plagued *Swift*

87. 9 U.S.C. § 3 (1947).
88. 9 U.S.C. § 4 (1947).
89. 291 U.S. 205 (1934).
90. 271 F.2d at 407.

v. Tyson's futile attempt to create uniformity of the law in state and federal courts. Criticism of the Court's grounding the decision in *Erie* on the Constitution was immediately forthcoming. As summarized by one author, many felt that:

> irrespective of the scope of the federal judicial power, Congress could constitutionally prescribe substantive law that shall be applied by federal courts, and that it would have been preferable to couch the *Erie* decision in terms of policy rather than in terms of the demands of the Constitution, since the basic issue was one of policy anyway, determinable without reference to the Constitution.[91]

An attitude such as this could well persuade the courts to de-emphasize the constitutional issues and place primary importance on policy considerations in determining the scope of the Arbitration Act.

The circuit court diversity cases since *Bernhardt* have been concerned with three policy considerations: (1) the policy behind the federal act to encourage arbitration of disputes in an effort to relieve pressure on crowded court dockets,[92] (2) the *Erie* policy of insuring like results in both federal and state courts,[93] (3) the conflict of laws policy that a contract transaction should be governed by the law of the jurisdiction having the most significant contacts with the transaction.[94] To these three policy considerations, a fourth should be added, although it has not been considered extensively by the courts. This is the conflict of laws policy of allowing the parties to a contract to choose the law applicable to their contemplated contract, so long as the law chosen has a reasonable relationship to the transaction.[95]

In some situations there will be no conflict between these policies and the court will have no difficulty choosing the applicable law and incidental to this, determining the scope of the act. Such was the case in *Lummus*, where the arbitration law of all the jurisdictions involved favored arbitration and the four policy considerations could be accommodated. The agreement to arbitrate was enforceable; the decision of the federal court did not differ from that which would have been rendered by a state court; and the law of the jurisdiction having the most significant contacts with the transaction as well as that chosen by the parties, was applied. However, in other cases, like the *American Airlines* case, all of these policy considerations could not be accommodated, and a choice had to be made. There the court's

91. Hill, *The Erie Doctrine and the Constitution*, 53 Nw. U. L. Rev. 427, 439 (1958).
92. See Robert Lawrence Co. v. Devonshire Fabrics Inc., *supra* note 76.
93. See, *e.g.*, Lummus Co. v. Commonwealth Oil Ref. Co., *supra* note 75; Ross v. Twentieth Century Fox Film Corp., *supra* note 84.
94. *Ibid.*
95. See Judge Lumbard's concurring opinion in Metro Industrial Painting Co. v. Terminal, *supra* note 76, at 385.

decision ultimately favored the policy of applying the law of the place of the most significant contact with the transaction. The court also accommodated the *Erie* policy of uniformity, although obviously not following a policy favoring arbitration. In cases such as this, where the policies conflict, courts will obviously decide the case in such a manner as to encourage the policy which it feels to be most important in the particular situation.

V. CONCLUSION

From a chronological review of the history of the application of federal arbitration law in federal courts, it is apparent that the courts have long been plagued by the fine distinctions involved in characterizing arbitration as substantive or procedural for purposes of determining the scope of application of federal arbitration law. The Supreme Court decision in *Bernhardt* went a long way in preventing the use of the substantive-procedural characterization as a mere means of justifying application of federal law. It emphasized that the characterization of arbitration is merely an aid in the process of determining the situations to which federal law is properly applicable. Although the existence of constitutional issues under *Erie*, which were involved in the application of federal arbitration law to diversity cases, was alluded to in *Bernhardt*, the courts since *Bernhardt* have begun to look at the important policy considerations in determining the scope of application of federal arbitration law. The very nature of arbitration precludes a wholly substantive or wholly procedural label for *Erie* purposes.[96] The lower federal courts, in distinguishing *Bernhardt* and applying the Arbitration Act as federal substantive law, recognized that *Bernhardt's* characterization of arbitration as wholly substantive for *Erie* purposes was inadequate. On the other hand, the difficulty which federal courts have had in determining the scope of the Arbitration Act, once they have characterized it as substantive law, illustrates that Mr. Justice Frankfurter's preclusion of the act's application in diversity cases may not be completely erroneous. Ultimately, the problem of determining the scope of federal arbitration law in diversity cases should be decided in the particular case as a conflicts choice of law question. In each particular case the conflict-

96. Although arbitration is essentially procedural, under certain circumstances it could affect the outcome of a particular dispute, and to that extent it is substantive. It is the rule of law applied to a particular fact situation and directing a particular result which is snbstantive. It is the method of applying the rule of law which is procedural. The procedural rule should not itself direct the legal results which flow from a particular faet situation. Arbitration does not actually direct how a particular rule of law should be applied but rather is a procedure which directs that no rule of law sball be applied. To the degree that arbitration results in a different result in a particuar fact situation than that prescribed by the rule of law, it is substantivo.

ing policies, including the constitutional considerations, should be weighed.[97] The analysis of a case should proceed somewhat along these lines: First, the court would determine the policy of both the federal and state law of arbitration. If these policies do not conflict, there is little reason to apply federal law. But if they do conflict, the court must look to the interests of the state and federal jurisdictions in applying its particular policy. For example, if the contract is in the steel industry, there are obvious national interests which dictate the enforcement of the federal policy. But, if the contract primarily affects the state, even though it may involve commerce, the interest of the state in applying its policy may be paramount. Finally, the court would look to whether it is important for the parties to be able to choose the applicable law and whether or not they did so.

It is recognized that this solution would not be an easy one to administer, but it would at least be uniform in a general sense, and one which would contend with the important factors involved in the resolution of the problem. By resolving the question in the same manner as a conflicts choice of law problem, the task of the attorney attempting to define his client's legal position under a particular contract containing an arbitration clause would probably be somewhat easier. As the situation now stands, the attorney has very little in the way of rules to aid him in arriving at a decision. Under the recommended solution he would at least have a reasonable basis for predicting the law applicable to a particular transaction. Furthermore, although the recommended solution does not afford complete aid, the assistance it would provide is more than is available under the present law.

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97. In Byrd v. Blue Ridge Rural Elec. Co-op. Inc., 356 U.S. 525 (1958), the Supreme Court suggested that the choice of law determination in diversity cases should be made on the basis of policy considerations after weighing the countervailing considerations. This case seems an obvious encroachment on the apparent constitutional requirements of *Erie*.