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Larry J. Saylor

Supreme Court Limits Federal Court Jurisdiction Under the Federal Arbitration Act

By Larry J. Saylor

A federal court has ordered the parties to arbitrate their dispute. Can the parties go back to the same court to confirm, vacate or modify the arbitrator's award? The answer is—not necessarily.

In a little-noticed recent decision, a nearly-unanimous U.S. Supreme Court significantly narrowed the jurisdiction of the federal courts to confirm, vacate or modify arbitration awards under the Federal Arbitration Act (FAA), 9 USC 1 et seq. The decision, *Badgerow v. Walters*, ___ US ___, 142 SCt 1310 (2022) sets a jurisdictional trap for the unwary.

Some background: Section 2 of the FAA, enacted in 1922, requires enforcement of "a contract . . . involving [interstate] commerce" to settle controversies by arbitration. [1] Section 4 provides that a party "may petition any United States district court which, save for such agreement, would have jurisdiction under title 28" to compel arbitration. [2] Section 5 allows the same court to appoint an arbitrator if the parties fail to do so. [3] Sections 9, 10 and 11 allow a federal court "in and for the district within which such award was made" to confirm an arbitration award, or to vacate or modify an arbitration award on narrow grounds. [4] Under the Supremacy Clause of the Federal Constitution, the FAA "governs actions in both federal and state court. . . ." [5] Michigan has enacted the Unform Arbitration Act, which contains similar language requiring enforcement of agreements to arbitrate and empowering a court to compel arbitration, appoint an arbitrator, and confirm, vacate or modify an arbitration award. [6]

In *Hall Street Assoc. v. Mattel, Inc.*, 552 US 576, 581-82 (2008), the Supreme Court held that the FAA does not itself establish federal subject matter jurisdiction, but only venue. Thus, the petitioner must identify an "independent jurisdictional basis" for

the relief requested under the FAA. The next year, in *Vaden v. Discover Bank*, 556 US 49, 62 (2009), the Court held that federal jurisdiction over a motion to compel arbitration under Section 4 can be established by "looking through" the petition to determine whether the underlying arbitration involves diversity of citizenship or a federal question.

In *Badgerow v. Walters*, the Court held that "look-through" federal question jurisdiction is not available under Sections 9, 10 or 11 of the FAA. The petitioner in *Badgerow* argued that the arbitration award should be vacated under Section 10 because it was tainted by fraud, and respondent asked the court to confirm the award under Section 9. Although diversity was lacking, the district court held it had "look through" jurisdiction under *Vaden* because the underlying claim raised a federal question. The Fifth Circuit affirmed. Parsing the differences in language between the FAA sections, the Supreme Court reversed. Eight of the nine justices joined in the opinion. Only soon-to-be-retired Justice Breyer dissented.

Badgerow requires an action to confirm, vacate or modify an arbitration award to be filed in state court unless the petition shows that (1) there is complete diversity of citizenship between the parties and at least $75,000 in dispute; or (2) the action to confirm, vacate or modify the arbitration award itself raises a question of federal law. Neither the FAA nor the issues in the underlying arbitration will be sufficient to satisfy (2). 142 SCt at 1316. The *Badgerow* Court does not identify any federal claims that would satisfy (2). Instead, the Court explains—counter-intuitively—that a challenge to the arbitrator's application of federal law generally states a claim only under state contract law. This is so, reasons the Court, because arbitration is a creature of contract: "[C]laims between non-diverse parties . . . may have originated in the arbitration of a federal-law dispute. But the underlying dispute is not now at issue" in a petition to confirm, vacate or modify the award. "Rather, the application concerns the contractual rights provided in the arbitration agreement, generally governed by state law. And adjudication of such state-law contractual rights—as this Court has held in addressing non-arbitration settlement of such state-law contractual rights—typically belongs in state courts." 142 SCt at 1321-22.

In his dissent, Justice Breyer denies the result is mandated by the statutory language, and questions the practicality of the line the majority draws: "Where the parties' underlying dispute involves a federal question (but the parties are not diverse), the majority holds that a party can ask a federal court to order arbitration under Section 4, but it cannot ask that same court to confirm, vacate or modify the order resulting under that arbitration under Section 9, 10 or 11. But why prohibit a federal court from considering the results of the very arbitration it has ordered and likely familiar with. Why force the parties to obtain relief—concerning arbitration of an underlying federal-question dispute—from a state court unfamiliar with the matter?" 142 SCt at 1325 (Breyer, J, dissenting).

After the majority opinion in *Badgerow*, only an amendment to the FAA would bring about the result Justice Breyer advocates. Given the winds currently blowing in Washington, DC against "forced" arbitration, such an amendment is not likely.

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[1] 9 USC 2.

[2] 9 USC 4.

[3] 9 USC 5.

[4] 9 USC 10, 11, 12.

[5] Burns v. Olde Discount Corp, 212 Mich. App. 576, 580 (1995).

[6] See MCL 691.1685 to 691.1687, 691.1691, and 691.1702 to 691.1704. A discussion of the standards for review of arbitration awards under the FAA and MUAA is beyond the scope of this article.

[7] See Ending Forced Arbitration of Sexual Assault and Sexual Harassment Act of 2021, Pub L No 117-90, 136 Stat 26; signed into law March 3, 2022, adding 9 USC 401 and 402, and amending several other sections of the FAA. Also see HR 963, Forced Arbitration Injustice Repeal Act of 2022, which if enacted would prohibit enforcement of pre-dispute agreements to arbitrate employment, consumer, antitrust, or civil rights disputes.

About the Author

Sheldon J. Stark *offers mediation, arbitration case evaluation and neutral third party investigative services. He is a Distinguished Fellow of the National Academy of Distinguished Neutrals, a Distinguished Fellow with the International Academy of Mediators and an Employment Law Panelist for the American Arbitration Association. He is also a member of the Professional Resolution Experts of Michigan (PREMi). He is past Chair of the council of the Alternative Dispute Resolution Section of the State Bar and formerly chaired the Skills Action Team. Mr. Stark was a distinguished visiting professor at the University of Detroit Mercy School of Law from August 2010 through May 2012, when he stepped down to focus on his ADR practice. Previously, he was employed by ICLE. During that time, the courses department earned six of the Association for Continuing Legal Education's Best Awards for Programs. He remains one of three trainers in ICLE's award-winning 40-hour, hands-on civil mediation training. Before joining ICLE, Mr. Stark was a partner in the law firm of Stark and Gordon from 1977 to 1999, specializing in employment discrimination, wrongful discharge, civil rights, business litigation, and personal injury work. He is a former chairperson of numerous organizations, including the Labor and Employment Law Section of the State Bar of Michigan, the Employment Law and Intentional Tort Subcommittee of the Michigan Supreme Court Model Civil Jury Instruction Committee, the Fund for Equal Justice, and the Employment Law Section of the Association of Trial Lawyers of America, now the American Association for Justice. He is also a former co-chairperson of the Lawyers Committee of the American Civil Liberties Union of Michigan. In addition, Mr. Stark is chairperson of Attorney Discipline Panel #1 in Livingston County and a former hearing referee with the Michigan Department of Civil Rights. He was a faculty member of the Trial Advocacy Skills Workshop at Harvard Law School from 1988 to 2010 and was listed in "*The Best Lawyers in America*" from 1987 until he left the practice of law in 2000. Mr. Stark received the ACLU's Bernard Gottfried Bill of Rights Day Award in 1999, the Distinguished Service Award from the Labor and Employment Law Section of the State Bar of Michigan in 2009, and the Michael Franck Award from the Representative Assembly of the State Bar of Michigan in 2010. In 2015, he received the George Bashara, Jr. Award for Exemplary Service from the ADR Section of the State Bar. He has been listed in "*dbusiness Magazine*" as a Top Lawyer in ADR for 2012, 2013, 2015, 2016, 2017, 2018, 2019 and 2020.*

Larry J. Saylor

Supreme Court Rejects Prejudice Requirement for Waiver of Arbitration Agreement

By Larry J. Saylor

In *Morgan v. Sundance, Inc.*[1], decided May 23, 2022, a unanimous Supreme Court clarified the standard for determining whether a party has waived its right to arbitrate a controversy by first engaging in litigation. Overruling decisions in nine circuits, the Court held that waiver could occur whether or not the adverse party has suffered prejudice. The Court explained, but left standing, its previous opinions holding the Federal Arbitration Act (FAA) adopts a "policy favoring arbitration". The Court's analysis presages issues for future litigation under the FAA.

The facts in *Morgan* were egregious. Morgan, an hourly employee of Sundance, a Taco Bell franchisee, filed a nationwide collective action alleging that Sundance violated federal law requiring overtime payment. Although Morgan's employment agreement contained an arbitration clause, Sundance litigated the case for more than seven months. Morgan filed an answer and affirmative defenses that failed to mention arbitration. After Morgan's motion to dismiss was denied and mediation was unsuccessful, Sundance reversed course and filed a motion asking the court to stay the case and compel arbitration under the FAA. Morgan opposed the motion, arguing that Sundance had waived its right to arbitrate by engaging in litigation for so long. The district court agreed with Morgan, but the Eighth Circuit reversed, holding Sundance's tardiness had not caused Morgan prejudice because discovery had not begun.

The Supreme Court reversed, noting that there is no similar prejudice requirement for waiver of other contractual rights. The Court recognized that its previous opinions have repeatedly held the FAA adopts a federal "policy favoring arbitration." It explained, however, that policy "is merely an acknowledgement of the FAA's commitment to overrule the judiciary's longstanding

refusal to enforce agreements to arbitrate and place such agreements on the same footing as other contracts. . . . Accordingly, a court must hold a party to its arbitration contract just as the court would any other kind. But a court may not devise novel rules to favor arbitration over litigation." [2] The Court resolved a split among the circuits, observing that nine circuits, including the Sixth Circuit, had required prejudice for waiver of an agreement to arbitrate, while two had rejected the requirement. [3]

The immediate takeaway from *Morgan v. Sundance* is unsurprising: To avoid waiver, an agreement to arbitrate should be enforced without delay. The eventual impact of the case, however, may be broader. The *Morgan* Court does not identify any other "novel rules . . . favor[ing] arbitration" that are in jeopardy. But the Court itself has said that in construing an agreement to arbitrate, "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." [4] Does *Morgan* signal that in the future, the Court will construe agreements to arbitrate by applying normal state-law rules of contractual interpretation, without a thumb on the scale from the FAA? Perhaps, as the Court stated: "The federal policy is about treating arbitration contracts like all others, not about fostering arbitration." [5]

This issue will no doubt continue to percolate in the courts.

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[1] ____ US ___, 142 SCt 1708 (2022).

[2] 142 SCt at 1713 (internal quotation marks omitted), quoting *Granite Rock Co. v. Teamsters*, 561 U.S. 287, 302 (2010).

[3] See 142 SCt at 1712 & nn. 1, 2, collecting cases. In *O.J. Distributing, Inc. v. Hornell Brewing, Inc.*, 340 F.3d 345, 355-56 (6th Cir. 2003), the Sixth Circuit held that prejudice was required, but readily found prejudice on facts analogous to those in *Morgan v. Sundance*.

[4] Volt Info. Sciences, Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468, 475–76 (1989) (citing Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25 (1983)).

[5] 142 SCt at 1709.

About the Author

Larry J. Saylor, senior counsel in Miller Canfield's Detroit office, is a neutral on the American Arbitration Association's commercial, large complex case and appellate panels, and a Fellow of the Chartered Institute of Arbitrators. He has more than 40 years' experience litigating complex business disputes in state and federal courts throughout the country, and in domestic and international arbitration. Larry currently serves on the Council of the ADR Section of the State Bar of Michigan, and formerly served as an adjunct professor at University of Detroit Mercy School of Law, as Chair of the Antitrust, Franchising and Trade Regulation Section of the State Bar, and on the Council of the Appellate Practice Section. He received his JD, magna cum laude, from the University of Michigan Law School, and clerked for Hon. George E. MacKinnon on the U.S. Court of Appeals for the D.C. Circuit.