Arbitration analysis: The Federal Arbitration Act (FAA) provides the legislative framework for the enforcement of arbitration agreements and arbitral awards in the United States. Supreme Court decisions over the last several decades ensure that the FAA’s 'pro-arbitration mandate' must be broadly interpreted and universally applied by both state and federal courts. Parties seeking to enforce an arbitration agreement or arbitral award in the United States need not be concerned that 'the old [judicial] hostility toward arbitration' or 'the failure of state arbitration statutes to mandate enforcement of arbitration agreements' will thwart their ability to do so. Parties involved in arbitration subject to the New York or Panama Convention should also consider the potential advantages these Conventions provide. Claudia T. Salomon and Samuel B.C. de Villiers of Latham & Watkins' New York Office discuss the history, development and shortcomings of the FAA.

While arbitration provides parties with an efficient alternative to the courts when disputes arise, such an alternative is only useful to the extent it can be effectively enforced. From its origin in 1925 and through significantly evolving case law, the United States Federal Arbitration Act (FAA) has become a powerful tool for parties seeking to enforce both agreements to arbitrate and the arbitral awards issued by arbitrations in the US. When drafting and entering into arbitration agreements in commercial contracts with US-based parties or where assets are likely to be based in the US, parties should understand why and how the FAA works, how the Supreme Court has interpreted the FAA's scope, and how to leverage the New York and Panama Conventions to compensate for the FAA's limitations.

Scope of the Federal Arbitration Act

The FAA sets out the legislative framework for the enforcement of arbitration agreements and arbitral awards in the United States. Passed in 1925, the FAA was intended to ensure agreements to arbitrate in maritime transactions and commerce were 'valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract' (9 U.S.C.S. § 2).

The FAA's implementing provisions provide that if a party to a contract containing an arbitration clause initiates contract-related litigation, either of the parties may ask the court to stay the litigation (9 U.S.C.S. § 3) and compel the other party to resolve the dispute through arbitration (9 U.S.C.S. § 4). The FAA provides that the court should determine if the dispute is 'referable to arbitration' before staying litigation or compelling arbitration:

- a court should only stay judicial proceedings 'upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement' (9 U.S.C.S. § 3)
- 'The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement... If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof' (9 U.S.C.S. § 4)

However, the Supreme Court has clarified that many questions as to the validity and scope of an arbitration agreement should be decided by the arbitrators, rather than the court.

The FAA also empowers arbitrators to call third-party witnesses, compel them to appear (and provide any documents they have that are material to the case), and hold such witnesses in contempt if they fail to comply (9 U.S.C.S. § 7). However, because arbitrators do not possess the authority to enforce compliance with their orders, parties must apply to the federal court where the arbitration is seated to obtain any necessary enforcement measures.

The FAA provides the procedures by which the prevailing party may seek to enforce an arbitral award (9 U.S.C.S. § 9) and the procedures by which the non-prevailing party may seek to vacate the award (9 U.S.C.S. § 10(a)(1)-(4)). In addition, the FAA prescribes limited grounds under which a court may modify an arbitral award (9 U.S.C.S. § 11(a)-(c)). Importantly, the FAA also makes international arbitral awards arising from arbitral proceedings in other countries enforceable in United States courts (9 U.S.C.S. § 15).
The Supreme Court evolves from arbitration skeptic to supporter

The Supreme Court has not always embraced arbitration, and early Supreme Court decisions were highly skeptical that arbitration proceedings could adequately enforce a party's legal rights. (See, eg, Bernhardt v Polygraphic Co. of Am., 350 U.S. 198, 203 (1956) ("Arbitration carries no right to trial by jury... [a]rbitrators do not have the benefit of judicial instruction on the law [and] need not give their reasons for their results; the record of their proceedings is not as complete as it is in a court trial; and judicial review of an award is more limited than judicial review of a trial"); see also Wilko v Swan, 346 U.S. 427, 435-36 (1953).)

However, the Supreme Court began to reconsider the value of arbitration as an efficient alternative to litigation, and in 1976 Chief Justice Warren Burger called for ‘a reappraisal of the values of the arbitration process.' (Warren E. Burger, Keynote Address, Agenda for 2000 A.D.--A Need for Systematic Anticipation, 70 F.R.D. 79, 94 (1976) (addressing the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice (The Pound Conference)).) Noting that '[t]here is nothing incompatible between efficiency and justice,' (Id. at 92) he recommended greater use of ‘the well-developed forms of arbitration' to settle disputes (Id. at 94). In 1984, the Supreme Court declared that Congress's essential purpose in enacting the FAA was to overcome the 'old [judicial] hostility toward arbitration.' (Southland Corp. v Keating, 465 U.S. 1, 14 (1984)). The Court has since issued multiple decisions implementing a broad 'national policy favoring arbitration' (Southland, 465 U.S. at 10) under the FAA that requires courts in the United States to strictly enforce agreements to arbitrate and arbitral awards, while limiting judicial interference with the arbitral process.

Supreme Court case law clarifies a national policy favouring arbitration under the FAA

The FAA is applicable to both state and federal courts

Before the 1980s there was some disagreement among the US courts as to whether the FAA applied to state courts. In the 1983 case Moses H. Cone Mem'l Hosp. v Mercury Constr. Corp., the Supreme Court summarily resolved this issue in favour of the FAA's broad-reaching power. The Court declared that the FAA is a 'congressional declaration of a liberal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary,' and that 'as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.' (Id. at 24-25 (emphasis added.).) The Court added (in dicta) that the FAA 'create[s] a body of federal substantive law of arbitrability' equally applicable in both state and federal courts (Moses H. Cone Mem'l Hosp. v Mercury Constr. Corp., 460 U.S. 1, 24-27 (1983)). A year later, in Southland Corp. v Keating, the Court converted this dicta into controlling law in a case reviewing the actions of a state court (Southland, 465 U.S. 1.). Again emphasising that the FAA represents a broad 'national policy favoring arbitration' (Id. at 10), the Court declared that the FAA must have been intended to control both state and federal courts, or the FAA would be inadequate to fulfill its two central purposes: overcoming 'the old [judicial] hostility toward arbitration' and addressing 'the failure of state arbitration statutes to mandate enforcement of arbitration agreements (Id. at 14). The Court therefore held that the FAA not only controls state courts, it also preempts state law that would bar the enforcement of an arbitration agreement:

- 'The Arbitration Act creates a body of federal substantive law... applicable in state and federal court' (Id. at 12) (internal quotation marks omitted)
- 'In enacting [the FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration' (Id. at 10)
- 'In holding that the Arbitration Act preempts a state law that withdraws the power to enforce arbitration agreements, we do not hold that [state courts are bound by the act’s procedural rules]’ (Id. at 16) (emphasis added)

State cannot pass laws inconsistent with the FAA mandate to broadly enforce agreements to arbitrate

The fact that an arbitration agreement survives a challenge to the formation of the agreement itself is well established in the United States. In the years since Southland, the Supreme Court has reviewed an unusually large number of cases involving general contract challenges to the enforcement of arbitration agreements and, as reflected in the cases that follow, has consistently limited the application of these challenges under the FAA.

As early as the 1967 case Prima Paint, the Supreme Court held that courts may only consider a party's specific
challenge that the agreement to arbitrate was procured by fraud; a general challenge that the entire contract was procured by fraud must be decided by the arbitral tribunal (Prima Paint Corp. v Flood & Conklin Mfg. Co., 388 U.S. 395 (1967)). Because a party is far less likely to have been wrongfully induced into agreeing to arbitrate disputes arising out of a contract, as compared to entering into the contract, this ‘severability’ doctrine, severing the analysis of an individual arbitration clause from the analysis of the rest of the contract, greatly curtails a court’s involvement in deciding contract challenges such as fraud and duress where a contract contains an agreement to arbitrate (Id. at 402-03). The concept of ‘severability’ is sometimes also referred to as ‘separability’. See, eg, id. at 421 (Black, J, dissenting).

In Buckeye Check Cashing v Cardegna, in 2006, the Supreme Court furthered this line of reasoning. The Court considered whether the severability doctrine adopted in Prima Paint regarding a contract that might not be binding on the parties (due to fraud in the inducement) should also apply to a contract that might be intrinsically invalid (due to illegality) (Buckeye Check Cashing, Inc. v Cardegna, 546 U.S. 440, 442 (2006)). Examples of illegal contracts would include a contract to commit murder or rob a bank; in the case of Buckeye Checking, the challenged loan contract was alleged to be illegal from the outset because it provided for ‘usurious interest rates’ that rendered it ‘criminal on its face’ under Florida lending and consumer-protection laws. The Court held that the ‘distinction between void and voidable contracts’ was ‘irrelevant’ (Id. at 446). If two parties agree in writing to the arbitration of contract-related disputes, that agreement is always severable from the rest of the contract, and is the only part of the agreement that a court may consider (Id.). An agreement to arbitrate disputes is not itself illegal, and if that agreement, considered alone, was fairly entered into, then any challenge to the underlying contract must be sent to the arbitrator to decide (Id. at 448-49). The court explained:

'[i]t is true, as respondents assert, that the Prima Paint rule permits a court to enforce an arbitration agreement in a contract that the arbitrator later finds to be void. But it is equally true that respondents’ approach permits a court to deny effect to an arbitration provision in a contract that the court later finds to be perfectly enforceable. Prima Paint resolved this conundrum - and resolved it in favor of the separate enforceability of arbitration provisions. We reaffirm today that, regardless of whether the challenge is brought in federal or state court, a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator.’

In Rent-A-Center, West v Jackson, in 2010, the Supreme Court continued to uphold an arbitrator’s power to resolve contract challenges raised by parties seeking judicial review of such challenges. The Court used the severability doctrine to enforce a sub-clause of a challenged arbitration agreement stating that the arbitrator, rather than the courts, would decide all questions of arbitrability, including any gateway challenge to the validity of the arbitration agreement itself (Rent-A-Center, West v Jackson, 130 S. Ct. 2772, 2779 (2010)).

While Prima Paint and Buckeye had held an ‘agreement to arbitrate’ to be severable from a global challenge to the validity of a contract that set forth other substantive contractual obligations between the parties, the contract in Rent-A-Center consisted only of the agreement to arbitrate itself (Id.). In Rent-A-Center, the Court further underlined the breadth of the severability doctrine by holding that the arbitration agreement’s sub-clause to ‘arbitrate arbitrability’ was severable from the greater ‘agreement to arbitrate’, and since Jackson’s challenges were not specifically directed at this sub-clause, the threshold issue of arbitrability must be decided by an arbitrator (Id.).

State laws inconsistent with the FAA

In AT&T Mobility LLC v Concepcion, in 2012, the Supreme Court underlined the supremacy of the FAA in rejecting an unconscionability challenge from a state court. The Court considered whether a clause in a form arbitration agreement waiving a customer’s right to bring a class action rendered the arbitration agreement invalid under California case law making such class action waivers unconscionable in certain consumer contracts (AT&T Mobility LLC v Concepcion, 131 S. Ct. 1740 (2011)). Holding that individualised proceedings are an inherent and necessary element of arbitration that do not permit blanket rules banning class action waivers (Id. at 1750-52), the Supreme Court held the California unconscionability law invalid, despite the fact that unconscionability is a ground that ‘exist[s] at law or in equity for the revocation of any contract’ (Id. at 1746 (internal quotation marks omitted)). The Court further held that states cannot pass laws inconsistent with the FAA mandate to broadly enforce agreements to arbitrate, even if such laws are ‘desirable for unrelated reasons’ (Id. at 1753). The California courts that developed the unconscionability rule at issue in Concepcion, for example, believed such a rule was necessary to prevent corporations from forcing their customers into contracts of adhesion. This clarification underlined the Court’s previous holding that ‘public policy’ exceptions to the FAA’s pro-arbitration mandate are similarly impermissible (see Mitsubishi Motors Corp. v Soler Chrysler-Plymouth, 473 U.S. 614, 626-27 (1985) (reversing a First Circuit holding that some public policy issues are so critical that they must be left in the hands of the courts; ordering that the dispute under review be sent to arbitration; and noting that ‘we are well past the time when judicial suspicion of the desira-
bility of arbitration and of the competence of arbitral tribunals inhibited the development of arbitration as an al-
ternative means of dispute resolution’)).

Courts have limited grounds to vacate or modify arbitration awards

The Supreme Court has reinforced the FAA’s ‘liberal policy favoring arbitration’ when considering a court’s power
to vacate an arbitral award (Hall St. Assocs., LLC v. Mattei, 552 U.S. 576, 588 (2008) (noting that the ‘national policy
favoring arbitration’ requires ‘just the limited review needed to maintain arbitration’s essential virtue of resolving
disputes straightaway’). Because an arbitration party seeking to have an arbitral award vacated must apply to the
courts of the country where the award was issued to seek such vacatur, courts in the United States may only vacate
arbitral awards issued in the United States in most circumstances (see, eg, Karaha Bodas v Perusahaan Pertam-bangan
Minyak Dan Gas Bumi Negara, 500 F.3d 111, 115 n.1 (2d Cir. 2007)). In 2008, the Supreme Court con-
fi.rmed that the four very limited grounds listed in the FAA for vacating an arbitral award are the exclusive grounds
for overturning an award issued from an arbitration seated in the United States and therefore subject to vacatur
under the FAA (Id. at 578).

In summary, the non-prevailing party may move the appropriate court to vacate an arbitral award based on:

- fraud by the opposing party in securing the award (9 U.S.C.S. § 10(a)(1));
- the tribunal’s corruption or evident partiality to one of the parties (9 U.S.C.S. § 10(a)(2));
- other misconduct by the tribunal in granting the award (9 U.S.C.S. § 10(a)(3)); or
- the tribunal grossly ‘exceed[ing] its powers’ in issuing the award (9 U.S.C.S. § 10(a)(4)). (For example,
a tribunal might exceed its powers if it addresses an issue that was not within the scope of the
agreement to arbitrate (see, eg, Westerbeke v Daihatsu Motor, 304 F.3d 200, 220 (2d Cir. 2002))
(providing an analysis of whether an arbitral tribunal exceeded its powers turns on ‘whether the arb-
itrators had the power based on the parties’ submissions or the arbitration agreement, to reach a
certain issue’.).

There is dispute among the Circuits over whether courts may employ a fifth ground for vacatur (the arbitrators’
‘manifest disregard for the law’) despite the Supreme Court’s holding that the four grounds for vacatur enumerated
by the FAA are ‘exclusive’. Some Circuit courts have held that the ‘manifest disregard’ standard is merely ‘a judicial
gloss on the specific grounds for vacatur enumerated in section 10 of the FAA’ (see, eg, Stolt-Nielsen SA v Animal-
Feeds Int’l, 548 F.3d 85, 94 (2d Cir. 2008), reversed and remanded on other grounds by Stolt-Nielsen SA v Animal-
Feeds Int’l, 559 U.S. 662 (2010) (agreeing with the Seventh Circuit that an arbitral award may be vacated for mani-
fest disregard of the law where ‘the arbitrator knew of the relevant legal principle, appreciated that this principle
controlled the outcome of the disputed issue, and nonetheless willfully flouted the governing law by refusing to
apply it’ (Id. at 95) (internal brackets, quotation marks and citation omitted)).

Other Circuit courts have ruled that the Supreme Court’s ‘unequivocal holding that the statutory grounds listed in
section 10 are the exclusive means for vacatur’ means that ‘manifest disregard of the law is no longer an inde-
pendent ground for vacating arbitration awards under the FAA’ (Frazier v Citifinancial, LLC, 604 F.3d 1313, 1323 (11th
Cir. 2010), quoting Citigroup Global Mkts. v. Bacon, 562 F.3d 349, 350 (5th Cir. 2009) (brackets omitted)).

In practice, vacating an arbitral award on the ground that an arbitral tribunal exceeded its powers is very difficult.
For example, an analysis of whether a tribunal exceeded its powers does not turn on ‘whether the arbitrators cor-
rectly decided [a certain] issue’ (Stolt-Nielsen, 559 U.S. at 694 (emphasis added) (internal quotation marks and ci-
tation omitted)). Rather, in the context of exceeding an arbitrator’s powers, ‘[i]t is only when [an] arbitrator strays
from interpretation and application of the agreement and effectively dispense[s] his own brand of industrial justice
that his decision may be unenforceable’ (Id. at 671-72 (internal quotation marks and citation omitted)). The FAA
also prescribes the limited grounds under which a court asked to enforce or vacate an award may modify that arbi-
tral award (9 U.S.C.S. § 11(a)-(c) (permitting modification where ‘there was an evident material miscalculation of
figures or an evident material mistake in the description of any person, thing, or property referred to in the award,’
where ‘the arbitrators have awarded upon a matter not submitted to them, unless it is a matter not affecting the
merits of the decision upon the matter submitted,’ or where ‘the award is imperfect in matter of form not affecting
the merits of the controversy’)).
The New York and Panama Conventions

Two international conventions overlay the FAA, providing additional advantages to a party seeking to enforce an arbitration agreement or arbitral award in an action subject to one of the conventions. While the provisions of the FAA that do not conflict with the conventions remain applicable in such proceedings, some provisions that do not conform to the conventions provide benefits that are not available under the FAA alone.

The 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention) requires signatory states, including the United States, to recognize and enforce arbitration agreements entered into in fellow signatory states, and to recognize and enforce arbitral awards issued in such states. The New York Convention has been incorporated into Chapter 2 of the FAA, governing how US courts should enforce arbitration agreements or arbitral awards in disputes between a US citizen and a non-US citizen of another country signatory to the Convention (9 U.S.C.S. § 202). (Section 202 also makes the New York Convention applicable to arbitrations between two US citizens where the disputed contract ‘involves property located abroad, envisages performance or enforcement abroad, or has some other reasonable relation with one or more foreign states.’ Id. A corporation is deemed to be a US citizen ‘if it is incorporated or has its principal place of business in the United States.’ Id.)

The 1975 Inter-American Convention on International Commercial Arbitration (the Panama Convention) (Inter-American Convention on International Commercial Arbitration, 30 January 1975, 14 I.L.M. 336) was similarly incorporated into Chapter 3 of the FAA and governs how US courts (and other courts in the Americas) should enforce arbitration agreements or arbitral awards in disputes between a US citizen and a non-US citizen from one of the (exclusively) South, Central, and North America countries signatory to the Convention (9 U.S.C.S. § 302). If both the New York and Panama Conventions apply to an application for judicial assistance in enforcing an arbitration agreement or arbitral award, the Panama Convention will govern if the majority of parties to the arbitration agreement are citizens of Panama Convention signatories. (9 U.S.C.S. § 305).

Notably, the New York and Panama Conventions only address the enforcement of arbitration agreements and arbitral awards, and neither Convention contains rules for vacating an award. The Conventions are silent on vacating awards because only the courts of the country where an arbitration is seated have the power to vacate the resulting arbitral award, and that country’s law will govern a motion to vacate the award. (See, eg, Karaha Bodas, 500 F.3d at 115 n.1). Thus, a US court can only vacate an arbitral award if it was rendered in the United States. Because any US enforcement of an award rendered in the New York Conventions will not be subject to either the New York or Panama Conventions, which only apply to the enforcement of foreign awards, such an award may only be vacated on one of the four limited grounds for vacatur provided by Chapter 1 of the FAA. Chapters 2 and 3 of the FAA provide that the rules set out in Chapter 1 also apply to actions and proceedings brought under the New York and Panama Conventions, to the extent that Chapter 1 is not in conflict with any provision of the relevant Convention (9 U.S.C.S. §§ 208, 307). Thus, Chapter 1 of the FAA remains important when considering any action where one of the Conventions would apply. For example, if an action is subject to the New York Convention based on the parties’ respective nationalities, and one party requires the aid of a US court to compel arbitration in another country, that party will bring an action pursuant to both Chapter 1 (guiding a court’s actions in compelling an arbitration proceeding) and Chapter 2 (reinforcing the necessity that the court compel the arbitration proceeding in accord with the New York Convention). (See, eg, Mitsubishi, 473 U.S. at 618 (‘Mitsubishi brought an action against Soler in [] United States District Court... under the Federal Arbitration Act and the [New York] Convention. Mitsubishi sought an order, pursuant to 9 U. S. C. §§ 4 and 201, to compel arbitration in accord with [the parties’ contractual agreement to arbitrate disputes]’ (emphases added))).

Navigating the intersections of the FAA and the Conventions

A party seeking to enforce an arbitration agreement in an action subject to one of the Conventions enjoys some advantages compared to a party enforcing an arbitration agreement under Chapter 1 of the FAA alone. For example, under Chapter 1 of the FAA, a US district court only has the power to compel arbitration in its own district (9 U.S.C.S. § 4). In contrast, under the New York and Panama Conventions, a court is empowered to ‘direct that arbitration be held in accordance with the agreement at any place therein provided for, whether that place is within or without the United States’ (9 U.S.C.S. §§ 206, 303. Notably, if an arbitration agreement subject to one or both of the conventions does not specify a seat, the court’s authority to direct the seat of the arbitration will be derived from Chapter 1 of the FAA, limiting the court’s power to compel arbitration to its own district. 9 U.S.C.S. § 4). Similarly, a party seeking to confirm a Convention award has more time to seek such confirmation from the courts compared to a party seeking to confirm an arbitral award under Chapter 1 of the FAA alone. While Chapter 1 of the FAA provides that such confirmation must be sought within one year of the issuance of the award (9 U.S.C.S. § 9), the Con-
ventions allow for confirmation within three years (See 9 U.S.C.S. §§ 207, 302).

Further, to seek the enforcement of an arbitration agreement or arbitral award in a federal district court, the court must have jurisdiction over the 'subject matter' of the case. Because federal courts generally have jurisdiction to address any matter related to the 'subject' of federal law, they usually have subject matter jurisdiction over cases involving substantive federal statutes such as the FAA (see, eg, Moses H. Cone Mem'l Hosp., 460 U.S. at 26 n.32 (observing that 'a body of federal substantive law' would usually create 'independent federal-question jurisdiction under 28 U. S. C. § 1331')). However, in 1983, when the Supreme Court declared that the FAA is indeed a body of substantive federal law, the Court took the unusual step of excepting the statute from the general rule conferring subject matter jurisdiction. (Id. (Noting that because it does not create federal-question jurisdiction, the FAA is 'something of an anomaly in the field of federal-court jurisdiction').) Parties to an arbitration agreement subject to the New York or Panama Convention need not concern themselves with this anomaly, because subject matter jurisdiction is automatically conveyed on district courts under the Conventions (9 U.S.C.S. §§ 207, 302 (section 302 incorporates § 207 of the New York Convention into the Panama Convention)). Where neither Convention applies, however, a party seeking to enlist the assistance of a federal court in enforcing arbitration rights must assert an independent basis for the court's subject matter jurisdiction. (For example, federal law provides subject matter jurisdiction to district courts in any action between US citizens of different states or between a US citizen and a foreign citizen, provided that the damages alleged are over $75,000. See 28 USC § 1332. A district court would also acquire subject matter jurisdiction in an action implicating both Section 1 of the FAA and another federal law that does supply 'federal question' jurisdiction.)

Summary

The FAA provides the legislative framework for the enforcement of arbitration agreements and arbitral awards in the United States. Supreme Court decisions over the last several decades ensure that the FAA's 'pro-arbitration mandate' must be broadly interpreted and universally applied by both state and federal courts. Parties seeking to enforce an arbitration agreement or arbitral award in the United States need not be concerned that 'the old [judicial] hostility toward arbitration' or 'the failure of state arbitration statutes to mandate enforcement of arbitration agreements' will thwart their ability to do so. Parties involved in arbitration subject to the New York or Panama Convention should also consider the potential advantages these Conventions provide.

This article was originally published on Lexis®PSL Arbitration on 17/04/14.