Denver Law Review

Volume 76
Issue 3 *Tenth Circuit Surveys*

Article 2

January 1999

Arbitration

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INTRODUCTION

Enacted in 1925, the Federal Arbitration Act (FAA),[1] represents a congressional endorsement of arbitration and, effectively, a codification of freedom of contract. The Act allows parties to enter into, and to have enforced, arbitration agreements.[2] The FAA "does not affect any contract that has not the agreement in it to arbitrate, and only asks . . . the parties to come in, and carry through, in good faith, what they have agreed to do. It does nothing more than that."[3]

The United States Supreme Court has championed this Act of Congress with nearly constitutional regard.[4] The Court has made clear that the FAA's broad reach will be given great deference; judicial resistance to or undermining of arbitral resolution will not be sanctioned.[5] The exact extent of the deference to be granted, however, remains somewhat undefined. When the FAA will, or must, yield to another federal statute is an issue that has been debated since the Act's inception.[6]

The United States Court of Appeals for the Tenth Circuit addressed this issue twice during the survey period,[7] reaching different outcomes. In *McWilliams v. Logicon*,[8] the court found that the Americans with Disabilities Act (ADA)[9] does not preclude application of the FAA, but in fact encourages arbitration of disputes.[10] In *Davister Corp. v. United Republic Life Insurance Co.*,[11] the court held that the McCarran-Ferguson Act,[12] which grants power to the states to regulate the business of insurance, preempts the FAA. The Court determined that the public interest of protecting policyholders outweighed the freedom of contract principle embodied in the FAA.[13] The incongruent decisions in *McWilliams* and

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1. 9 U.S.C. §§ 1–14 (1994).
2. *See id.* at § 2.
3. THOMAS E. CARBONNEAU, ALTERNATIVE DISPUTE RESOLUTION: MELTING THE LANCES AND DISMOUNTING THE STEEDS 141 (1989) (citing 65 CONG. REC. 1931 (1924) (statement of Rep. Graham)).
4. *See id.* at 127.
5. *See id.*
6. *See* Michael A. Landrum & Dean A. Trongard, *Judicial Morphallaxis: Mandatory Arbitration and Statutory Rights*, 24 WM. MITCHELL L. REV. 345, 360–70 (1998) (outlining the development of the Supreme Court's interpretation and application of the FAA to agreements to arbitrate statutory-based claims).
7. The survey period addresses cases decided by the United States Court of Appeals for the Tenth Circuit between September 1, 1997, and August 31, 1998.
8. 143 F.3d 573 (10th Cir. 1998).
9. 42 U.S.C. §§ 12101–12213 (1994).
10. *See McWilliams*, 143 F.3d at 576.
11. 152 F.3d 1277 (10th Cir. 1998).
12. 15 U.S.C. §§ 1011–1015 (1994).
13. *See Davister*, 152 F.3d at 1282.

Davister illustrate the undefined supremacy of the FAA when it is implicated in a claim brought under another federal statute.

Conversely, it is relatively clear when courts will defer the FAA to state law principles. As a federal statute, the FAA preempts any inconsistent state law.[14] The FAA's applicability, however, is dependent on the existence of a valid agreement to arbitrate which, in turn, is dependent on state law principles regarding contract formation.[15] Thus, in state law actions, the courts' role is limited to the determination of whether a valid arbitration agreement exists and to the enforcement of rendered arbitration awards. The Tenth Circuit decided two cases during the survey period that are consistent with this principle of FAA supremacy in state law actions. In *Avedon Engineering, Inc. v. Seatex*,[16] the court limited its review to the arbitrability of the plaintiff's claim. In *Miera v. Dairyland Insurance Co.*,[17] the court limited its review to the enforcement of the rendered arbitration award. These two cases illustrate the recognized role of state law actions that implicate the FAA.

This survey examines the Tenth Circuit's decisions relating to the Federal Arbitration Act during the survey period. Part I provides a general background on the FAA, including the judicial deference traditionally granted to the Act. Part II discusses the Tenth Circuit's decisions relating to the FAA's supremacy over other federal statutes. Specifically, Part II considers the court's decisions involving situations when parties contractually agree to arbitrate their disputes, subsequently have a dispute arise implicating federal law and, in resolving the dispute, one party wants to be released from its agreement to arbitrate. Part III reviews the Tenth Circuit's decisions relating to the applicability of the FAA in actions brought under state law.

I. BACKGROUND: THE FEDERAL ARBITRATION ACT AND JUDICIAL DEFERENCE

A. *The Federal Arbitration Act and Federal Law*

The Federal Arbitration Act ensures the "[v]alidity, irrevocability and enforcement of agreements to arbitrate."[18] The Supreme Court has consistently upheld this Act with an almost unbending presumption in

14. *See, e.g.*, Allied-Bruce Terminix Cos. v. Dobson, 513 U.S. 265, 272–73 (1995); Southland Corp. v. Keating, 465 U.S. 1, 15–16 (1984); *see also* Ellwood F. Oakley, III & Donald O. Mayer, *Arbitration of Employment Discrimination Claims and the Challenge of Contemporary Federalism*, 47 S.C. L. REV. 475, 497–98 (1996) (noting that while the *Southland* majority held that the FAA was substantive federal law, preempting inconsistent state law, the dissent viewed the FAA as procedural in nature, applying only in federal courts with no preemptive effect). *See also* infra Part I.B.

15. *Cf.* Progressive Cas. Ins. Co. v. C.A. Reaseguradora Nacional de Venezuela, 991 F.2d 42, 45–46 (2d Cir. 1993).

16. 126 F.3d 1279 (10th Cir. 1997).

17. 143 F.3d 1337 (10th Cir. 1998).

18. 9 U.S.C. § 2 (1994).

favor of arbitrability. In what has been described as the "arbitration trilogy,"[19] the Court's decisions in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*,[20] *Southland Corp. v. Keating*,[21] and *Dean Witter Reynolds Inc. v. Byrd*,[22] firmly hold that the Court will sustain the fundamental congressional objective embodied in the FAA. In *Moses Cone*, the Court established that the FAA provides, as a matter of federal law, that issues concerning the scope of arbitrability should be resolved in favor of arbitration.[23] In *Southland*, the Court broadened the scope of the FAA by holding that, pursuant to the Supremacy Clause of the United States Constitution, state courts, as well as federal courts, must apply the substantive law of the FAA:[24] "In creating a substantive rule applicable in state as well as federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements."[25] *Dean Witter* involved an alleged violation of a federal statute—the United States Securities Act of 1934.[26] Upon Byrd's complaint in federal district court arising out of a brokerage agreement containing an arbitration provision, Dean Witter moved the court to compel arbitration pursuant to the provision.[27] In a unanimous opinion, the Court held that "the Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed."[28] The Court founded each decision on its sensitivity to the "fundamental congressional intent to ensure judicial enforcement of privately made agreements to arbitrate."

The "Court's unbending objective: fostering the unfettered recourse to arbitration,"[29] was again evidenced in 1987 in *Shearson/American Express, Inc. v. McMahon*.[30] In this landmark case, the Supreme Court effectively overruled *Wilko v. Swan*,[31] a case in which the Court had carved an exception to the FAA's broad applicability.[32] The *Wilko* Court

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19. Linda R. Hirschman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1306–07 (1985).

20. 460 U.S. 1 (1983). In *Moses*, the Supreme Court held that the court of appeals has the authority to remand a case to compel arbitration, in order to facilitate Congress's goal of prompt arbitration. *See id.* at 29.

21. 465 U.S. 1 (1984). *Southland* involved a California franchise law which limited certain types of arbitration. *See Southland*, 465 U.S. at 3–4.

22. 470 U.S. 213 (1985). The Court held that the district court erred when it refused a motion to compel arbitration of state claims against a securities broker-dealer. *See Moses Cone.*, 470 U.S. at 223–24.

23. *See Moses Cone*, 460 U.S. at 24–25.

24. *See Southland*, 465 U.S. at 13–16.

25. *Id.* at 16 (footnotes omitted).

26. *See Dean Witter*, 470 U.S. at 214.

27. *See id.* at 214–15.

28. *Id.* at 218. (emphasis added).

29. *Id.* at 127.

30. 482 U.S. 220 (1987).

31. 346 U.S. 427 (1953).

32. *See Wilko*, 346 U.S. at 433–34.

determined that the arbitration provision at issue in a brokerage contract, which was regulated by the Securities Act of 1933,[33] violated the public policy of the Securities Act, rendering the arbitration agreement unenforceable.[34] In *McMahon*, the issue before the court focused on the arbitrability of claims brought under the Securities Exchange Act of 1934[35] and the Racketeer Influenced and the Corrupt Organizations Act (RICO).[36] In a 5-4 holding, the Court "further amplifie[d] the already extensive reach of the emphatic public policy favoring arbitration."[37] As the Securities Exchange Act of 1934 and RICO do not have express language barring arbitration, the Court held that the FAA governs, and thus any claims brought under either act involving a valid arbitration agreement must be arbitrated.[38] Underlying this decision was again the Court's seemingly unyielding preference for arbitration when a valid arbitration agreement exists.

B. *The Federal Arbitration Act and State Law*

Since its enactment in 1925, the FAA has raised issues of federalism. Enacted during the *Swift v. Tyson*[39] era of federal common law, the decision in *Erie Railroad Co. v. Tompkins*[40] in 1939 raised the question of whether the FAA provided procedural or substantive rights.[41] The status of the FAA, and thus its applicability in diversity suits, was not determined for nearly thirty years.

In 1967, the Supreme Court, in *Prima Paint Corp. v. Flood & Conklin Manufacturing. Co.*,[42] held that when a contract involves interstate commerce, courts must apply the FAA.[43] The Court did not directly address the federalism issue, but effectively decided that issue in its opinion.[44] Holding that Congress could provide substantive directives to federal courts in areas where it has authority to act, the Court implicitly held that the FAA created federal substantive rights—federal substantive

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33. 15 U.S.C. §§ 77a–77aa (1994).

34. *Wilko*, 346 U.S. at 438.

35. 15 U.S.C. §§ 78a–78ll (1994).

36. 18 U.S.C. §§ 1961–1968 (1994); *see* Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 222 (1987).

37. CARBONNEAU, *supra* note 3, at 126.

38. *See McMahon*, 482 U.S. at 238, 242.

39. 41 U.S. 1 (1842).

40. 304 U.S. 64 (1938).

41. *See Erie Railroad*, 304 U.S. at 78. The *Erie* Doctrine, while a murky area of the law, is interpreted as a prohibition against the application of federal substantive law when state created substantive rights would be affected. *Cf.* CARBONNEAU, *supra* note 3, at 141 n.13.

42. 388 U.S. 395 (1967).

43. *See Prima Paint*, 388 U.S. at 406.

44. *Cf.* CARBONNEAU, *supra* note 3, at 109.

rights that must be applied in federal court.[45] The Court's subsequent decision in *Southland* made clear that, under the Supremacy Clause, the state courts must apply the FAA as well.[46]

The Supreme Court has clearly voiced that the strong policy favoring the FAA will be honored. A valid arbitration agreement will be enforced even though the underlying claim may have been resolved differently under state or federal law. As the decision in *McMahon* indicates, only when Congress has expressly banned arbitration of certain disputes will the policy favoring arbitration yield.[47] The Tenth Circuit during the survey period primarily followed this precedent. The decisions in *Avedon* and *Miera* are consistent with the supremacy granted the FAA in state law actions. The court's decision in *McWilliams* similarly is consistent with the strong policy favoring arbitration. *Davister*, however, creates an exception to the broad applicability of the FAA. Holding that the public policy of protecting insurance policyholders outweighs the public policy of promoting arbitration, *Davister* represents the rare situation when a court overrules the applicability of the FAA without express congressional direction to do so.

II. CASE DISCUSSION: FEDERAL STATUTES AND THE FEDERAL ARBITRATION ACT

Congress enacts federal statutory law to protect various public policy interests: the ADA,[48] for example, was enacted to protect disabled individuals; the McCarran-Ferguson Act[49] was enacted to protect insurance policyholders; the FAA was enacted to protect parties' ability to agree to arbitrate their disputes. Many interests protected by federal statute are subject to contractual agreements—agreements in which parties may agree to arbitrate disputes. The contractual interests protected by the FAA often seem at odds with those interests protected by other federal statutes. In arbitration, arbitrators are not required to apply the law.[50] Thus, whether a party waives statutory protection by entering an agreement to arbitrate is an issue with which the courts have struggled, and on which the Supreme Court has remained silent. During the survey period, the Tenth Circuit decided two cases involving a conflict between a federal statute and the FAA. In *McWilliams v. Logicon*,[51] the court held that the public policy interest protected by the ADA did not outweigh, nor conflict with, the policy of the FAA favoring arbitration. In *Davister*

45. *See id.*; *see also Prima Paint*, 388 U.S. at 424–25 (Black, J., dissenting) (criticizing the majority for circumventing the "forum shopping" prohibitions under *Erie* by failing to require that federal substantive law created under the FAA be applied by state courts).

46. Southland Corp. v. Keating, 465 U.S. 1, 13–16 (1984).

47. Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 226–27 (1987).

48. 42 U.S.C. §§ 12101–12213 (1994).

49. 15 U.S.C. §§ 1011–1015 (1994).

50. *See* Landrum & Trongard, *supra* note 6, at 370–74.

51. 143 F.3d 573 (10th Cir. 1998).

Corp. v. United Republic Life Insurance Co.,[52] the court held that the public policy of the McCarran-Ferguson Act outweighed the freedom of contract policy embodied in the FAA. This section examines these two decisions, provides a comparison of the Tenth Circuit's decisions to those of other circuits, and analyzes the potential ramifications of the Tenth Circuit's rulings.

A. *Tenth Circuit Decisions*

1. *McWilliams v. Logicon*[53]

a. *Facts*

Logicon, Inc. employed McWilliams as a work area controller for approximately seven years.[54] McWilliams' employment agreement contained an arbitration agreement stating that "'any controversies, claims, and/or disputes arising out of the termination of [his] employment with [Logicon], shall be settled exclusively through binding arbitration . . . pursuant to the Federal Arbitration Act.'"[55] Logicon fired McWilliams in May of 1995.[56] In response, McWilliams filed suit in federal district court claiming that his termination violated the ADA.[57] He alleged that the company fired him because he suffered from a number of disabling conditions for which he had requested accommodation.[58] Logicon moved to stay litigation pending arbitration and the court granted this motion in consideration of the employment agreement.[59] The arbitrator entered an award in favor of Logicon and the district court affirmed.[60] McWilliams appealed.[61]

b. *Issues Considered*

The Tenth Circuit considered three issues: (1) was McWilliams employed in interstate commerce, and thus within the FAA's exclusionary language of section 1,[62] (2) are claims brought under the ADA subject to binding arbitration in accordance with the FAA, and (3) did Logicon waive its right to arbitrate by waiting until after McWilliams had filed suit to move for arbitration.[63]

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52. 152 F.3d 1277 (10th Cir. 1998).
53. 143 F.3d 573 (10th Cir. 1998).
54. *See McWilliams*, 143 F.3d at 574.
55. *Id.*
56. *See id.* (quoting the arbitration agreement contained in the employment agreement).
57. *See id.*
58. *See id.*
59. *See id.* at 574–75.
60. *See id.* at 575.
61. *See id.*
62. *See id.*; *see also infra* note 65 and accompanying text.
63. *See McWilliams*, 143 F.3d at 575.

c. *Decision*

Applying a de novo standard of review[64] to all three issues, the court first considered whether application of the FAA was precluded by the exclusionary language of section 1 which states: "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."[65] Citing to circuits that have construed this exclusion narrowly, the court determined that section 1 excludes only those workers engaged in the channels of foreign or interstate commerce.[66] The court concluded that McWilliams' employment as a "work area controller" did not directly affect the channels of commerce, and therefore, did not preclude applicability of the FAA under section 1.[67]

The court then considered whether McWilliams' ADA claim precluded enforcement of the arbitration agreement.[68] Citing to the strong federal policy favoring arbitration, the court relied on *Gilmer v. Interstate/Johnson Lane Corp.*,[69] holding that the presumption in favor of arbitrability exists even when a party's claim is founded upon statutory rights.[70] The Tenth Circuit concluded that McWilliams' ADA claim was arbitrable, finding that the ADA encourages rather than prohibits arbitration.[71]

Finally, the court considered whether Logicon had waived its right to arbitration by waiting until after McWilliams had filed his complaint to commence arbitration. The court analyzed the alleged waiver under *Peterson v. Shearson/American Express Inc.*,[72] and *Metz v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*,[73] which defined factors relevant to a determination of whether a party has waived its right to enforce an arbitration agreement. The *Peterson/Metz* factors assessed by the *McWilliams* court, included: (1) were the parties' actions inconsistent with the right to arbitrate; (2) were the parties well into preparation for litigation when one party invoked arbitration; (3) did the party request arbitration near the trial date; (4) did the defendant seeking arbitration file a counterclaim without asking for a stay of the proceedings; (5) had intervening steps, such as taking advantage of judicial discovery, taken place; and (6) had the delay affected, misled, or prejudiced the opposing party.[74] In applying these factors, the court found that Logicon's conduct was not inconsis-

64. *See id.* (relying on Armijo v. Prudential Ins. Co., 72 F.3d 793, 796 (10th Cir. 1995)).
65. 9 U.S.C. § 1 (1994).
66. *See McWilliams*, 143 F.3d at 575–76.
67. *See id.* at 576.
68. *See id.*
69. 55 U.S. 20 (1991).
70. *See McWilliams*, 143 F.3d at 576 (citing *Gilmer*, 55 U.S. at 26).
71. *See id.*; *see also* 42 U.S.C. § 12212 (1994).
72. 849 F.2d 464, 467–68 (10th Cir. 1988).
73. 39 F.3d 1482, 1489 (10th Cir. 1994).
74. *See McWilliams*, 143 F.3d at 576.

tent with its right to arbitrate under the employment agreement; the parties were not well into preparation; Logicon had invoked arbitration shortly after McWilliams filed his claim; McWilliams was not required to defend against a counterclaim; and Logicon had not abused discovery or any other judicial procedures that would not have been available in an arbitral proceeding.[75] The court, therefore, concluded that Logicon had not waived its right to enforce the arbitration agreement, and it consequently affirmed the lower court's order compelling arbitration.[76]

d. *Analysis*

McWilliams represents the general judicial consensus regarding the applicability and supremacy of the FAA. The FAA will rarely yield to statutory claims. When a valid arbitration agreement exists, the role of the judiciary is thus limited to (1) determining the arbitrability of the parties' dispute, and (2) the subsequent enforcement of the arbitrator's decision.

2. *Davister Corp. v. United Republic Life Insurance Co.*[77]

a. *Facts*

United Republic Life Insurance Company (United) and Davister Corporation entered into an agreement whereby United would purchase, via a stock transfer, R.G. Acquisition Corporation (RGA) from Davister.[78] The deal included a transfer of real property interests in Texas which constituted RGA's principal assets.[79] The agreement regarding the property transfer contained an arbitration provision.[80] Subsequent to this agreement, the Utah Insurance Commissioner reviewed the transaction and notified United that the transaction was improper and must be reversed.[81] Before reversal of the transaction was complete, the Utah Commissioner filed suit in Utah state court seeking control of United.[82] The Commissioner then filed suit in Texas state court to gain control of the real property interest involved in the transaction.[83] Davister intervened, seeking to rescind the contract, claiming that the order from the Commissioner to reverse amounted to a failure of consideration in its transaction with United.[84] In the meantime, the Utah state court issued an order compelling the liquidation of United and appointing the Commis-

75. *See id.* at 576–77.
76. *See id.* at 577.
77. 152 F.3d 1277 (10th Cir. 1998).
78. *See Davister*, 152 F.3d at 1278.
79. *See id.*
80. *See id.*
81. *See id.*
82. *See id.*
83. *See id.*
84. *See id.*

sioner as liquidator.[85] The Utah state court then ordered a stay of all claims against United pursuant to Utah statute; the Texas state court honored the stay.[86] Davister then filed suit in United States District Court for the District of Utah against the Commissioner, and against United, seeking to compel arbitration pursuant to the agreement between the parties related to the Texas property interest.[87] The district court refused to compel arbitration, and Davister appealed.[88]

b. *Issue Considered*

At issue before the court was whether the FAA must yield to a state court blanket stay in an insurance liquidation setting—specifically, "whether state law governing insurance company delinquency proceedings reverse pre-empt the [FAA] under the McCarran-Ferguson Act."[89] Davister argued that the national policy favoring arbitration embodied in the FAA mandated arbitration when the parties have agreed to submit their dispute to arbitration.[90] United and the Utah Commissioner argued that the McCarran-Ferguson Act[91] does not allow any act of Congress to preempt any state law regarding the regulation of the business of insurance and thus the arbitration provision could not be enforced under the FAA, but must be assessed under relevant state law.[92]

c. *Majority Opinion*

The McCarran-Ferguson Act provides: "No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."[93] Therefore, the court began its analysis by considering whether the liquidation proceeding against United fell within the Act's meaning of "the business of insurance."[94] Relying on *United States v. Fabe*,[95] the court determined that a state statute enacted specifically to protect insurance policy holders satisfies the statutory meaning of the "business of insurance" and impli-

85. *See id.*
86. *See id.*
87. *See id.*
88. *See id.*
89. *Id.* at 1280 (quoting Munich American Reinsurance Co. v. Crawford, 141 F.3d 585, 587 (5th Cir. 1998)).
90. *See id.* at 1278.
91. 15 U.S.C. § 1012 (1994). *See also* infra note 96 and accompanying text.
92. *See Davister*, 152 F.3d at 1279.
93. 15 U.S.C. § 1012(b) (1994).
94. *Davister*, 152 F.3d at 1279.
95. 508 U.S. 491 (1993). *Fabe* provides a three part test to determine what insurance is, and thus when the McCarran-Ferguson Act should be applied: "(1) does the federal statute at issue 'specifically relate to the business of insurance;' (2) was the state statute enacted 'for the purpose of regulating the business of insurance'; (3) would application of the federal statute 'impair, interfere, or supercede' the state statute." *Davister*, 152 F.3d at 1279 n.1 (quoting *Fabe*, 508 U.S. at 500–01).

cates the McCarran-Ferguson Act.[96] Citing the Fifth Circuit's decision in *Munich American Reinsurance Co. v. Crawford*,[97] the court then held that the FAA is reverse pre-empted whenever the McCarran-Ferguson Act is implicated.[98]

Applying this analysis to the *Davister* facts, the court concluded that Utah enacted the statute consolidating claims against a liquidating insurer to protect policyholders.[99] Thus, the court held that the McCarran-Ferguson Act was implicated and application of the FAA was reverse pre-empted.[100] The court recognized that the parties had agreed to arbitrate disputes arising out of the property transfer agreement; however, it stated that it would not allow a "putative creditor to pluck from the entire liquidation proceeding one discrete issue and force arbitration contrary to the blanket stay entered by the Utah state court."[101] Thus, in a liquidation setting, the FAA will not govern agreements to arbitrate; state law, on the other hand, will control the transaction pursuant to the McCarran-Ferguson Act.

d. *Dissenting Opinion*

In dissent, Judge Lucero argued that the majority opinion adopted an overly broad interpretation of *Fabe* and the majority had wrongly provided an exception to the supremacy of the FAA without the necessary express command from Congress.[102] Stating that *Fabe* limits the business of insurance merely to the "protection of policyholders," Judge Lucero argued that the blanket stay of an arbitral proceeding is a benefit to all creditors and not specifically a benefit to policyholders.[103] Further, he asserted that Utah's law does not mandate against arbitration within the insurance context, and therefore, the FAA should not have been precluded from its applicability absent express legislative direction.[104]

e. *Analysis*

The Tenth Circuit made a conspicuous move in holding claims within the jurisdiction of the McCarran-Ferguson Act immune from the FAA. To overcome the strong presumption of arbitrability, express congressional language mandating exclusive judicial jurisdiction is usually required.[105] The Tenth Circuit in *Davister* carved an exception to the ap-

96. *Davister*, 152 F.3d at 1281–82.
97. 141 F.3d 585 (5th Cir. 1998).
98. *See Davister*, 152 F.3d at 1281.
99. *See id.*
100. *See id.*
101. *Id.*
102. *See id.* at 1282–83.
103. *Id.*
104. *See id.* at 1283.
105. *Cf.* CARBONNEAU, *supra* note 3, at 130.

plicability of the FAA when Congress had not expressly mandated a judicial remedy. The *Davister* decision, therefore, conflicts with the strong presumption in favor or arbitration.

The McCarran-Ferguson Act provides that the business of insurance shall be subject to the laws of the several states.[106] The Act provides that a private contract between two parties may contain an arbitration clause; it further declares that state law principles will govern the interpretation of insurance contracts.[107] Insurance contracts, however, involve interstate commerce, thus invoking the applicability of the FAA.[108] Hence, regarding the enforceability of an arbitration agreement, the following issue is raised: whether the FAA or state law is applicable when an insurance company becomes insolvent and the agreement provides for arbitration of disputes arising out of the liquidation.

B. *Other Circuits*

There is a split on this issue within the circuits, and silence from the Supreme Court. The Second and Ninth Circuits have held that the McCarran-Ferguson Act does not preclude application of the FAA. In *Hamilton Life Insurance Co. v. Republic National Life Insurance Co.*,[109] the Second Circuit held that McCarran-Ferguson does not exempt the business of insurance from other federal statutes unless such compliance would conflict with state laws regulating insurance.[110] The court stated that "[t]he plain and unambiguous statutory language is persuasive evidence that the McCarran-Ferguson Act was not intended to preclude the application of these federal statutes to insurance unless they invalidate, impair or supersede applicable State legislation regulating the business of insurance."[111] Holding that state arbitration statutes do not invalidate, impair, or supersede states' regulation of the business of insurance, but regulate "the method of handling contract disputes generally," the court refused to find the FAA reverse pre-empted by operation of New York law regulating the business of insurance.[112]

The Ninth Circuit, in *Bennett v. Liberty National Fire Insurance Co.*,[113] held that Montana's insolvency statute does not regulate the busi-

106. *See* 15 U.S.C. § 1012(a) (1994).

107. *Cf.* Willy E. Rice, *Federal Courts and the Regulation of the Insurance Industry: An Empirical and Historical Analysis of Courts' Ineffectual Attempts to Harmonize Federal Antitrust, Arbitration, and Insolvency Statutes with the McCarran-Ferguson Act—1941–1943*, 43 CATH. U. L. REV. 399, 432–33 (1994) (arguing that the McCarran-Ferguson Act should be eliminated and a federal regulation of insurance put in place).

108. *See id.*

109. 408 F.2d 606 (2d Cir. 1969).

110. *See Hamilton*, 408 F.2d at 611.

111. *Id*; *see also* 15 U.S.C. § 1012(b) (1994).

112. *Hamilton*, 408 F.2d at 611. The court referred to the Texas Arbitration Act and the New York Arbitration Act specifically in determining that state law relating to arbitration did not operate to regulate the business of insurance. *See id.*

113. 968 F.2d 969 (9th Cir. 1992).

ness of insurance and, therefore, does not preclude applicability of the FAA.[114] The court rested its decision on its determination that the liquidator-plaintiff sought to enforce rights primarily derived from the insolvent insurer's contract rather than from Montana's insolvency regulation.[115] The court held that because the underlying dispute between the parties was one of contract, and not one of insurance policyholders' rights, the parties were compelled to arbitrate their dispute pursuant to the FAA.[116] In its decision, the court rejected the argument that the public policy interest furthered by the regulation of insolvent insurers should outweigh the federal interest in compelling arbitration under the FAA.[117] Finding no harm to the liquidator, but merely an alternative forum for resolution, the court rejected the reverse preemption effect of the McCarran-Ferguson Act.[118]

The Tenth Circuit, with its decision in *Davister*, joined the Fifth and Sixth Circuits in finding that state statutes regulating liquidation are protected from federal preemption by the Federal Arbitration Act.[119] The Fifth Circuit in *Munich*,[120] imposed a per se rule of reverse preemption denying the enforceability of any arbitration agreement in insolvency proceedings.[121] The Sixth Circuit, in *Fabe v. United States Department of Treasury*,[122] held that Ohio's liquidation statute "protecte[d] the interests of the insured" and "regulate[d] the 'business of insurance,'" and was thus protected from federal preemption.[123] Accepting certiorari on *Fabe*, the Supreme Court failed to define the relationship between the McCarran-Ferguson Act and the FAA.[124] The Court reversed the Sixth Circuit's decision, but only on the grounds that "to the extent that [the Ohio priority statute at issue] is designed to further the interests of other creditors . . . it is not a law enacted for the purpose of regulating the business of insurance."[125]

This lack of direction from the Supreme Court has led to a split in the circuits on the question of whether the FAA applies to insurance contracts. The Tenth Circuit's decision marks a rare instance where other public policy concerns outweigh the presumption favoring arbitrability. *Davister* further marks the rare instance where the presumption favoring arbitrability is overcome, not by a congressional command, but by judicial directive.

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114. *See Bennett*, 968 F.2d at 972–73.
115. *See id.* at 970.
116. *See id.* at 972.
117. *See id.*
118. *See id.*
119. *Cf.* Rice, *supra* note 107, at 438–39.
120. 141 F.3d 585 (5th Cir. 1998); *see also* infra notes 97–99 and accompanying text.
121. *See Munich*, 141 F.3d at 595–96.
122. 939 F.2d 341 (6th Cir. 1991).
123. *Fabe*, 939 F.2d at 350–51.
124. *See* United States v. Fabe, 508 U.S. 491, 508 (1993).
125. *Fabe*, 508 U.S. at 508.

III. CASE DISCUSSION: STATE COMMON LAW AND THE FEDERAL ARBITRATION ACT

A. *Tenth Circuit Cases*

1. *Avedon Engineering, Inc. v. Seatex*[126]

a. *Facts*

Twist, a manufacturing company that designs and produces clothing and accessories for snowboarding, is the assignor of Avedon Engineering, a Colorado corporation.[127] Twist began using textiles produced by Defendant Seatex, a New York-based division of Balson-Hercules, a Rhode Island corporation.[128] In preliminary dealings with Seatex, Twist negotiated quantity, price, and quality standards through telephone and facsimile communications.[129] Twist then ordered Seatex products and, in response, Seatex sent Twist its standard sales confirmation forms.[130]

At the bottom of the forms, special conditions appeared in small type, including a condition giving notice regarding arbitral resolution of disputes arising out of the transaction.[131] The back of the form contained two clauses relating to arbitration: one stating that disputes arising out of the transactions would be settled by arbitration; the other that any future transactions would be controlled by the terms of the sales confirmation form, unless superseded by a signed contract.[132] These terms were not negotiated by the parties, but were inserted unilaterally by Seatex through use of a standard form.[133] Twist received and paid for the goods ordered, but did not sign or return the sales confirmation forms.[134]

The dispute between the parties arose when Twist ordered waterproof fabric from Seatex, which subsequently peeled.[135] Consumers returned clothing made with this fabric to Twist.[136] After unsuccessfully trying to resolve the problem with Seatex, Twist sued in Colorado state court.[137] After removal to federal court on diversity basis, Seatex asserted that the arbitration clause became part of the contract pursuant to section 2-207 of the Uniform Commercial Code (UCC).[138]

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126. 126 F.3d 1279 (10th Cir. 1997).
127. *See Avedon*, 126 F.3d at 1281 & n.2.
128. *See id.* at 1281.
129. *See id.*
130. *See id.*
131. *See id.* at 1281 & n.3.
132. *See id.* at 1281 & n.4.
133. *See id.* at 1282.
134. *See id.*
135. *See id.*
136. *See id.*
137. *See id.*
138. *See infra* note 149 and accompanying text.

Twist argued that section 2-207 prohibited inclusion of the arbitration term because it would materially alter the contract.[139] The district court disagreed, holding that the arbitration clause did not materially alter the contract, and thus it granted Seatex's motion for a stay of litigation pending arbitration.[140] Six months passed, and Seatex moved for summary judgment for Twist's failure to timely arbitrate.[141] The court held that according to the contract, Twist was bound to initiate arbitration proceedings within one year of breach.[142] Twist had failed to do so, and the court thus granted Seatex's motion for summary judgment.[143]

b. *Issues Considered*

At issue before the Tenth Circuit was whether the parties had agreed to arbitrate the dispute and whether insertion of the terms materially altered the contract.[144] An ancillary, but ultimately dispositive, issue before the court was whether New York or Colorado law governed the contract.[145]

c. *Decision*

The court applied a de novo standard of review to both the district court's grant of the motion to compel arbitration and its denial of a jury trial on the issue of whether the parties had agreed to arbitrate the dispute.[146] Pursuant to the FAA, before compelling arbitration, the court first looked for an agreement to arbitrate.[147] The court held that section 2-207 of the UCC controlled the determination of the existence of an arbitration agreement.[148] Section 2-207 provides that unilaterally inserted terms become part of the contract unless (1) an offer is made expressly conditional to its terms, (2) additional terms are expressly objected to, or (3) the term materially alters the contract.[149]

The court assessed the agreement pursuant to section 2-207, finding Twist had neither limited its acceptance of any of the offers to their terms nor expressly objected to them in the preliminary sales confirmation forms.[150] Consequently, whether the unilaterally inserted term had become part of the contract depended on whether the term materially altered the contract.

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139. *See Avedon*, 126 F.3d at 1282.
140. *See id.*
141. *See id.*
142. *See id.*
143. *See id.*
144. *See id.* at 1283.
145. *Cf. id.* at 1284.
146. *See id.* at 1283.
147. *See id.* (referring to 9 U.S.C. §§ 3, 4 (1994)).
148. *See id.*
149. *See id.* at 1283 n.8 (quoting U.C.C. § 2-207 (1994)).
150. *See id.* at 1283–84.

Whether the inserted term regarding arbitration materially altered the contract depended upon which state's law governed the contract.[151] The difference in state law would affect two issues: the materiality of the arbitration clause and the one year limitation on the arbitration clause.[152]

Colorado had not addressed the issue of the materiality of an arbitration clause; thus, the court assumed that Colorado would apply "a conventional UCC analysis."[153] Under this analysis, the burden of showing that arbitration is a material alteration is on the party opposing its inclusion.[154] Conversely, New York presumes that arbitration is material and, thus, that it will not become part of the contract unless the parties expressly agree to it.[155]

Colorado had not adopted the general UCC provision permitting parties to contractually reduce their limitations period.[156] Under Colorado law, parties may not agree to reduce the time allowed to bring a claim to something less than the statute of limitations.[157] Thus, in Colorado the limitation on the time allowed to commence arbitration would be a material alteration to the contract. Conversely, New York has adopted the general UCC provision permitting parties to contractually agree to alter the limitations period to a minimum of one year.[158] Therefore, under New York law, the one-year limitation period would not materially alter the contract, as it would be a reasonably expected term of the agreement.[159]

Seatex argued that New York's law finding the arbitration clause a material alteration to the contract would always bar inclusion of an arbitration clause and that the FAA prohibits such a bar.[160] The court, however, held that the FAA does not preempt New York's interpretation of section 2-207.[161] The court noted that the existence of an arbitration agreement must be established before the FAA is invoked, because the FAA enforces private agreements to arbitrate and does not force parties to arbitrate when they had not agreed to do so.[162] State law governs whether an arbitration agreement exists. Consequently, the FAA will not preempt New York's interpretation of the materiality of arbitration agreements within the context of UCC section 2-207 in determining the validity of an agreement to arbitrate.[163]

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151. *See id.* at 1284.
152. *See id.*
153. *Id.*
154. *Id.*
155. *See id.* at 1285.
156. *See id.* at 1286 (citing COLO. REV. STAT. ANN. § 4-2-725 (West 1992)).
157. *See id.* (citing COLO. REV. STAT. ANN. § 4-2-725(1)).
158. *See id.* at 1285 (citing N.Y. U.C.C. LAW § 2-725(1) (McKinney 1997)).
159. *See id.*
160. *See id.* at 1286.
161. *See id.*
162. *See id.* at 1286–87.
163. *See id.* at 1287.

As the district court did not examine the choice of law issue, and since that issue would be determinative of whether an arbitration agreement existed, the Tenth Circuit remanded the case to the district court for determination of the choice of law issue.[164]

d. *Analysis*

The arbitrability of a dispute is an issue firmly within the jurisdiction of the courts.[165] This threshold issue, as the *Avedon* court held, must be determined pursuant to state contract law principles. As the Tenth Circuit did in *Avedon*, courts may consider whether parties actually agreed to arbitrate; indeed, arbitration is a creature of contract and, thus, can only be manifest by party agreement.[166] By limiting review to the validity of the arbitration agreement, courts grant deference to the Federal Arbitration Act, a posture that recognizes and respects the strong presumption in favor of arbitration because of its underlying principle of freedom of contract.

2. *Miera v. Dairyland Insurance Co.*[167]

a. *Facts*

Renetta Miera was injured in New Mexico in an automobile collision with an uninsured motorist on April 17, 1994.[168] Miera's insurer was Dairyland Insurance. Dairyland provided Miera with uninsured motorist protection as well as medical and collision coverage.[169] Following the accident, Miera submitted a claim to Dairyland, upon which the company paid $5,137.50 to the lienholder on Miera's vehicle and $1,134.91 to Miera for medical expenses.[170] Unable to resolve further personal injury and property loss claims by Miera, the parties submitted the issue to arbitration.[171] Arbitrators determined Miera's total loss as $17,134.91.[172] Dairyland then paid Miera $10,862.50, the difference between the amount previously paid and the amount awarded by the arbitrators.[173]

Miera filed suit in New Mexico state court to confirm the arbitration award and to seek further relief under New Mexico's Unfair Trade Prac-

164. *See id.* at 1288.

165. It is well recognized that *whether* an issue arbitrable may be decided by a court on contract law principles. This is true even if the agreement to arbitrate requires arbitral resolution of "all disputes between the parties," common language in arbitration agreements.

166. *Cf.* First Options v. Kaplan, 514 U.S. 938, 945 (1995).

167. 143 F.3d 1337 (10th Cir. 1998).

168. *See Miera*, 143 F.3d at 1338.

169. *See id.*

170. *See id.*

171. *See id.* at 1338–39.

172. *See id.* at 1339.

173. *See id.*

tices Act and Unfair Claims Practices Act.[174] Dairyland removed the suit to federal court based upon diversity jurisdiction.[175] Finding jurisdiction, the district court granted Dairlyand's motion for summary judgment on Miera's statutory claims.[176]

b. *Issue Considered*

Specifically before the court was the issue of whether, under New Mexico law, an insurer can offset amounts previously paid to a policyholder against an arbitration award of uninsured motorist damages in the same policy.[177]

c. *Decision*

In rendering its decision, the court first stated that arbitration is a creation of contract and that parties agree to the scope of arbitration.[178] The court then referred to *Quinones v. Pennsylvania General Insurance Co.*,[179] in which the plaintiff had been injured in an uninsured motorist collision.[180] While the jury awarded the plaintiff $25,000, the court did not instruct it on the collateral source rule, which would have allowed the plaintiff to recover past medical expenses although the insurer had already paid those claims under a separate clause in the insurance agreement.[181] The *Quinones* court founded its decision on public policy concerns that "[n]o policy would be served by requiring Penn General [the insurer] to twice pay . . . past medical expenses."[182]

The court found in *Miera* that the parties had agreed to the scope of arbitration.[183] Arbitrable issues were limited to the total amount of damages due, reserving the legal question of offset to later resolution.[184] Concluding that *Quinones* was controlling, the court held that Dairyland had paid medical and property loss bills of over $6,000 prior to arbitration.[185] The arbitration award specified that $1,134.91 represented reimbursement for necessary medical care.[186] Dairyland had paid this amount to the plaintiff for medical care.[187] The arbitrators had awarded

174. *See id.* (referring to Unfair Claim Practices Act, N.M. STAT. ANN. §§ 59A-16-20 to -30 (Michie 1978); Unfair Trade Practices Act, N.M. STAT. ANN. §§ 57-12-2 to -10 (Michie 1978)).

175. *See id.*

176. *See id.*

177. *See id.* at 1341.

178. *See id.*

179. *See id.* at 1341–42 (referring to Quinones v. Pennsylvania Gen. Ins. Co., 804 F.2d 1167 (10th Cir. 1986)).

180. *See Quinones*, 804 F.2d at 1169.

181. *See id.*

182. *Id.* at 1171.

183. *See Miera*, 143 F.3d at 1341.

184. *See id.*

185. *See id.*

186. *See id.*

187. *See id.*

$17,134.91 in total damages. Pursuant to Quinones, the court held that the insurer may offset amounts previously paid from the payment awarded under an uninsured motorist claim.[188] Consequently, the court determined that Dairyland had paid all damages owed to Renatta Miera.

d. *Analysis*

The FAA provides for judicial enforcement of arbitration awards.[189] In *Miera*, the Tenth Circuit did not review the merits of the award; the court merely determined the logistics of enforcing the rendered arbitral award. This power does not conflict with the FAA and, in fact, provides more evidence of its recognized supremacy. The limitation on judicial review ensures the integrity of the arbitral process and the respect for parties' freedom of contract.

CONCLUSION

State law review of arbitration issues is limited to determinations of whether valid arbitration agreements exist, and to enforcement of rendered arbitration awards. The Tenth Circuit cases *Miera* and *Avedon* conform with this well-recognized relationship. As these decisions illustrate, the role of state law in a claim implicating the FAA is well defined.

The relationship between the FAA and other federal statutes is not as well defined. Federal statutory claims subject to arbitration agreements are often challenged. The courts traditionally refuse to preempt the FAA unless Congress expressly provides that arbitration is not an available forum for dispute resolution of the claim. The Tenth Circuit followed this line of reasoning in *McWilliams*, holding that a claim brought under the ADA did not prevent the application of the FAA. The Tenth Circuit, however, carved a rare exception. Where Congress has not provided a mandate against arbitration, and where the Supreme Court has failed to clarify the relationship between the McCarran-Ferguson Act and the FAA, the Tenth Circuit forced the FAA to yield. *Davister* effectively allows state insurance law to preempt the FAA. Arbitration clauses in insurance contracts will only be valid and enforceable if they satisfy state laws regarding the arbitrability of insurance disputes. The *Davister* court concluded that the public policy of protecting the insured outweighs the public policy of protecting freedom of contract. *Davister* thus undermines the FAA and illustrates the undefined relationship between the FAA and other federal statutes.

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188. *See id.*

189. *See* 9 U.S.C. § 2 (1994).

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