What Badgerow May Mean For High Court's Other Arb. Rulings

By **Janice Sperow** (April 25, 2022, 4:26 PM EDT)

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In an almost unprecedented for these days 8-1 decision, the U.S. Supreme Court held on March 31 in Badgerow v. Walters that federal courts must determine federal subject matter jurisdiction to confirm or vacate an arbitration award under the Federal Arbitration Act from the face of the FAA petition itself.[1]

Specifically, the Supreme Court ruled that Sections 9 and 10 of the FAA do not permit federal courts to apply the look-through approach to federal jurisdiction.

At first blush, Badgerow seems to address a fairly narrow, rarely invoked basis for federal jurisdiction, but its import extends far beyond its holding. First, it may provide insight into how Justice Amy Coney Barrett will tackle the FAA. Second, it may indicate how the court as a whole will approach the other significant arbitration-related decisions before it. And third, it will shift more arbitration jurisprudence to state courts.

What is the look-through approach?

As every law student knows, federal courts have two main forms of subject matter jurisdiction: diversity, or controversies between citizens of different states worth over $75,000; and federal question, or issues arising under federal law.[2]

As a federal statute, the FAA might normally confer federal jurisdiction over related disputes, but the FAA does not itself create subject matter jurisdiction necessary for a federal court to resolve them. Rather, federal courts must find an independent jurisdictional basis to do so.[3]

In its 2009 ruling in Vaden v. Discover Bank, the Supreme Court adopted the look-through approach as a way to determine independent federal jurisdiction where none exists on the face of the FAA dispute. The approach allows federal courts to look through the immediate FAA dispute to determine jurisdiction based upon the underlying arbitral dispute.[4]

Importantly, the court based its look-through approach on the express language of Section 4 of the FAA.[5]

But, in Badgerow, the court held that this look-through approach does not apply to petitions brought under Sections 9 and 10.[6]

The Supreme Court will stick to the statutory language.

The court had previously approved the look-through approach based on Section 4's express language permitting a party to petition for an order to compel arbitration in a U.S. district court that, save for the arbitration agreement, would have jurisdiction over the parties' controversy.

The Supreme Court methodically parsed the statute's wording and ruled that the "save for" phrase means that the district court should determine whether it would have had

jurisdiction without the arbitration agreement by looking through to the parties' underlying substantive controversy. Attending to the language, the court found any other interpretation textually implausible.

Sections 9 and 10 of the FAA, however, do not share Section 4's distinct "save for" language.[7] Thus, in Badgerow, the court found Sections 9 and 10 do not permit the courts to rely upon the look-through approach. Instead, federal courts must determine whether they have subject matter jurisdiction over the case from the face of the FAA petition itself.

The court used a strict textual approach in reaching its decision, for eight of the nine justices agreed that the plain language controlled. As the court explained, it refused to "pull out of thin air" a rule "without textual support."[8] Indeed, the lone dissenter did not focus as much on statutory text but rather upon the practical advantages of a uniform jurisdictional rule for all FAA petitions.

Badgerow reveals a first glimpse into Justice Barrett's take on arbitration law.

Badgerow represents Justice Barrett's first Supreme Court decision interpreting the FAA. If representative of her general approach, it demonstrates an adjudicator faithful to both the narrow scopes of federal jurisdiction and statutory construction. It also reveals an inclination to limit the breadth of statutory language and the federal courts' exclusive control over the arbitral space.

Badgerow reaffirms the approach she took while on the U.S. Court of Appeals for the Seventh Circuit. On that bench, Justice Barrett authored a unanimous 2020 opinion in Wallace v. GrubHub Holdings Inc., ruling that food delivery drivers were not engaged in foreign or interstate commerce for purposes of the FAA's transportation worker exemption because they failed to show they actively engaged in moving goods across state lines.[9]

Parties should therefore expect Justice Barrett to join the majority when it comes to strict construction and narrow application of the FAA's exemption.

Badgerow may predict the outcome of key arbitration-related cases currently pending before the court.

If the court applies Badgerow's fidelity to text to the rest of its current arbitration-related docket, practitioners can expect some interesting outcomes. In particular, the decision could affect two closely watched cases.

For example, the court heard argument in Southwest Airlines Co. v. Saxon, which asks whether a ramp supervisor, who sometimes loads and unloads luggage from the airplane ramp, qualifies as a worker engaged in foreign or interstate commerce for purposes of the FAA's arbitration exemption.[10] During oral argument, several justices seemed receptive to the supervisor's inclusion, while others stayed silent on the point.

But, if the court interpreted the FAA's "engaged in interstate commerce" language broadly the way it has Congress' powers under the commerce clause, which extends to all activities that substantially affect commerce, then nearly every worker would come within the exemption and the exemption would swallow the rule.

Such a decision would essentially end predispute mandatory arbitration in employment disputes. The court avoids this outcome, however, if it follows its Badgerow approach to the FAA's text.

The exemption applies to seamen, railroad employees and any other class of workers engaged in foreign or interstate commerce. In 1925, when Congress enacted the FAA, Congress only had power to regulate these three groups of workers because the court's expansive interpretation of the commerce clause did not begin until 1937.

In 1925, the states controlled employment regulations for all other employees.

Thus, if the court interprets the provision narrowly as it did in Badgerow, it should limit the exemption to cover only workers actively engaged in transportation across state lines, like railroad employees, seamen and flight attendants, but not workers stationed in one state, such as the ramp supervisor in Saxon.

Admittedly, such a decision would create inconsistency between the meaning of commerce in the FAA and its meaning in the commerce clause. But in Badgerow, the majority rejected any concern about uniformity among the different provisions of the same FAA statute, much less consistency with independent constitutional provisions.

The court will also decide in Viking River Cruises Inc. v. Moriana whether the FAA covers private attorney general actions. Specifically, the court will consider whether the FAA requires enforcement of an arbitration agreement class action waiver, which encompasses a Private Attorneys General Act, or PAGA, claim, and therefore preempts contrary state law.

California law permits an aggrieved employee to bring a PAGA claim[11] on the state's behalf to recover civil penalties from an employer for state labor law violations experienced by himself or herself or other current or former employees.[12]

The California Supreme Court held an arbitration agreement waiving such PAGA claims unenforceable as against public policy and that the FAA did not preempt state law prohibiting such waivers.[13] The U.S. Court of Appeals for the Ninth Circuit later agreed because the state law prohibits a PAGA waiver in any contract, not just in arbitration agreements.[14]

The Supreme Court's decision will likely focus on the meaning of Section 2 of the FAA. Section 2 provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

Relying upon the supremacy clause, the court has held that the FAA preempts contrary state law and prohibits adjudicators from applying any state law that invalidates an arbitration agreement or outright prohibits the arbitration of a particular type of claim, unless the law applies to all contracts generally.[15]

Applying Badgerow's strict construction principle to Viking, the court should enforce Section 2 of the FAA strictly to preempt any arbitration-targeted law prohibiting PAGA waivers exclusively in the arbitration context, but uphold a state's general law prohibiting a PAGA waiver in any contract.

Practitioners should therefore expect the court to affirm the California Supreme Court's decision and hold that the FAA does not preempt the state's law prohibiting PAGA waivers because the court relied on two generally applicable state statutes, which did not single out arbitration, but instead applied to all employment contracts.[16]

Badgerow shifts more arbitration jurisprudence to the state courts.

Badgerow emphasized the important role of state courts in resolving arbitration petitions. The court ruled that, if a FAA petitioner cannot identify independent federal jurisdiction, then the action belongs in state court.[17]

The employer had argued that the look-through rule would provide federal courts with more comprehensive control over the arbitration process, while its rejection would "close the federal courthouse doors to many."

But the court rejected the argument, reminding practitioners that it has long recognized the state courts' prominent role in arbitral enforcement.[18] The court found good reasons why state, rather than federal, courts should handle arbitral enforcement, for most will involve contractual rights stemming from the parties' arbitration agreement — rights determined by state law.

The court thus gave state courts a significant role in implementing the FAA, as more and more motions to vacate or confirm arbitral awards will be left to them. In fact, given Badgerow, federal courts would almost never have federal question jurisdiction on a petition to confirm or vacate because, as the court noted, such petitions usually involve state contract law and the underlying dispute is now off limits.

Plus, without look-through, how will a diverse party enforce an award for a respondent? If the arbitrator awarded zero damages, will the award satisfy the $75,000 threshold for diversity jurisdiction?

Further, since Section 4 is the only FAA provision containing the "save for" language, arguably federal courts would no longer be able to entertain motions to appoint an arbitrator or to subpoena witnesses as those motions would not likely raise federal questions on their face.

Practitioners should therefore expect to find more federal courts dismissing FAA petitions and motions based upon lack of subject matter jurisdiction.

Parties wishing to remain in federal court will now need to demonstrate one of the following from the face of the petition: (1) federal question jurisdiction; (2) diversity jurisdiction; (3) nondomestic dispute jurisdiction under Section 2(b); or (4) pendent jurisdiction based upon a separate and independent federal claim. Conversely, practitioners can expect a significant uptick in state court filings of arbitration-related motions.

In addition, parties should assume that state courts will apply state procedural law, even though the FAA remains the governing substantive law. Practitioners can also anticipate a wide variety of outcomes as each state will inevitably apply its own interpretation of FAA's vacatur grounds.

For example, the FAA permits vacatur where the arbitrator exceeded her powers — a phrase subject to multiple interpretations.[19] Accordingly, wise counsel may wish to explicitly enumerate in the arbitration agreement itself the powers conferred and not conferred upon the arbitrator.

Likewise, each state court may consider non-FAA grounds for vacatur because it could hold the parties' arbitration agreement unconscionable or otherwise unenforceable under state law.

Further, if the court finds the offending clause nonseverable from the remainder of the provision or from the entire agreement, it could jettison other contract terms with it, leaving the parties to resolve their dispute all over again in court at great additional expense. In short, practitioners should anticipate great divergence in FAA enforcement depending on the state.

To avoid these issues, practitioners may wish to refine their choice of law and venue selections. Finally, as seasoned practitioners know, the FAA has very few provisions. As a result, federal courts usually supply law to fill the gaps. Now, parties can anticipate state courts to fill gaps with state arbitration law.

Rather than a narrow decision, Badgerow will now echo in both state and federal courthouses for quite some time.

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[1] Badgerow v. Walters, 596 U.S. _ (2022).

[2] See 28 U. S. C. §§ 1331, 1332(a).

[3] The Court held that the FAA does not support federal jurisdiction for domestic arbitrations and that, therefore, federal courts have to find an independent basis for federal jurisdiction when resolving a FAA dispute. Hall Street Associates, L.L.C. v. Mattel, Inc., 552 U.S. 576, 582 (2007). This holding only applies in the domestic arbitration context. International arbitrations have their own FAA section specifically conferring federal jurisdiction.

[4] Vaden v. Discover Bank, 556 U. S. 49 (2009).

[5] Id. at 62.

[6] Badgerow initiated arbitration against her employer's principals for unlawful termination. After arbitrators dismissed her claims, she filed suit in state court to vacate the arbitral award. Respondent removed the case to Federal District Court and applied to confirm the award. Badgerow then moved to remand the case to state court, arguing that the federal court lacked jurisdiction to resolve the parties' requests under Sections 9 and 10 of the FAA. The District Court applied Vaden's look through approach, found federal jurisdiction, and confirmed the award. The Fifth Circuit affirmed.

[7] The Court reminded practitioners that "when Congress includes particular language in one section of a statute but omits it in another section of the same Act," it views the choice to be deliberate. Collins v. Yellen, 594 U. S. ___ 2021.

[8] Wallace v. Grubhub Holdings, Inc., 970 F.3d 798 (7th Cir. 2020).

[9] Badgerow, supra.

[10] Section 1 of the FAA defines "commerce" as "commerce among the several States or with foreign nations," … "but 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." 9 U.S.C. Section 1.

[11] Cal. Lab. Code Section 2698.

[12] Cal. Lab. Code Section 2699(a).

[13] Iskanian v. CLS Transportation L.A., LLC, 59 Cal. 4th 348 (2014).

[14] Sakkab v. Luxottica Retail N. Am., Inc., 803 F.3d 425, 432, 434 (9th Cir. 2015).

[15] AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 344 (2011); Rent-A-Center, West, Inc. v. Jackson, 561 U.S. 63, 68 (2010); Doctor's Assocs., Inc. v. Casarotto, 517 U.S. 681, 687 (1996).

[16] California Civil Code section 1668 states: "All contracts which have for their object, directly or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." California Civil Code section 3513 states: "Anyone may waive the advantage of a law intended solely for his benefit. But a law established for a public reason cannot be contravened by a private agreement."

[17] Most, if not all, States in fact provide procedural vehicles, similar to those in the FAA, to enforce arbitration agreements—including, as here, to resolve post-arbitration disputes by means of confirming, modifying, or vacating arbitral awards. See, e.g., Revised Uniform Arbitration Act of 2000 §§22–24, 7 U. L. A. 26 (2009) (adopted in 21 States and the District of Columbia); Cal. Civ. Proc. Code Ann. §§1285–1287.6 (West 2022); N. Y. Civ. Prac. Law Ann. §§7510–7511 (West 2022).

[18] The Court has held that the FAA's core substantive requirement to enforce arbitration agreements like other contracts applies equally in state courts, as it does in federal courts. Southland Corp. v. Keating, 465 U. S. 1, 12– 16 (1984.

[19] 9 U.S.C. Section 10(a)(4).