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The Supreme Court Considers the Extent of Federal Subject Matter Jurisdiction Under the FAA

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The Supreme Court heard oral arguments yesterday in Vaden v. Discover Bank, No. 07-773, a case in which the Court is expected to determine the boundaries of federal jurisdiction to compel arbitration under the Federal Arbitration Act ("FAA"). Specifically, the Court in Vaden is poised to resolve a circuit split concerning the circumstances under which federal courts have jurisdiction to hear petitions to compel arbitration. Whereas some circuit courts have found federal jurisdiction when the underlying dispute involves a federal question, others have rejected this basis for federal jurisdiction and required some other independent basis (e.g., diversity jurisdiction or an admiralty law dispute).[1]

BACKGROUND

The Vaden appeal relates to a state court action in which Discover Financial Services, Inc. ("DFS"), a servicing company affiliated with Discover Bank, sued Betty Vaden, a Discover card holder, for failing to pay a $10,000 credit card balance. Vaden counterclaimed with a number of state class action claims, which primarily were breach of contract claims concerning increased interest rates and late fees.

Discover Bank, the lender, and DFS (together, "Discover Bank") filed suit in federal court to compel Vaden to submit her counterclaims to arbitration, arguing that federal jurisdiction existed because the state law claims were completely preempted by the Federal Deposit Insurance Act ("FDIA"). The district court sided in favor of Discover Bank, finding: (1) Vaden had entered into a binding arbitration agreement; and (2) Discover Bank had standing to sue for arbitration notwithstanding the fact that Vaden's state-law claims were filed against DFS.

On appeal, the Fourth Circuit Court of Appeals addressed whether the district court properly had subject matter jurisdiction. The issue turned on the court's interpretation of Section 4 of the FAA, which provides that a petition to compel arbitration may be filed in "any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties . . . ."

Vaden argued that the "save for" provision required courts to determine whether they would have jurisdiction to enforce specific performance of the arbitration agreement assuming the agreement did

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[1] The question before the Court was not directly relevant to international arbitrations. The FAA already provides an express independent basis for federal subject matter jurisdiction for cases involving international commerce and governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. See 9 U.S.C. § 203."

not improperly oust their jurisdiction. She maintained that Congress included the "save for" provision to overcome the common law principle of ouster. Under the doctrine of ouster, long since rejected, courts refused to enforce specific performance of an arbitration agreement because it would "oust" the court of its jurisdiction.

The Fourth Circuit rejected Vaden's argument and held that federal courts must examine the underlying dispute, not the petition to arbitrate, to determine whether a federal question is presented. The Court of Appeals provided three grounds for its decision. First, interpreting "save for" as "but for" or "notwithstanding," the Court reasoned that the statute instructed federal courts to examine whether they would have jurisdiction absent the agreement. Second, Section 4's reference to Title 28 evidences Congress' intent to grant jurisdiction if a district court were to have jurisdiction under any section within Title 28, and thus interpreting the FAA to prevent a petition based on federal question jurisdiction would effectively rewrite the statute. Third, the phrase "controversy between the parties" refers to the substantive conflict between the parties, not merely the dispute over arbitration. The Fourth Circuit remanded the case to the district court to determine whether federal question jurisdiction existed in the underlying dispute.

On remand, the district court found that Vaden's state-law counterclaims were completely preempted by the FDIA because the Act limits state's abilities to regulate interest rates imposed by out-of-state banks, such as Discover Bank. The court further found the FDIA's language mirrors language in the National Bank Act, which the Supreme Court has found completely preempts state law usury claims against national banks. The complete preemption of Vaden's state law counterclaims, the court reasoned, converted the counterclaims into federal claims and created federal question jurisdiction in the underlying dispute.

On appeal, the Fourth Circuit agreed with the district court, finding that: (1) Vaden's state law counterclaims were completely preempted; and (2) the preemption created subject matter jurisdiction in the district court to hear the petition to compel arbitration.

SUMMARY OF THE ARGUMENT

Before the Supreme Court yesterday, Petitioner Vaden argued that the "save for such agreement" provision of Section 4 of the FAA was necessary to overcome the doctrine of ouster. Section 4's language, Petitioner claimed, directs federal courts to determine whether they have jurisdiction over the petition to arbitrate absent the ouster doctrine.

The Court was skeptical of Petitioner's argument. A number of Justices inquired as to why the ouster doctrine was not already overcome by Section 2 of the FAA, which states that arbitration agreements founded in contracts arising from admiralty or transactions involving commerce are "enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The Justices also questioned Petitioner on why Section 2's explicit statement that arbitration agreements are enforceable in law or in equity fails to overcome the ouster doctrine, requiring Petitioner's interpretation of Section 4.

Chief Justice Roberts and Justice Stevens pressed Petitioner on her interpretation of "save for the agreement" in Section 4. Specifically, Justice Stevens wondered how the language could refer to

ouster when, read literally, it instructed courts to determine if there were jurisdiction absent the arbitration agreement: "Doesn't it just instruct the court to decide whether, if there were no such agreements, would there be Federal jurisdiction in the underlying dispute? . . . The text says nothing about the ouster doctrine." Petitioner contended that the historical context surrounding the provision supported her position. Agreeing with Justice Stevens, Chief Justice Roberts observed that the language appeared to require that courts put aside the agreement and look to the underlying dispute. According to Chief Justice Roberts, Petitioner's interpretation was "a tough sell." Chief Justice Roberts generally was skeptical of Petitioner's argument, noting that it "is a confession of error if you have to rewrite the statute to get to your position."

The Court also scrutinized Petitioner's argument that courts should not look beyond the face of the complaint to determine federal court jurisdiction. Chief Justice Roberts and Justice Scalia questioned Petitioner as to why federal courts should examine underlying disputes to determine diversity jurisdiction, but not to determine whether there is a federal question. Petitioner responded that, in diversity cases, courts may examine underlying disputes to determine the amount in controversy, and thus courts should do the same when determining the amount in controversy in connection with a petition to compel under the FAA.[2]

Respondents argued that the Court should accept the simplest construction of Section 4 and interpret the "save for" provision as an instruction to look at the underlying controversy. Justice Ginsburg responded by asking whether the dispute was the debt or the counterclaim. Under Respondents' interpretation, Section 4 instructs courts to look to the underlying controversy, not a specific lawsuit. Respondents argued that a court must answer the hypothetical inquiry as to whether a court would have jurisdiction over the subject matter of the underlying dispute.

Respondents' argument also was met with resistance. Justice Scalia asked whether Respondents' interpretation of Section 4 allows district courts to determine federal jurisdiction based on imagined complaints or counterclaims arising from the underlying dispute. Discover Bank responded that it was inconceivable that Congress had the narrow interpretation proffered by Petitioner. Unconvinced, Justice Scalia found it "close to inconceivable . . . that Congress wanted us to . . . construct litigation that is not yet in existence."

When asked whether its interpretation requires courts to examine the underlying dispute to determine diversity jurisdiction, Respondents argued that "parties" as used in Section 4 referred to the parties to the arbitration petition, and thus courts need not look beyond the petition under those circumstances. Furthermore, Respondents claimed that Petitioner's interpretation of Section 4 requires that the amount in controversy in diversity cases be satisfied by the arbitration agreement (or the violation thereof), which Justice Breyer acknowledged would rarely occur.

On rebuttal, Petitioner emphasized that courts would have trouble applying Respondents' interpretation of Section 4 because there always would be hypothetical federal claims based on the

[2] Although Petitioner had argued that Respondents lacked standing to bring the petition in her briefing, the Court did not address the issue during oral argument.

underlying dispute. Justice Breyer was not convinced, noting that the Court could establish rules as to how courts should determine whether they have jurisdiction over the underlying dispute.

IMPLICATIONS

In deciding this case, the Court hopefully will resolve the important question of how far federal court jurisdiction extends to compel arbitration between parties to an arbitration agreement. The Courts of Appeals have split on this fundamental question. The Second and Ninth circuits have interpreted federal jurisdiction narrowly, requiring an independent basis of federal jurisdiction excluding a federal question in the underlying dispute (e.g., diversity or an admiralty law). See Westmoreland Capital Corp. v. Findlay, 100 F.3d 263 (2d Cir. 1996); Blue Cross v. Anesthesia Care Associations Medical Group, 187 F.3d 1045 (9th Cir. 1999). By contrast, the Fourth Circuit (in Vaden) and the Eleventh Circuit also have found jurisdiction when the underlying dispute between the parties involves a federal question. See Discover Bank v. Vaden, 396 F.3d 366 (4th Cir. 2005); Tamiami Partners, Ltd. v. Miccosukee Tribe, 177 F.3d 1212 (11th Cir. 1999). If the Supreme Court adopts the broader interpretation of Section 4, the Court would open the federal district courts to additional petitions to compel arbitration not currently allowed under the Second and Ninth Circuits' interpretation. In the event the Supreme Court were to reverse the Fourth Circuit and adopt the narrower interpretation of the FAA, parties still would be able to enforce arbitration agreements involving non-diverse parties in state courts.

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