Ex parte Jones: But did you Contemplate Substantial Interstate Activity?

Plaintiff was an Alabama businessman and the sole shareholder of Birmingham Protection Systems, Inc. ("BPS"), an Alabama corporation. Defendant also was an Alabama businessman. Defendant entered into a stock purchase agreement with plaintiff, whereby plaintiff was to sell all of his BPS stock to defendant. The agreement contained an arbitration provision requiring the parties to arbitrate any disputes arising under the agreement. When disputes arose, plaintiff sued in Jefferson County Circuit Court. The trial court ordered arbitration. Subsequently, plaintiff petitioned the Supreme Court of Alabama for a writ of mandamus requiring the trial court to set aside its order directing arbitration.[1] The Alabama Code provides that courts cannot specifically enforce predispute arbitration agreements.[2] However, the Federal Arbitration Act ("FAA"),[3] if applicable, preempts on public policy grounds any state law that denies enforcement of arbitration agreements.[4] Plaintiff contended that the arbitration provision was unenforceable because the stock purchase agreement did not involve interstate commerce, and thus, it did not invoke the FAA.[5] Defendant argued that under the court's "slightest nexus test"[6] the agreement did involve interstate commerce, and therefore, it fell within the scope of the FAA.[7] The Supreme Court of Alabama found for plaintiff and granted the writ.[8] The court held that in determining whether an agreement containing an arbitration clause involves interstate commerce for

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1. Ex parte Jones, 628 So. 2d 316, 317 (Ala. 1993).
2. ALA. CODE § 8-1-41 (1993).
3. 9 U.S.C. §§ 1-14 (1970 § Supp. 1994).
4. A.G. Edwards & Sons, Inc. v. Syrud, 597 So. 2d 197, 198 (Ala. 1992).
5. 628 So. 2d at 317.
6. The Alabama Supreme Court espoused the "slightest nexus test" in *Ex parte Costa & Head (Atrium) Ltd.*, 486 So. 2d 1272 (Ala. 1986), saying that "the requirement of the [Federal Arbitration Act] that an arbitration agreement 'involve commerce' has been construed very broadly so that the slightest nexus of the agreement with interstate commerce will bring the agreement within the ambit of the FAA." 486 So. 2d at 1275.
7. 628 So. 2d at 317.
8. *Id.*

purposes of enforcing the arbitration clause, the proper test to be applied is not the "slightest nexus test" but rather the "contemplation test," which asks "whether at the time, the parties entered into [the contract] and accepted the arbitration clause, they contemplated substantial interstate activity."[9]

Alabama courts used a two-pronged test to determine if the FAA is applicable to a transaction within the state.[10] First, the contract must contain an arbitration agreement voluntarily entered into by the parties, and second, the contract must be one involving interstate commerce.[11] In Alabama two distinct lines of cases developed concerning the applicable standard for determining whether an agreement containing an arbitration clause involves interstate commerce. The first line of cases construing "interstate commerce" began with *Ex parte Costa & Head (Atrium) Ltd.*[12] In *Costa & Head*, a dispute between the owner of a construction project and the project's general contractor, the court first adopted the "slightest nexus test" by holding that "the requirement of the FAA that an arbitration agreement 'involve commerce' has been construed very broadly so that the slightest nexus of the agreement with interstate commerce will bring the agreement within the ambit of the FAA."[13] This decision adopted the reasoning followed in most other jurisdictions and brought Alabama law generally in line with the majority of other states.[14] However, in 1989 the court adopted a new test for determining interstate commerce that resulted in a second line of cases. Instead of the "slightest nexus test," the court in *Ex parte Warren*,[15] a case involving an automobile sales contract, adopted the new standard of "whether at the time [the parties] entered into [the contract] and accepted the arbitration clause, they contemplated substantial interstate activity."[16] The court hinted, however, that this "contemplation test" should be applied narrowly to the facts of *Warren*.[17] No other jurisdiction had adopted this subjective test.[18] The court followed *Warren* with a case that was almost factually identical to

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9. *Id.* at 318.
10. Ex parte Warren, 548 So. 2d 157, 159 (Ala. 1989).
11. *Id.*
12. 486 So. 2d 1272 (Ala. 1986).
13. *Id.* at 1275.
14. Stanley D. Bynum & J. David Pugh, *Enforcing Arbitration Agreements in Alabama: A Double Standard Dilemma*, 54 ALA. LAW. 38, 38 (Jan. 1993).
15. 548 So. 2d 157 (Ala. 1989).
16. *Id.* at 159-60 (quoting Metro Indus. Painting Corp. v. Terminal Constr. Co., 287 F.2d 382, 387 (2d Cir. 1961) (Lumbard, C.J., concurring), *cert. denied*, 368 U.S. 817 (1961)).
17. *Id.* at 160.
18. Bynum & Pugh, *supra* note 14, at 40.

it in *Ex parte Williams*.[19] Relying on the factual similarities, the court again applied the "contemplation test" of *Warren*.[20] But in 1990, while it did not apply either of the tests, the court in *Roscoe v. Jones*[21] did reemphasize the narrow application of the "contemplation test" to the *Warren* facts.[22] Yet in *Ex parte Clements*,[23] decided the next year, the court returned to the *Warren* standard and applied the "contemplation test" to a dispute involving a stock purchase agreement.[24] In 1992 the court reverted back to the "slightest nexus test" in *Maxus, Inc. v. Sciacca*,[25] a construction case. However, two months later in *Ex parte Brice Building Co.*[26] the court recognized that it had created two distinct tests[27] and went on to hold that the *Costa & Head* "slightest nexus test" constitutes the appropriate standard for determining the involvement of interstate commerce for arbitration purposes.[28] The court followed its *Brice Building* opinion with four additional decisions in 1992-93 applying the "slightest nexus test."[29] Yet the court still was

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19. 555 So. 2d 146 (Ala. 1989).
20. *Id.* at 148.
21. 571 So. 2d 1043 (Ala. 1990).
22. *Id.* at 1046.
23. 587 So. 2d 317 (Ala. 1991).
24. *Id.* at 319.
25. 598 So. 2d 1376, 1379 (Ala. 1992).
26. 607 So. 2d 132 (Ala. 1992).
27. *Id.* at 133-34.
28. *Id.* at 134.
29. *See* A.J. Taft Coal Co. v. Randolph, 602 So. 2d 395 (Ala. 1992); Circle "S" Industries, Inc. v. Berryman, 613 So. 2d 329 (Ala. 1993); Garikes, Wilson & Atkinson, Inc. v. Episcopal Foun., 614 So. 2d 447 (Ala. 1993); First Real Estate Corp. of Ala. v. Brown Marx Tower L.P., 620 So. 2d 648 (Ala. 1993).

In *A.J. Taft Coal* lessors of surface mining rights on their property brought suit against lessee seeking damages for trespass and nuisance alleging that lessee had built and maintained roads over their property in order to haul coal from lands of a third party who was not a party to the surface lease agreement. 602 So. 2d at 396. The court applied the "slightest nexus test" and determined that there was not a sufficient nexus with interstate commerce to bring the agreement within the ambit of the FAA even though one of the parties to the agreement had signed the contract in a different state, some of the parties were not residents of Alabama, and some of the payments under the agreement were mailed through the U.S. mails. *Id.* at 397.

In *Circle "S" Industries*, the parties entered into a settlement agreement which contained an arbitration clause. 613 So. 2d at 330. When plaintiffs alleged that defendant had violated his obligations under the agreement, the court applied the "slightest nexus test" in determining that the agreement involved interstate commerce such that the arbitration provisions could be enforced under the FAA. *Id.* at 331.

In *Garikes, Wilson* the court applied the "slightest nexus test" in determining that the FAA did not apply to a contract between an Alabama architectural firm and an Alabama property owner in a dispute over nonperformance of administerial duties in connection with

concerned that it had a double standard problem.

In *Ex parte Jones*, the court initially recognized that the sole issue for decision was whether the stock purchase agreement involved interstate commerce.[30] If so, the agreement would invoke the FAA, which would render the arbitration provision enforceable.[31] The court began its analysis by noting the *Costa & Head* "slightest nexus test" and the facts applicable in determining the presence of interstate commerce.[32] While the court intimated that one could reasonably conclude that the facts in the instant case would not satisfy even the *Costa & Head* standard,[33] it declined to apply that test and instead applied the standard of *Warren*.[34] Yet the court again noted that previously it had held the *Warren* "contemplation test" applicable only to its narrow factual context.[35] The court in the present case acknowledged the confusion and inconsistency generated by the existence of two different standards.[36] Without specifically identifying its reasons, the court concluded that the *Warren* test was a more reasoned approach than the *Costa & Head* standard[37] and overruled those cases that espoused a standard inconsistent with *Warren*.[38] In adopting the *Warren* standard, the court adopted the language for the test from the concurring opinion in a Second Ciruict Court of Appeals case, *Metro Industrial Painting Corp. v. Terminal Construction Co.*[39] In *Metro Industrial*, Chief Judge Lumbard in his concurrence noted that the Second Circuit had previously found that Congress intended to use to the fullest possible extent its powers to regulate commerce as it was affected by arbitration agreements.[40] Yet he proposed the subjective "contemplation test" stating that congressional intent in enacting the FAA was not to affect all contracts possessing

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construction of a heating and cooling system on the property. 614 So. 2d at 449.

In *First Real Estate*, New York owners of commercial buildings in Alabama filed suit in a dispute alleging fraud, breach of contract, and negligence against the Alabama property manager based on an agreement negotiated in Alabama. 620 So. 2d at 649. The court applied the "slightest nexus test" in determining that telephone calls and mail by persons in different states to communicate about activity that was purely local did not establish a sufficient nexus with interstate commerce for the FAA to apply. *Id.*

30. 628 So. 2d at 317.
31. *Id.*
32. *Id.*
33. *Id.* at 318.
34. *Id.*
35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. 287 F.2d 382, 387 (2nd Cir. 1961) (Lumbard, C.J., concurring).
40. *Id.* at 386.

interstate commerce elements but rather to provide an extra-judicial process for those who were engaged in interstate transactions.[41] Chief Judge Lumbard said that Congress was not seeking to regulate interstate commerce in enacting the FAA, as "[t]he Arbitration Act may be avoided entirely by those engaged in interstate traffic if they merely refrain from including any arbitration provisions in their contracts . . . . The Congressional intent was not . . . to impose an adjudication system on those who wished none . . . [but] to assure those who desired arbitration . . . that their expectation would not be undermined by federal judges, or . . . state courts or legislatures."[42] In adopting the *Warren* "contemplation test" the court rejects the reasoning it had adopted in *Costa & Head*, which was derived originally from *Snyder v. Smith*[43] and *Southland Corp. v. Keating*.[44] In *Snyder* the Seventh Circuit Court of Appeals relied on the Supreme Court's language in *Southland* that said that the "involving commerce" requirement of the FAA was not an inexplicable limitation on the power of federal courts, but rather was a necessary qualification on a statute intended to apply in state and federal courts.[45] By equating the breadth of "involving commerce" with the extent of Congress' power to regulate under the Commerce Clause, the Seventh Circuit reasoned that the Supreme Court had suggested that Congress intended the FAA to apply to all contracts it could constitutionally regulate.[46] Yet the Alabama court chose to discard this reasoning at least partially because of what it called the "more reasoned approach" espoused in *Metro Industrial* and *Warren*. However, Justice Maddox, in his dissent in the present case, suggests that the majority also may have chosen the "contemplation test" because the United States Supreme Court denied certiorari in *Warren*.[47]

In the present case the court resolved its double standard for determining whether a contract involves interstate commerce in favor of the *Warren* "contemplation test." Parties no longer will have to speculate as to which test the court will apply to their facts, nor can they argue for application of one test over the other. For the FAA to apply in Alabama, one must show that the parties contemplated, at the time of contracting, substantial interstate activity arising from the agree-

41. *Id.* at 387.
42. *Id.*
43. 736 F.2d 409 (7th Cir. 1984), *cert. denied*, 469 U.S. 1037 (1984).
44. 465 U.S. 1 (1984).
45. 736 F.2d at 417-18 (quoting Southland Corp. v. Keating, 465 U.S. 1 (1984)).
46. *Id.* at 418.
47. 628 So. 2d at 319 (Maddox, J., dissenting).

ment.[48] *Jones* represents the court's preference for a subjective standard over an objective one. The court has burdened the lower courts with having to determine on a case-by-case basis the state of mind of the contracting parties in any dispute.[49] Furthermore, this "contemplation test" "encourages the party seeking to avoid arbitration to fabricate, after the fact, his alleged 'state of mind' at the time of contracting to avoid the enforcement of an unambiguous, written arbitration clause."[50] In fact, a party seeking to invoke the FAA under this standard may not reasonably be able to sustain his burden of proving such a subjective element, especially in the absence of contractual language setting forth the contemplations of the parties. The result is that a party unable to prove his contracting partner's state of mind at the time the parties entered into the contract will not be able to avail himself of the arbitration process in Alabama even though both parties signed a contract agreeing to submit their disputes to just such an arbitration tribunal.

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48. 287 F.2d at 387 (Lumbard, C.J., concurring).
49. Bynum & Pugh, *supra* note 14, at 43.
50. *Id.*