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The Majority Approach to Arbitration Waiver: A Workable Test or A License for Litigants to Play Games with the Courts?

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The Majority Approach to Arbitration Waiver: A Workable Test or A License for Litigants to Play Games with the Courts?

JAMES SAVAGE*

TABLE OF CONTENTS

I. INTRODUCTION.....	217
II. BACKGROUND	220
A. <i>The Federal Arbitration Act</i>	220
B. <i>Expansive interpretation of the FAA</i>	222
C. <i>Arbitration Waiver</i>	223
D. <i>The Majority Approach</i>	224
1. The participation element originates from the traditional waiver test.. ..	224
2. The origins of the prejudice element.....	225
E. <i>The Minority Approach</i>	227
III. INSTANT CASE	227
A. <i>Factual Background</i>	227
B. <i>Holding and Reasoning</i>	228
IV. ANALYSIS	229
A. <i>A major flaw in the the Cabinetree approach</i>	229
B. <i>The sound basis for the majority approach in traditional notions of estoppel</i>	231
V. CONCLUSION.....	232

I. INTRODUCTION

The freedom of parties to agree to arbitrate their disputes is enshrined by contract law and federal law.¹ By inserting a mandatory arbitration clause in a contract, both parties agree that, should a dispute arise between them, they

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1. See 9 U.S.C. § 2 (2012) (“A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable”); see also *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) (“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.”).

will not bring the matter to court.² Instead, they agree to submit any disputes to a mutually-agreed-to third party, such as the American Arbitration Association; this third-party acts like a judge and resolves the dispute.³ Arbitration has many advantages, such as reducing the cost and increasing the efficiency of dispute resolution.⁴ Because of these reduced costs and greater efficiency⁵, businesses can pass along their savings to consumers by offering them lower prices and more value.

Notwithstanding all of these advantages, the freedom of parties to insert enforceable arbitration clauses in their contracts has its fair share of detractors.⁶ Big businesses often insert such clauses in take-it-or-leave-it consumer contracts, such as credit card and cell phone agreements.⁷ Consumers who want or need the service provided by these businesses are forced to agree to mandatory arbitration clauses, which grant to both parties the legal right to insist upon arbitration as the sole dispute resolution method.⁸ While almost no one disagrees that arbitration is efficient and less costly, some argue that it is an unfair process.⁹ Since the business party usually appears before the third-party arbitrator repeatedly, whereas the consumer appears before him only once, the arbitrator may feel inclined to find in favor of the business party, its repeat customer.¹⁰

This debate between efficiency and the unfairness underlies any discussion about arbitration.¹¹ This note will address this debate by analyzing merely one facet of arbitration: arbitration waiver.¹² All of the circuits agree that when a party with a contractual right to arbitrate chooses to litigate a dispute, the party's election to litigate *may* waive his ability to move the case out of court and into arbitration.¹³ However, they disagree about what test should be applied to decide whether a particular election to litigate constitutes arbitration waiver.¹⁴ The circuits have formulated

2. *Arbitration*, U.S. SEC. & EXCH COMM'N, <http://www.sec.gov/answers/arbproc.htm> (last visited April 1, 2012).

3. *Id.*; see also *About American Arbitration Association*, AM. ARBITRATION ASS'N, <http://www.adr.org/aaa/faces/s/about> (last visited April 1, 2012).

4. Jane Spencer, *Signing Away Your Right to Sue*, THE WALL ST. J. (Oct. 01, 2003), <http://online.wsj.com/article/SB106495674838886400.html>.

5. *Id.*

6. *Editorial: Beware the Fine Print*, N.Y. TIMES (June 26, 2010), <http://www.nytimes.com/2010/06/27/opinion/27sun2.html>.

7. *Id.*

8. *Id.*

9. *Id.*

10. *See id.*

11. *Editorial*, *supra* note 6; Spencer, *supra* note 4.

12. *E.g.*, *Erdman Co. v. Phoenix Land & Acquisition, LLC*, 650 F.3d 1115, 1117 (8th Cir. 2011); *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390 (7th Cir. 1995); *Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 (2d Cir. 1968).

13. *E.g.*, *Erdman*, 650 F.3d at 1117; *Cabinetree*, 50 F.3d at 390; *Carcich*, 389 F.2d at 696.

14. *See Erdman*, 650 F.3d at 1118–19 (“There is a circuit split over whether the party asserting waiver must show prejudice.”).

primarily two different tests.¹⁵ In the majority of circuits, two elements must be proven: (1) the party seeking arbitration must have participated in litigation; and (2) the party resisting arbitration must show that he will suffer prejudice.¹⁶ A minority of circuits keep the first element, but the prejudice requirement has been eliminated.¹⁷

A discussion of this circuit split is timely because the U.S. Supreme Court, in 2011, expressed its desire to resolve the split by granting certiorari in an arbitration waiver case.¹⁸ Although the case was dismissed later that same year,¹⁹ it appears clear that arbitration waiver is an issue the Court may seek to take up in the future.

Before we begin an examination of arbitration waiver, notice that there are two competing policies underlying it. On the one hand, if the courts make it too easy to waive an arbitration provision, they risk undermining the bargained-for contractual term, the enforcement of which may lead to greater efficiency of dispute resolution²⁰ and the resulting benefits to consumers, like lower prices. On the other hand, if the courts make it too difficult to waive an arbitration provision, they risk allowing for abuse: litigants will be able to go to court at first and then assert their contractual right to move the case to arbitration²¹ when litigation turns against them.²² The Seventh Circuit has aptly named this abuse a game of “heads I win, tails you lose.”²³

This note seeks to prove that the majority test, which requires prejudice, should be adopted by all of the circuits.²⁴ In order to prove this, this note will first discuss the Federal Arbitration Act, a law that requires that arbitration clauses be placed on the same footing as other contractual terms.²⁵ Second, this note will examine the majority and minority approaches to arbitration waiver.²⁶ Finally, this note will show that the majority approach is preferable because only this approach places arbitration clauses on the same footing as other contractual terms.²⁷

15. *Id.*

16. *Id.* at 1117.

17. *E.g.*, *St. Mary's Med. Ctr. of Evansville, Inc. v. Disco Aluminum Prods. Co.*, 969 F.2d 585, 590 (7th Cir. 1992) (“While none of our cases has stated explicitly that a court may find waiver absent prejudice, that principle is implicit in our repeated emphasis that waiver depends on all the circumstances in a particular case rather than on any rigid rules and that prejudice is but one relevant circumstance to consider in determining whether a party has waived its right to arbitrate.”).

18. *Citibank, N.A. v. Stok & Assocs., P.A.*, 387 F. App'x 921 (11th Cir. 2010), *cert. granted*, 79 U.S.L.W. 3475 (U.S. Feb. 22, 2011).

19. *Citibank, N.A.*, 387 F. App'x 921, *cert. dismissed*, 79 U.S.L.W. 3686 (U.S. June 2, 2011).

20. Spencer, *supra* note 4.

21. Procedurally, a case is moved to arbitration by the filing of a motion to stay the matter, pending arbitration. *See, e.g.*, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 400 (1967).

22. Spencer, *supra* note 4.

23. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 391 (7th Cir. 1995).

24. *See infra* Part IV.

25. *See infra* Part II.A–B.

26. *See infra* Part II.C–E; *see also infra* Part III.

27. *See infra* Parts IV–V.

II. BACKGROUND

A. *The Federal Arbitration Act*

Despite the criticism that arbitration receives today, it is nothing like the hostility that arbitration received in the eighteenth and nineteenth centuries.²⁸ In the words of Congress, English common law courts were jealous “for their own jurisdiction This jealousy survived for so lon[g] a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts. The courts have felt that the precedent was too strongly fixed to be overturned without legislative enactment”²⁹ This common law precedent meant that, although two parties may include an arbitration term in their contract, courts were free to, and often did, ignore such terms to allow a controversy to proceed in court.³⁰ American courts adopted this anti-arbitration bias.³¹ Thus, for much of American history, arbitration clauses were not placed on the same footing as other contract clauses.³²

However, this common law precedent began to receive great scrutiny.³³ In the late nineteenth and early twentieth centuries, the United States rapidly industrialized.³⁴ This industrialization increased the number of business disputes, and businesses realized that they needed a way to resolve disputes out of court that was more efficient.³⁵ Nevertheless, the courts remained obstinate, maintaining the common law bias of ignoring arbitration agreements and hearing all disputes.³⁶

Therefore, businesses sought the help of legislatures to force courts to enforce arbitration agreements.³⁷ First, they lobbied states for laws that

28. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984) (citing H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924)).

29. *Id.*; see also Preston Douglas Wigner, *The United States Supreme Court's Expansive Approach to the Federal Arbitration Act: A Look at the Past, Present, and Future of Section 2*, 29 U. RICH. L. REV. 1499, 1502 (1995). He observes that the English courts originally adopted this anti-arbitration rule because of an economic incentive. *Id.* For each decision rendered, the English courts earned a fee. *Id.* To enforce an arbitration agreement would deprive them of this fee. *Id.* Although this incentive was no longer driving American courts, they still kept the anti-arbitration rule, with minimal justification for it. *Id.*

30. *Southland*, 465 U.S. at 13 (citing *Hearing on S. 4214 Before a Subcomm. of the Senate Comm. on the Judiciary*, 67th Cong., 4th Sess. 6 (1923) (remarks of Sen. Walsh)) (“The Arbitration Act sought to ‘overcome the rule of equity, that equity will not specifically enforce any arbitration agreement.’”).

31. Wigner, *supra* note 29, at 1502.

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. Wigner, *supra* note 29, at 1503.

would protect arbitration agreements and won several victories at that level.³⁸ Then, they lobbied Congress.³⁹

In 1925, their lobbying efforts succeeded.⁴⁰ Congress enacted the Federal Arbitration Act (“FAA”), which provided that “a contract evidencing a transaction involving commerce to settle by arbitration a controversy . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.”⁴¹ In enacting the FAA, Congress clearly meant to overturn the common law precedent against arbitration.⁴² For the FAA to apply to a transaction, the transaction need only be contained in a “contract evidencing a transaction involving commerce.”⁴³ The Court has noted that the *transaction involving commerce* requirement is not difficult to meet, and it rarely bars the application of the FAA.⁴⁴

Furthermore, in order to ensure that these agreements are enforced, Section 3 of the FAA directs that all “courts of the United States” must grant a motion to stay litigation, pending arbitration, if the court determines that the contract requires the matter to be arbitrated.⁴⁵ Before the *Southland* decision discussed below, many commentators pointed out that the phrase “courts of the United States” suggested that Section 3 was only applicable to federal courts and not to state courts.⁴⁶ According to this view, the FAA was merely a procedural law passed to control the federal courts.⁴⁷

On the other hand, others have pointed to Section 2’s reference to “a contract evidencing a transaction involving commerce,” noting that this phrase suggests that Congress was invoking its commerce clause power in passing the FAA.⁴⁸ Under this view, the FAA would apply to both the states and the federal courts as substantive law.⁴⁹ A review of the legislative history of the FAA provided no answers to this debate.⁵⁰ Thus, this debate was left largely unsettled until the *Southland* case, discussed below.⁵¹

38. *Id.*

39. *Id.*

40. *Id.*

41. 9 U.S.C. § 2 (2012).

42. Larry J. Pittman, *The Federal Arbitration Act: The Supreme Court’s Erroneous Statutory Interpretation, Stare Decisis, and A Proposal for Change*, 53 ALA. L. REV. 789, 799 (2002).

43. 9 U.S.C. § 2 (2012).

44. Jon R. Schumacher, *The Reach of the Federal Arbitration Act: Implications On State Procedural Law*, 70 N.D. L. REV. 459, 462–63 (1994) (citing *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 401 n.7).

45. 9 U.S.C. § 3 (2012); *Id.* at 463.

46. Schumacher, *supra* note 44, at 463.

47. *Id.* at 463–65.

48. *Id.* at 464–65.

49. *Id.*

50. *Id.* at 461 n.25 (providing a good discussion of the FAA’s perplexing legislative history. In a House Report, Congress stated that “[t]he purpose of this bill is to make valid and enforceable [sic] agreements for arbitration contained in contracts involving interstate commerce or within the jurisdiction or [sic] admiralty, or which may be the subject of litigation in the Federal courts.”).

51. *See id.* at 464–65.

B. *Expansive interpretation of the FAA*

In *Southland Corp. v. Keating*, franchisees of certain 7-Eleven stores sued their franchisor, the Southland Corporation (“Southland”), in California Superior Court.⁵² Southland’s agreement with its franchisees contained an arbitration clause.⁵³ Based on that clause, it moved to stay the proceedings pending arbitration.⁵⁴ The Superior Court granted the motion to stay on all claims except those covered by a California statute, the Franchise Investment Law (“FIL”).⁵⁵ As interpreted by the California Supreme Court, claims brought under the FIL must be brought to a judicial forum and may not be arbitrated.⁵⁶

Southland appealed, and the case eventually reached the U.S. Supreme Court.⁵⁷ The Court found that the FIL was in direct conflict with the FAA because the FAA required the enforcement of arbitration clauses and the FIL attempted to prevent the enforcement of these clauses in certain cases.⁵⁸ Because of this direct conflict between state and federal law, the FIL was preempted.⁵⁹

However, before the Court’s decision, remember that it was an open question whether the FAA applied to a case like *Southland* at all, which was initiated in state court.⁶⁰ In fact, certain members of the Court believed that the FAA only applied to federal courts and that the preemption of the FIL would only apply if the case were brought in federal court.⁶¹ Therefore, because *Southland* was brought in state court, some on the Court believed that the California statute requiring judicial resolution of claims could be given effect.⁶²

The majority, however, rejected this interpretation, holding that the FAA was substantive law applicable to both state and federal courts.⁶³ Because the FAA applied to both state and federal courts, it preempted the FIL’s

52. *Southland Corp. v. Keating*, 465 U.S. 1, 3–5 (1984).

53. *Id.*

54. *Id.* at 4.

55. *Id.* at 4–5.

56. *Id.*

57. *Id.* at 5.

58. *Southland*, 465 U.S. at 10.

59. *Id.* *But see id.* at 18 (Stevens, J., dissenting) (noting that “it is by no means clear that Congress intended entirely to displace State authority in this field.”).

60. Schumacher, *supra* note 44, at 463.

61. *See Southland*, 465 U.S. at 26 (O’Connor, J., dissenting) (observing that the American Bar Association Committee that lobbied for enactment of the FAA stated “the statute establishes a procedure in the Federal courts for the enforcement of arbitration agreements . . .”).

62. *Id.*

63. *Id.* at 12.

attempt to prevent the enforcement of arbitration clauses, even though the franchisees sued in California state court.⁶⁴

In reaching its decision that broadly construed the arbitration right, the Court articulated that the purpose of the FAA was to ensure that the arbitration right was placed on the *same footing* as any other contract right.⁶⁵ The *same footing* policy is important in analyzing the scope of various aspects of the arbitration right, including arbitration waiver.⁶⁶ Therefore, when this note examines the two approaches to waiver, it will consider which approach places the arbitration right on the *same footing* as all other contract rights.⁶⁷ This note will conclude that the approach that places the arbitration right on the *same footing* is the proper approach consistent with the FAA, as interpreted by the Court in *Southland*.⁶⁸

C. Arbitration Waiver

Section 2 of the FAA provides that “a contract . . . to settle by arbitration a controversy . . . shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*”⁶⁹ Arbitration waiver is one of the those grounds.⁷⁰ If a party who has a right to arbitrate under his contract waives that right, he must proceed in court and may not seek resolution of the matter in arbitration.⁷¹

An arbitration term can be waived by participating in litigation.⁷² This type of waiver occurs when a party brings a case to court, notwithstanding an arbitration term in his contract.⁷³ The participation by the party in a court proceeding may be conduct that reveals his intent to waive his contractual right to arbitrate.⁷⁴

64. *Id.* at 5, 10.

65. *Id.* at 16. Some might argue that the Court meant to put the arbitration on a better footing than other contract rights based upon the “national policy favoring arbitration” that it also enumerates in this case. *Id.* at 10. However, it is important to note that the “national policy favoring arbitration” exists merely to ensure “the enforcement of arbitration agreements.” *Id.*

66. *Southland*, 465 U.S. at 16; *see also* *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 389–90 (7th Cir. 1995) (citing *St. Mary’s Medical Center of Evansville, Inc. v. Disco Aluminum Prods. Co.*, 969 F.2d 585 (7th Cir.1992)) (suggesting that some courts improperly use the “federal policy favoring arbitration” to interpret arbitration clauses more favorably than other contract clauses. The courts should treat arbitration clauses “no less hospitably” than other contract clauses).

67. *Southland*, 465 U.S. at 16; *Cabinetree*, 50 F.3d at 390.

68. 465 U.S. at 16.

69. 9 U.S.C. § 2 (2012) (emphasis added).

70. *Id.*

71. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390 (7th Cir. 1995).

72. *Id.*

73. *Id.*

74. *Id.*

Although the circuits all agree that a showing must be made that the movant⁷⁵ participated in litigation, there is a circuit split as to whether any additional showing is necessary.⁷⁶ The minority approach is that the non-movant⁷⁷ need only show that the movant *participated in litigation*.⁷⁸ In contrast, the majority approach is that non-movant must show both that 1) the movant *participated in litigation* and that, from this *participation in litigation*, 2) he has suffered *prejudice*.⁷⁹ This note will begin with an examination of the majority approach, which requires a showing that the non-movant has suffered *prejudice*.⁸⁰

D. *The Majority Approach*

1. The participation element originates from the traditional waiver test

Because *Southland* requires that arbitration be put on the same footing as all other contract terms, it is important to consider the traditional contract law test for waiver and compare it to the arbitration waiver test applied by the circuits.⁸¹ In contract law, waiver is defined as the (1) “intentional relinquishment” of a (2) “known right.”⁸² In the arbitration context, the second part of this definition, the knowledge requirement, is typically not included as a separate element in the arbitration waiver analysis⁸³ because it is rarely difficult to prove; the movant is often the one who drafted the arbitration clause and thus has knowledge of his right to arbitrate.

75. The movant is the party who seeks to bring the case, now being litigated in court, to arbitration. Thus, the movant files a motion to stay the case, pending arbitration.

76. See *Erdman Co. v. Phoenix Land & Acquisition, LLC*, 650 F.3d 1115, 1118–19 (8th Cir. 2011) (“There is a circuit split over whether the party asserting waiver must show prejudice.”).

77. The non-movant is the party who does not want the case, now in court, to be brought to arbitration. Thus, he opposes the movant’s motion to stay the case, pending arbitration.

78. The following three cases hold that prejudice is not a required element in the waiver analysis, although it may be considered as a factor. *Hill v. Ricoh Ams. Corp.*, 603 F.3d 766, 774–75 (10th Cir. 2010); *St. Mary’s Med. Ctr. of Evansville, Inc. v. Disco Aluminum Prods. Co.*, 969 F.2d 585, 590 (7th Cir. 1992); *Nat’l Found. for Cancer Research v. A.G. Edwards & Sons, Inc.*, 821 F.2d 772, 777 (D.C. Cir. 1987).

79. For cases applying the 2-part participation and prejudice test, see *Citibank, N.A. v. Stok & Assocs., P.A.*, 387 F. App’x 921, 923 (11th Cir. 2010); *Crossville Med. Oncology, P.C. v. Glenwood Sys., LLC*, 310 F. App’x 858, 859 (6th Cir. 2009); *Forrester v. Penn Lyon Homes, Inc.*, 553 F.3d 340, 343 (4th Cir. 2009); *Ehleiter v. Grapetree Shores, Inc.*, 482 F.3d 207, 222 (3d Cir. 2007); *Walker v. J.C. Bradford & Co.*, 938 F.2d 575, 577 (5th Cir. 1991); *Sweater Bee by Banff, Ltd. v. Manhattan Indus., Inc.*, 754 F.2d 457, 461 (2d Cir. 1985). For cases applying the 3-part test, which includes a knowledge requirement, see *Erdman*, 650 F.3d at 1117; *Fisher v. A.G. Becker Paribas Inc.*, 791 F.2d 691, 694 (9th Cir. 1986). For a case applying an alternative test, see *Jones Motor Co. v. Chauffeurs, Teamsters & Helpers Local Union No. 633 of New Hampshire*, 671 F.2d 38, 44 (1st Cir. 1982) (applying a 6-factor test).

80. *E.g.*, *Erdman*, 650 F.3d at 1117 (applying the 3-part test).

81. *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984).

82. *Ryder v. Bank of Hickory Hills*, 146 Ill. 2d 98, 104 (1991).

83. See *supra* note 79 for cases that entirely omit the knowledge requirement from their arbitration waiver test and instead focus solely on participation and prejudice.

In contrast, the first part of this definition, the intent requirement, is embodied in the *participation in litigation* element of the arbitration waiver test.⁸⁴ In essence, the movant's *participation in litigation* is conduct that implies his intent to waive his arbitration right.⁸⁵

2. The origins of the prejudice element

Intent and knowledge are the only elements required by the traditional contract law theory of waiver.⁸⁶ However, in the majority of circuits, courts have added a third element, prejudice, to show arbitration waiver.⁸⁷ This element is absent from the traditional contract law waiver test.⁸⁸ Because of its absence from the traditional test, some have argued that it should be eliminated from the arbitration waiver test as well.⁸⁹ Therefore, this note will examine the origin of the prejudice requirement in the arbitration context.

Prejudice appears to originate from a Second Circuit case, *Carcich v. Rederi A/B Nordie*.⁹⁰ In that case, longshoremen were injured while working on a ship.⁹¹ They sued the ship's owners, and the owners then brought a third-party complaint against the shipping company, the Cunard Steamship Company ("Cunard").⁹² On July 15, 1964, Cunard answered the complaint, arguing that the case should be arbitrated pursuant to a term in their contract.⁹³ However, Cunard did not officially move to stay the case pending arbitration until November 1966.⁹⁴ The district court denied the motion, and Cunard appealed.⁹⁵

The plaintiffs argued that Cunard, by taking over two years to move to stay the proceedings, waived its contractual right to arbitrate.⁹⁶ However, the Second Circuit disagreed, finding that there was no waiver.⁹⁷ Although the court admitted that taking two years was certainly an act inconsistent with the right to arbitrate, this "mere delay" was not enough.⁹⁸ There needed to be

84. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390 (7th Cir. 1995).

85. *Id.*; see also *Ryder*, 146 Ill. 2d at 105 ("Waiver may be made by an express agreement or it may be implied from the conduct of the party who is alleged to have waived a right.")

86. *Ryder*, 146 Ill. 2d at 104.

87. *E.g.*, *Erdman Co. v. Phoenix Land & Acquisition, LLC*, 650 F.3d 1115, 1117 (8th Cir. 2011).

88. *Ryder*, 146 Ill. 2d at 104.

89. See *infra* Part II.E; see also *infra* Part III.

90. *Erdman*, 650 F.3d at 1120 n.4 ("We can trace the origins of our prejudice requirement to *Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 (2d Cir.1968).").

91. *Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 693–94 (2d Cir. 1968).

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.* at 696.

96. *Id.*

97. *Carcich*, 389 F.2d at 696.

98. *Id.*

some showing of prejudice to the plaintiffs, and that element was absent here.⁹⁹

In subsequent cases, the Second Circuit has explained that prejudice relates to some sort of “inherent unfairness—in terms of delay, expense, or damage to a party’s legal position—that occurs when the party’s opponent forces it to litigate an issue and later seeks to arbitrate that same issue.”¹⁰⁰ Thus, there are two parts to the prejudice analysis: (1) the *delay and expense sub-element*, and (2) the *legal position sub-element*.¹⁰¹ In *Carcich*, for example, the court observed that prejudice would have been found if the movant could be shown to have taken “unfair advantage of discovery proceedings which would not have been available to it in arbitration”¹⁰² While the *delay and expense sub-element* was present, the *legal position sub-element* was absent because the defendant had not availed himself of the mechanisms of discovery.¹⁰³ Therefore, the court found that there was no prejudice to the plaintiffs, and Cunard could properly move the matter from litigation to arbitration.¹⁰⁴

The *legal position sub-element* of prejudice is a fact-specific inquiry, and several factors often lead to a finding of damage to one’s legal position, although none are conclusive.¹⁰⁵ The factors include: (1) the use of depositions, (2) the filing of motions on the merits, and (3) the raising of “thirteen affirmative defenses.”¹⁰⁶

Thus, the prejudice element, which focuses on the unfairness to the non-movant resisting arbitration, has a long-standing history in arbitration law.¹⁰⁷ Nevertheless, in recent years, at least three circuits have begun to question the need for this element in the arbitration waiver test.¹⁰⁸

99. *Id.*

100. PPG Indus., Inc. v. Webster Auto Parts, Inc., 128 F.3d 103, 107 (2d Cir. 1997).

101. *Id.*; see 3 Commercial Arbitration § 50:48 (2012) (“The true test of prejudice is not delay alone. Rather, the waiver of the right to arbitrate must be viewed both as to the length of time the court case has continued as well as the degree to which the party (who later proposes arbitration) has engaged the machinery of litigation. This makes the assessment of prejudice a qualitative judgment as to the intensity of the litigation.”); see also Frye v. Paine, Webber, Jackson & Curtis, Inc., 877 F.2d 396, 399 (5th Cir. 1989) (holding that “[b]oth delay[s] and the extent of the moving party’s participation in judicial proceedings” factor into a determination of prejudice).

102. 389 F.2d at 696.

103. *Id.*

104. *Id.*

105. Rush v. Oppenheimer & Co., 779 F.2d 885, 887–91 (2d Cir. 1985).

106. *Id.*; see S. Broward Hosp. Dist. v. Medquist, Inc., 258 F. App’x 466, 467–68 (3d Cir. 2007) (ruling that contests over the merits of a case suggest prejudice but non-merit motion practice does not cause prejudice unless it is extensive); see also Baker v. Conoco Pipeline Co., 280 F. Supp. 2d 1285, 1301 (N.D. Okla. 2003) (finding that the movant’s use of “[l]imited interrogatories,” but not depositions, prior to moving to stay arbitration did not prejudice the non-movant).

107. *Carcich*, 389 F.2d at 696 (2d Cir. 1968); see *Rush*, 779 F.2d at 887 (citing *Carcich*, 389 F.2d at 696); see also Erdman Co. 650 F.3d at 1120 n.4 (recognizing that *Carcich*, 389 F.2d at 696, was the origin of the prejudice element).

108. *Hill*, 603 F.3d at 772–73; *St. Mary’s Med. Ctr. of Evansville, Inc.*, 969 F.2d at 590–91; *Nat’l Found. for Cancer Research*, 821 F.2d at 777.

E. *The Minority Approach*

Three circuits have chosen to eliminate prejudice as an element of arbitration waiver.¹⁰⁹ Instead, they focus on the *participation in litigation* element that examines how a movant's participation in litigation may reveal an intent to forfeit his or her right to move the case to arbitration.¹¹⁰ In discussing the minority approach, this note will analyze the Seventh Circuit's arbitration waiver test, primarily because this circuit goes the furthest in eliminating almost all vestiges of prejudice from its waiver analysis.¹¹¹ The Seventh Circuit reached its current waiver test through two cases.¹¹² First, in *St. Mary's Medical Center of Evansville, Inc. v. Disco Aluminum Products Co.*, the Seventh Circuit turned prejudice from an element of arbitration waiver into a mere factor.¹¹³ Prejudice would remain part of the analysis, but a showing of prejudice was no longer required to prove arbitration waiver.¹¹⁴ Second, three years later, in *Cabinetree of Wisconsin, Inc. v. KraftMaid Cabinetry Inc.*, the Seventh Circuit did something even more revolutionary; in an opinion written by Chief Judge Posner, the Circuit almost completely eliminated the role of prejudice in the waiver analysis.¹¹⁵

III. INSTANT CASE

A. *Factual Background*

Cabinetree was a retailer of kitchen cabinets, sinks, faucets, and similar items.¹¹⁶ In 1989, it entered into a written agreement with KraftMaid, a manufacturer of cabinets, to purchase its products.¹¹⁷ In addition to their written contract, the parties also orally agreed that Cabinetree would be the exclusive retailer of KraftMaid products in the Milwaukee/Waukesha area.¹¹⁸ For about two years, the relationship went well.¹¹⁹

109. The following three cases hold that prejudice is not a required element in the waiver analysis, although it may be considered as a factor: *Hill*, 603 F.3d at 772–75; *St. Mary's Med. Ctr. of Evansville, Inc.*, 969 F.2d at 590; *Nat'l Found. for Cancer Research*, 821 F.2d at 777–78.

110. See *St. Mary's Med. Ctr. of Evansville, Inc.*, 969 F.2d at 589 (“The district court could reasonably conclude from all of this that Disco acted inconsistently with any intent to assert its right to arbitrate”).

111. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390 (7th Cir. 1995) (“Today we take the next step in the evolution of doctrine, and hold that an election to proceed before a nonarbitral tribunal for the resolution of a contractual dispute is a presumptive waiver of the right to arbitrate.”).

112. *Id.*; *St. Mary's*, 969 F.2d at 590.

113. 969 F.2d at 590.

114. *Id.*

115. *Cabinetree*, 50 F.3d at 390–91.

116. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 914 F. Supp. 296, 297 (E.D. Wis. 1996) (hereinafter “Cabinree II”).

117. *Id.* at 297–98.

118. *Id.* at 297–99.

119. *Id.* at 299.

However, in 1992, things began to sour when KraftMaid started selling its products to two other retailers—Menards and Handy Andy—in the Milwaukee/Waukesha area.¹²⁰ The competition from these two retailers caused a drop in Cabinetree’s sale of KraftMaid products.¹²¹ In response to this drop in sales, KraftMaid told Cabinetree that it would no longer sell its cabinets to Cabinetree on credit.¹²²

Cabinetree viewed the failure to extend credit as termination of a franchise relationship and the sale to other retailers in the Milwaukee/Waukesha area as a breach of an oral exclusivity agreement.¹²³ Cabinetree sued in Wisconsin state court on September 30, 1993.¹²⁴ On November 4, 1993, KraftMaid removed the case to federal district court.¹²⁵ Then, on July 11, 1994, KraftMaid “dropped a bombshell into the proceedings” when it moved to stay the matter pending arbitration.¹²⁶ The district court denied the motion, and KraftMaid appealed.¹²⁷

B. *Holding and Reasoning*

On appeal, the Seventh Circuit held that KraftMaid had waived its contractual right to move to stay the case pending arbitration.¹²⁸ In so finding, the court enumerated a new rule for arbitration waiver: “an election to proceed before a nonarbitral tribunal for the resolution of a contractual dispute is a presumptive waiver of the right to arbitrate.”¹²⁹ Thus, the court focused the waiver inquiry solely on what the movant did or did not do; it eliminated almost any inquiry into the prejudice element.¹³⁰ Because KraftMaid had removed the case to federal court without also moving to stay the case pending arbitration, it elected to forgo its right to assert the arbitration right.¹³¹

The court found that this new rule was better founded in contract law.¹³² In the court’s view, the prejudice element was not consistent with the

120. *Id.*

121. *Id.*

122. *Cabinetree II*, 914 F. Supp. at 299.

123. *Id.* at 297, 299.

124. *Id.* at 297.

125. *Id.*

126. *Cabinetree*, 50 F.3d at 389; *Cabinetree II*, 914 F. Supp. at 297.

127. *Cabinetree II*, 914 F. Supp. at 297.

128. *Cabinetree*, 50 F.3d at 391.

129. *Id.* at 390.

130. *Id.* However, note that the court allowed for a very narrow exception where prejudice might apply. *Id.* at 391. If the movant could establish that special circumstances existed, such as “doubts about arbitrability,” then the burden would shift to the movant to establish prejudice. *Id.* Nevertheless, absent a showing of special circumstances, this rule places the burden squarely on the party who wishes to uphold the contract. *Id.*

131. *Cabinetree*, 50 F.3d at 390.

132. *Id.*

traditional contract law waiver test, which focuses on intent.¹³³ It explained that adding the prejudice element put the arbitration right on a better footing than all other contract rights, and the right to arbitrate should only be put on the same footing as all other contract rights.¹³⁴

According to the court, if the arbitration right is to be put on the same footing as all other contract terms, the intent-based waiver test must be used.¹³⁵ The court found that intent could be implied from KraftMaid's conduct.¹³⁶ Because KraftMaid's conduct of removing the case to federal court without moving to stay the case pending arbitration showed an intent to waive its arbitration right, the court held that Cabinetree presumptively waived its right to arbitrate.¹³⁷

IV. ANALYSIS

A. *A major flaw in the Cabinetree approach*

Although the Seventh Circuit's presumptive waiver rule has gained some academic praise, this approach is flawed because it lacks any basis in contract law notions of waiver.¹³⁸

When examining contract law, one finds that it is nearly impossible for courts to imply waiver of a contract term based on conduct alone.¹³⁹ One court stated that implied waiver only arises where there are "undisputed acts or language so inconsistent with a purpose to stand on the contract provisions as to leave no opportunity for a reasonable inference to the contrary."¹⁴⁰ A Texas court acknowledged the difficulty of proving implied waiver, stating that "without an admission of waiver by the opposite party, it is difficult to prove waiver as a matter of law."¹⁴¹

133. *Id.*; *Ryder*, 585 N.E.2d at 49.

134. *Cabinetree*, 50 F.3d at 390–91.

135. *Id.*; *Ryder*, 585 N.E.2d at 104–05. Once again, it is noted that the knowledge element is rarely an issue in arbitration waiver because the party asserting waiver is usually the party who drafted the arbitration clause. *See supra* note 79 for cases that entirely omit the knowledge requirement from their arbitration waiver test and instead focus solely on participation and prejudice.

136. *Cabinetree*, 50 F.3d at 390.

137. *Id.*

138. *Id.* For an example of an article favoring the adoption of the *Cabinetree* presumption in other circuits, see Zachary Kerner, *Jung v. Skadden, Arps, Slate, Meagher & Flom*, 53 N.Y.L. SCH. L. REV. 179, 188–89 (2009).

139. *Cohen v. Independence Blue Cross*, 820 F. Supp. 2d 594, 606 (D.N.J. 2011).

140. *Id.*; *see also Sturbridge Home Builders, Inc. v. Downing Seaport, Inc.*, 890 A.2d 58, 65 (R.I. 2005) ("A waiver may be proved indirectly by facts and circumstances from which intention to waive may be clearly inferred.") (citing 28 AM. JUR. 2d *Estoppel and Waiver* § 225 (2000)). It is also interesting to note that the Seventh Circuit, in applying Illinois law in a diversity case, restated this very same rule: an implied waiver must be "clearly inferable from the circumstances." *Bank v. Truck Ins. Exch.*, 51 F.3d 736, 739 (7th Cir. 1995).

141. *RM Crowe Prop. Servs. Co., v. Strategic Energy, L.L.C.*, 348 S.W.3d 444, 449 (Tex. Ct. App. 2011).

The reluctance of courts to imply waiver of a contractual term is at the very heart of contract law.¹⁴² A contract right is bargained for, and its terms represent the express intent of the parties.¹⁴³ Even with contracts of adhesion, the parties have the opportunity to read the contract, and they manifest their express intent to be bound by entering into the agreement.¹⁴⁴ This express intent should not be lightly overturned through implied intent inferred from actions or inactions of questionable meaning.¹⁴⁵

In fact, the Seventh Circuit, the very same court that was willing to imply waiver in the arbitration context, has acknowledged the danger of implying waiver in another context.¹⁴⁶ In a case involving an alleged breach of contract by an insurance company, the court discussed the “inherent implausibility of offers to prove ‘bare’ waiver in a contractual setting.”¹⁴⁷ The court noted that “[u]nless the right waived is a minor one . . . , why would someone give it up in exchange for nothing?”¹⁴⁸

It is clear that an arbitration clause represents the parties’ express intent to resolve any disputes between them by arbitration.¹⁴⁹ Under a traditional contract law waiver theory, conduct may implicitly waive a contract right only if it clearly manifests an intent to forgo that right.¹⁵⁰ A party’s participation in litigation, however, is not conduct that clearly manifests an intent to forgo the arbitration right because there are other reasonable inferences that can be drawn from a party’s election to bring a case to court.¹⁵¹ As the Seventh Circuit itself noted, a party might not be certain if an issue is arbitrable.¹⁵² If that party arbitrates and then learns that the issue is not arbitrable, the statute of limitations might have passed, and the court might refuse to litigate the matter.¹⁵³ Therefore, a party might bring a case to court merely with the intent of determining whether an issue may be arbitrated.¹⁵⁴ Notice that the party’s intent to determine whether an issue may be arbitrated is not an intent to forgo the arbitration right.¹⁵⁵

Therefore, it may not properly be said that participation in litigation clearly manifests an intent to forgo arbitration.¹⁵⁶ The minority approach is

142. *Bank*, 51 F.3d at 739–40.

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *Bank*, 51 F.3d at 739–40.

149. *Id.*

150. *Cohen*, 820 F. Supp. 2d at 606.

151. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 390–91 (7th Cir. 1995).

152. *Id.*

153. *See id.* (acknowledging that there are a “variety of circumstances” that do not suggest an intention to forgo the arbitration right).

154. *Id.*

155. *Id.*

156. *Id.*

simply not grounded in contract law; an intent to forgo arbitration is not clearly inferable from a party's participation in litigation.¹⁵⁷

B. *The sound basis for the majority approach in traditional notions of estoppel*

The majority approach states that arbitration waiver requires both *participation in litigation* and *prejudice*.¹⁵⁸ While the Seventh Circuit correctly noted that prejudice is absent from the traditional waiver test, it failed to consider whether another contract law theory might support the majority rule.¹⁵⁹ If it had, the Seventh Circuit might have found justification for the majority rule in the theory of waiver by estoppel.¹⁶⁰

Under waiver by estoppel, a contract right is given up if the waiving party's conduct causes the non-waiving party to be "misled to his or her *prejudice* by the conduct of the other party into the honest and reasonable belief that the other party was not insisting upon some right."¹⁶¹ Unlike waiver, estoppel is a doctrine founded upon equity and fairness.¹⁶² It is not necessarily meant to give effect to the party's intent.¹⁶³ Instead, estoppel prevents injustice by prohibiting a party from "repudiat[ing] a course of action on which another party has relied to his detriment."¹⁶⁴

The majority view on arbitration waiver should be adopted by all of the circuits because only this test is consistent with a traditional contract law theory—waiver by estoppel.¹⁶⁵ As even proponents of the minority view recognize, arbitration waiver is about whether it is *fair* to subject the non-moving party to arbitration when the movant has participated in litigation.¹⁶⁶ To answer this fairness inquiry, the majority view properly focuses on the question of prejudice, which asks whether the non-moving party has detrimentally relied on the moving party's participation in litigation.¹⁶⁷ By focusing on fairness and by assessing fairness in terms of detrimental

157. *Cabinetree*, 50 F.3d at 390–91.

158. *E.g.*, *Erdman Co.*, 650 F.3d at 1117.

159. *See Cabinetree*, 50 F.3d at 390–91.

160. *Id.*; 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.).

161. 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.) (emphasis added); *see also Saverslak v. Davis-Cleaver Produce Co.*, 606 F.2d 208, 213 (7th Cir. 1979) ("An estoppel . . . arises only when a party's conduct misleads another to believe that a right will not be enforced and causes him to act to his detriment in reliance upon this belief.").

162. *Knorr v. Smeal*, 836 A.2d 794, 799 (N.J. 2003).

163. *Oakland Raiders v. Oakland-Alameda Cnty. Coliseum, Inc.*, 51 Cal. Rptr.3d 144, 153–54 (Cal. Ct. App. 2006) ("While the question of waiver ordinarily turns on the intent of the party against whom it is asserted, estoppel focuses solely on the party's *conduct* . . .").

164. *Knorr*, 836 A.2d at 799.

165. *Erdman Co.*, 650 F.3d at 1117; 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.).

166. *Cabinetree*, 50 F.3d at 391 ("Neither in its briefs nor at oral argument did Kraftmaid give any reason for its delay in filing the stay besides needing time 'to weigh its options.' That is the worst possible reason for delay . . . It wanted to play heads I win, tails you lose.").

167. *E.g.*, *Erdman Co.*, 650 F.3d at 1117.

reliance, the majority view has adopted the traditional contract law notion of estoppel, which permits courts to avoid giving contracts their full effect when it would not be equitable.¹⁶⁸

Because the majority view has adopted this test from contract law and the minority view has not, only the majority view truly places the arbitration right on the same footing as all other contract rights.¹⁶⁹ Therefore, it is incumbent on all the circuits to maintain or adopt the majority view on arbitration waiver because only this view is consistent with the FAA, which has been interpreted to require that the arbitration right be put on the same footing as all contract rights.¹⁷⁰

V. CONCLUSION

As this note has discussed, in order for the arbitration right to be placed on the same footing as other contract rights, a court should require the non-movant to prove that he has suffered some prejudice, such that the movant should be estopped from moving to stay the case, pending arbitration.¹⁷¹ Note that, by enforcing arbitration like all other contract rights, society appreciates many benefits.¹⁷² Facilitating arbitration reduces the cost, and increases the efficiency, of dispute resolution.¹⁷³ These reduced costs and increased efficiencies¹⁷⁴, which often benefit businesses directly, may also flow to consumers in the form of lower prices and higher value.

Despite these benefits, perhaps it is unfair for arbitration clauses to be treated the same as all other contractual clauses.¹⁷⁵ For example, there are concerns that arbitrators may not be as unbiased as state and federal judges, and they may favor the business party over the consumer.¹⁷⁶ This same concern applies to arbitration waiver as well, where it seems unfair that a party may bring a case to court “to weigh its options” and then move to stay the case pending arbitration.¹⁷⁷ The Seventh Circuit has called this a game of “heads I win, tails you lose.”¹⁷⁸

168. *Id.*; 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.).

169. *Southland Corp.*, 465 U.S. at 15-16; *Erdman Co.*, 650 F.3d at 1117.

170. 9 U.S.C.A. § 2 (West 2012); *Southland*, 465 U.S. at 15-16; *Erdman Co.*, 650 F.3d at 1117.

171. 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.).

172. Spencer, *supra* note 4, at D1.

173. *Id.*

174. *Id.*

175. *Editorial*, *supra* note 6.

176. *Id.*

177. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 391 (7th Cir. 1995).

178. *Id.*

Nevertheless, this line of reasoning ignores a very fundamental principal to American jurisprudence—freedom of contract.¹⁷⁹ It is important to be mindful that arbitration is not being forced on the parties.¹⁸⁰ Instead, the parties have voluntarily agreed to enter into a contract with a mandatory arbitration clause.¹⁸¹ In so doing, they have the power both to craft an arbitration clause in whatever way they see fit, or, at the very least, to refuse to enter into it.¹⁸² Their election to enter into a contract, rather than a court’s after-the-fact second-guessing, should generally signal its inherent fairness, absent evidence of fraud, duress, or coercion.¹⁸³

Furthermore, even in cases where a court finds after-the-fact that enforcement of a contract is unfair, contract law affords the court some latitude not to enforce the contract under the doctrine of estoppel.¹⁸⁴ This doctrine, embodied in the majority approach’s prejudice requirement, is a workable test that should prevent any game of “heads I win, tails you lose.”¹⁸⁵

Courts, such as the Seventh Circuit, are not free to weaken the arbitration waiver test such that it does not comport with general contract law.¹⁸⁶ Eliminating the *prejudice* requirement has exactly that result.¹⁸⁷ It places arbitration on a lesser footing than all other contract provisions.¹⁸⁸ In the FAA, Congress decided to place arbitration on the same footing as all other

179. See 16B AM. JUR. 2d *Constitutional Law* § 641 (2012) (discussing freedom of contract and how “courts will not limit this freedom to contract except under certain situations, such as the provision being against public policy, made under fraud or duress, and other considerations where the court in a legal proceeding has before it the unreasonableness of the contract provision”).

180. *Id.*

181. *Id.*

182. *Id.* (“The freedom of contract also entails the freedom not to contract.”). This argument is particularly compelling in cases such as *Southland* and *Cabinetree*, where the parties were both businesses. In contrast, where one of the parties is a consumer and the other is a business, it could be argued that the first power, the power to craft the agreement, is not present. Of course, the second power, the power to refuse to enter the contract, remains.

183. 16B AM. JUR. 2d *Constitutional Law* § 641 (2012).

184. 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.).

185. *Cabinetree of Wis., Inc. v. Kraftmaid Cabinetry, Inc.*, 50 F.3d 388, 391 (7th Cir. 1995); 13 WILLISTON ON CONTRACTS § 39:29 (4th ed.). In reality, the problem is not the prejudice requirement at all. The real potential for abuse, which could create the “heads I win, tails you lose” situation, arises if courts fail to strictly apply the prejudice factors discussed in the text accompanying note 107. See *Cabinetree*, 50 F.3d at 391 (referring to “heads I win, tails you lose”). However, courts adhering to the majority view do in fact apply these factors strictly. For example, although the Fifth Circuit maintains “[a] presumption against waiver” and places “a heavy burden of proof” on the party asserting waiver, it acknowledges that “[a]ny attempt to go to the merits and to retain still the right to arbitration is clearly impermissible.” *Petroleum Pipe Americas Corp. v. Jindal Saw, Ltd.*, 575 F.3d 476, 481 (5th Cir. 2009) (quotations omitted).

186. *Cabinetree*, 50 F.3d at 391.

187. *Id.*

188. *Id.*

contract provisions.¹⁸⁹ Only Congress, not the courts, is free to change this policy.¹⁹⁰

189. *Southland Corp. v. Keating*, 465 U.S. 1, 13 (1984) (citing H.R. REP. NO. 96, 68th Cong., 1st Sess. 1 (1924)).

190. *Id.* The need for judicial restraint in this instance is particularly important because the FAA was passed to overturn a common law precedent against arbitration.