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A commentary article reprinted from the December 2019 issue of Mealey's International Arbitration Report

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Commentary

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Introduction

In the 1989 decision of *Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior University*, the United States Supreme Court held that, though the Federal Arbitration Act ("FAA") pre-empts state laws to the extent of any conflicts, it does not "prevent enforcement" of state rules where "parties have *chosen* in their agreement to abide by the state rules of arbitration."[1] Perhaps more controversially, the Supreme Court declined to disturb the decision of the intermediate California court that the relevant contract's generic choice-of-law clause sufficed, as a matter of California law, to incorporate the California rules of arbitration into the contract.[2] The Court based its reasoning on the assertion that "the interpretation of private contracts is ordinarily a question of state law, which this Court does not sit to review."[3]

Since *Volt*, federal courts have wrestled with what role state law should play in the analysis of whether the parties have "chosen in their agreement to abide by the state rules of arbitration." Those efforts became more complicated after *Mastrobuono v. Shearson Lehman Hutton, Inc.* in 1995.[4] In that decision, which construed a New York choice-of-law clause, the Court conspicuously did not apply New York contract law to determine whether the generic clause in question incorporated New York's arbitration rules. Instead, it applied general principles of contract interpretation to conclude that, in that particular contract, the choice-of-law clause was not intended to replace the FAA.[5] The Court's only attempt to reconcile the seeming inconsistency with the approach in *Volt* was to note in passing that *Volt* involved deference to a state court's construction of the contract in question, whereas *Mastrobuono* involved *de novo* review of a federal court decision.[6]

Lower federal courts have interpreted the interplay between *Volt* and *Mastrobuono* in various ways. Some have reasoned that the primary difference is whether a case originates in state court, in which case a federal court must defer to the state court's interpretation of a generic choice-of-law clause, or in federal court, where no deference is needed.[7] Others have concluded that state contract-interpretation rules apply *only* when the state arbitration law at issue does not conflict with federal policy, and that federal courts otherwise should apply federal interpretive law to assess whether the parties truly intended to select state arbitration law to the exclusion of the FAA.[8] Still others appear to treat *Mastrobuono* as establishing that a generic choice-of-law provision will almost never be enough to displace the FAA.[9] In each of these cases, federal courts will typically ignore state contract law entirely when interpreting the scope of a generic choice-of-law provision.[10]

However, parties wishing to include both an arbitration clause and a choice-of-law clause in their contract ignore state law at their peril. While the lower federal courts appear to have narrowed *Volt*'s holding regarding deference to state interpretations of choice-of-law clauses, the Supreme Court recently reaffirmed that aspect of *Volt*'s holding.[11] No matter the tension with *Mastrobuono*, it appears that state contract law still has a role to play in at least some federal court decisions concerning the scope of choice-of-law clauses. Moreover, because the FAA does not confer subject matter jurisdiction, many domestic arbitration agreements will ultimately be construed in *state* court. Accordingly, parties who expect that the FAA will govern their arbitration should be aware of state law rules about the effect of including a choice-of-law clause. This article examines the state of the law in five of the largest states.

New York

While *Mastrobuono* was still pending, New York's highest court—the Court of Appeals—ruled in *Smith Barney Harris Upham & Co. v. Luckie* that a choice-of-law clause that provided that New York law supplied the "basis of decision for questions concerning not only the agreement, but more critically, its enforcement" justified a decision to differ from the result that would have been dictated by the FAA.[12] The Second Circuit Court of Appeals immediately questioned the continuing vitality of this holding based on the fact that it relied in its reasoning on the appellate court decision later overturned by *Mastrobuono*.[13] However, New York courts continued to cite to the decision, and in 2005, the New York Court of Appeals revisited the issue. The New York Court of Appeals upheld *Luckie*'s holding as to clauses that specify that the choice of law will apply to enforcement, but made clear that in the "absence of more critical language concerning enforcement in the choice of law clause," the court should not conclude that New York's arbitration rules apply instead of the FAA's.[14] The effect of the two decisions is to establish that New York's arbitration rules will only replace the FAA's when the parties include specific language in their choice-of-law clause making clear their intent to do so.

California

Since *Volt*, at least some California courts have scaled back the conclusion that a generic choice of law clause incorporates California's arbitration rules. In a widely cited opinion in *Mount Diablo Medical Center v. Health Net of California, Inc.*, an intermediate California court acknowledged the New York Court of Appeals' decision in *Luckie*, the Supreme Court's decision in *Mastrobuono*, and the assortment of federal courts to adopt default rules in the wake of *Mastrobuono*—all suggesting that a generic choice-of-law clause is not enough to select state arbitration law over the FAA.[15] It rested its decision on the fact that the clause in question, like that in *Luckie*, specified that California law would govern the contract's "*enforcement*" and not just its interpretation."[16] This said, another California intermediate appellate court recently interpreted a generic choice-of-law provision with no reference to "enforcement" to select state arbitration law.[17] Accordingly, the law in California should be considered unsettled.

Texas

Like New York and at least some California courts, Texas' highest court has held that the applicability of its own state's arbitration statute depends on the precise language of the arbitration clause. In *In re Olshan Foundation Repair Co., LLC*, the Supreme Court of Texas was faced with the question of whether the Texas Arbitration Act ("TAA") or the FAA governed each of four consumer claims against a company—if the TAA applied, then the arbitration agreements would be deemed unenforceable, whereas if only the FAA applied, the defendant could compel arbitration.[18] Three of the four claims were subject to arbitration agreements providing for arbitration "pursuant to the arbitration laws in your state."[19] The remaining agreement provided for arbitration "pursuant to the Texas General Arbitration Act."[20]

The court observed broadly that "[c]ourts rarely read such general choice-of-law provisions to choose state law to the exclusion of federal law."[21] It then turned to the language of the two provisions at issue. It concluded that the provision to arbitrate "pursuant to the arbitration laws in your state" did not demonstrate an intent to select Texas arbitration law to the exclusion of the FAA, since "just as the FAA is part of the substantive law of Texas, the FAA would be part of the arbitration laws in Texas."[22] So, the parties to agreements with that provision could compel arbitration under the FAA, notwithstanding that the arbitration agreement would be unenforceable under the TAA. In contrast, for the agreement providing for arbitration "pursuant to the Texas General Arbitration Act," the court concluded that because the FAA was not *part of*

the TAA specifically, the TAA governed "at least to the extent the two are inconsistent."[23] Because the TAA rendered that agreement unenforceable, the court refused to compel arbitration. Thus, in Texas, parties must specifically reference the TAA if they wish it to apply in lieu of the FAA.

Illinois

While the Illinois Supreme Court has not spoken on the issue, several of the state's intermediate appellate courts have concluded that generic choice-of-law clauses establish what law governs the arbitration, even when the state law would otherwise be preempted by the FAA. *Glazer's Distributors of Illinois, Inc. v. NWS-Illinois, LLC*[24] offers a paradigmatic example. The contracts at issue in *Glazer's* selected Illinois law.[25] The court explained that because the parties had selected Illinois law and "there [wa]s nothing in those contracts to support a conclusion that Illinois law was inapplicable to the arbitration provision," Illinois law applied to whether the party seeking to compel arbitration had earlier waived the right to arbitration.[26] The FAA "d[id] not apply, even where interstate commerce [wa]s involved."[27]

Other Illinois courts have reached similar conclusions,[28] including—interestingly—as to generic choice-of-law clauses that select the law of *other* states.[29] There are, however, some outliers. One intermediate appellate court intimated that "general choice-of-law clauses do not incorporate state rules which govern allocation of authority between arbitrators and courts,"[30] but ultimately resolved the question on other grounds.[31] Nevertheless, parties wishing to adopt Illinois' substantive law but resolve arbitration disputes under the FAA should be careful to reference the FAA explicitly in their contract.

Florida

Florida's intermediate appellate courts generally conclude that where the parties have adopted a generic choice of law clause, the FAA preempts state law whenever the two conflict to any degree. For example, one court held that where an agreement was governed by the laws of the State of New York but also adopted a broad arbitration provision, the "contract [did] not show an intent to apply a state law which would remove from arbitration an issue that would otherwise be arbitrable under the FAA."[32]

Several Florida courts have gone even further than the federal courts, suggesting that even where a contract plainly evidences the parties' intent to have state arbitration laws govern the arbitration, a court still may never apply state law when in conflict with the FAA. In one case, the court concluded that while it was "permissible" under *Volt* to specify "the procedures of the Florida Arbitration Code as being applicable to [the] transaction," the arbitration agreements . . . must still be enforced in a way which is consistent with the substantive provisions of the FAA."[33] While the Florida Supreme Court overturned the decision on other grounds, it agreed that "the FAA was implicated" despite the choice-of-law provision.[34] Another case stated that "[i]t is settled that the parties to an arbitration agreement involving commerce may contract to apply the arbitration laws of a specific state—but *only* so long as that state's arbitration laws are not in conflict with [the United States Arbitration Act]."[35] In general, Florida courts seem unwilling to read choice-of-law clauses as evincing an intent to replace the FAA.

Conclusion

Of the five large states profiled here—New York, California, Texas, Illinois, and Florida—only Illinois has wholeheartedly taken the Supreme Court's invitation in *Volt* to construe a generic choice-of-law clause as evincing an agreement to replace the FAA. The other states, like the federal circuit courts that have wrestled with the issue, have adopted rules designed to ensure that only those parties that truly intended to agree to be governed by a state's arbitration code will find themselves bound by its terms. Together, their decisions reflect a concern that parties not find out after the fact that, by choosing the law to govern their agreement, they inadvertently excluded themselves from taking advantage of the FAA. The fact that the Illinois intermediate courts have taken a different approach, however, counsels that, before agreeing that their agreement will be governed by the law of an unfamiliar state, parties should investigate whether that decision will have unforeseen implications for whether and how they can enforce their arbitration agreements.

Endnotes

1. 489 U.S. 468, 472 (1989) (emphasis added).
2. *Id.* at 470-72; 474.

3. *Id.* at 474.

4. 514 U.S. 52 (1995).

5. *See id.* at 62–63.

6. *See id.* at 60 n.4.

7. *See, e.g.*, *Ferro Corp. v. Garrison Indus., Inc.*, 142 F.3d 926, 934–35 (6th Cir. 1998); *PaineWebber Inc. v. Elahi*, 87 F.3d 589, 594 n.5 (1st Cir. 1996).

8. *See, e.g.*, *P.R. Tel. Co. v. U.S. Phone Mfg. Corp.*, 427 F.3d 21, 28–29 (1st Cir. 2005); *Roadway Package Sys. v. Kayser*, 257 F.3d 287, 295–96, 298–99 (3d Cir. 2001), *abrogated on other grounds by Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576 (2008). Also following this principle, the Second Circuit applied *state* contract law where it determined that there was no substantive conflict between the state arbitration rule at issue and the FAA. *See Security Ins. Co. of Hartford v. TIG Ins. Co.*, 360 F.3d 322, 327–28 (2d Cir. 2004).

9. *See UHC Mgmt. Co. v. Comp. Scis. Corp.*, 148 F.3d 992, 996 (8th Cir. 1998); *Ferro Corp.*, 142 F.3d at 936; *Porter Hayden Co. v. Century Indem. Co.*, 136 F.3d 380, 382–83 (4th Cir. 1998).

10. *See, e.g.*, *Dialysis Access Center LLC v. RMS Lifeline Inc.*, 932 F.3d 1, 8 (1st Cir. 2019) ("Given our case law, we reiterate—a general choice-of-law contract provision is not enough to displace the FAA's standard of review . . . .").

11. *See DIRECTV, Inc. v. Imburgia*, 136 S. Ct. 463, 468 (2015) ("[T]he Federal Arbitration Act allows parties to an arbitration contract considerable latitude to choose what law governs some or all of its provisions, including the law governing enforceability of a class-arbitration waiver. In principle, they might have portions of their contract governed by the law of Tibet [or] the law of pre-revolutionary Russia . . . . Since the interpretation of a contract is ordinarily a matter of state law to which we defer, we must decide not whether [the state court's] decision is a correct statement of California law but whether (assuming it is) that state law is consistent with the Federal Arbitration Act."). Like *Volt*, *DIRECTV* involved review of a state court decision and thus does not resolve whether lower federal courts are required to defer to state-court precedent.

12. 85 N.Y.2d 193, 202 (N.Y. 1995).

13. *PaineWebber Inc. v. Bybyk*, 81 F.3d 1193 (2d Cir. 1996).

14. *Diamond Waterproofing Systems, Inc. v. 55 Liberty Owners Corp.*, 4 N.Y.3d 247, 253 (N.Y. 2005).

15. 101 Cal. App. 4th 711, 719–24 (Cal. Ct. App. 2002).

16. *Id.* at 724.

17. *See Citizens of Humanity, LLC v. Applied Underwriters, Inc.*, 17 Cal. App. 5th 806, 818 (Cal. Ct. App. 2017) (concluding that a generic choice-of-law provision requiring an agreement to "be exclusively governed by and construed in accordance with the laws of Nebraska" incorporated Nebraska's arbitration law, and distinguishing *Mastrobuono*). Although the California Supreme Court has not explicitly weighed in on whether a generic choice-of-law provision must reference "enforcement" to select state arbitration law over the FAA, it has established a different proposition: that even where the parties provide that "[t]he designation of a situs or specifically a governing law for this agreement or the arbitration shall not be deemed an election to preclude application of the [FAA], if it would be applicable," a generic choice-of-law provision covering interpretation and enforcement does not exclude application of state *procedural* law on arbitration to the exclusion of FAA procedure. *See Cronus Invs., Inc. v. Concierge Servs.*, 107 P.3d 217, 224—25 (Cal. 2005). This does not fully answer when parties should be taken to have selected state substantive law on arbitration to the exclusion of the FAA.

18. 328 S.W.3d 883, 888 (Tex. 2010).

19. *See id.* at 886–87.

20. *See id.* at 887.

21. *Id.* at 890. *Olshan Foundation Repair* relied in part on an earlier decision, *In re L & L Kempwood Associates, L.P.*, where the Supreme Court of Texas held that a generic choice-of-law clause selecting "the law of the place where the Project is located" did not *exclude* the application of the FAA to compel arbitration. 9 S.W.3d 125 (Tex. 1999). That case, however, did not address what happens when the FAA and a state arbitration law are arguably in tension.

22. *See Olshan Found. Repair*, 328 S.W.3d at 890.

23. *See id.*

24. 876 N.E.2d 203 (Ill. App. Ct. 2007).

25. *See id.* at 207–08.

26. *See id.* at 212–13, 216–18. The decision observed that *Mastrobuono* did not dictate otherwise because *Mastrobuono* involved an inconsistency within the arbitration agreement that generated ambiguity, therefore appearing to treat *Mastrobuono* as the outlier and *Volt* as the default rule. *See id.* at 213.

27. *Id.* at 212.

28. *See State Farm Mut. Auto. Ins. Co. v. George Hyman Const. Co.*, 715 N.E.2d 749, 754 (Ill. Ct. App. 1999) (applying Illinois arbitration law where the contract was to be "interpreted in accordance with the laws of the jurisdiction in which the Project is located").

29. *See Yates v. Doctor's Assocs., Inc.*, 549 N.E.2d 1010, 1015 (Ill. App. Ct. 1990) (concluding that a choice-of-law clause required application of Connecticut arbitration law); *see Onken's Am. Recyclers, Inc. v. Cal. Ins. Co.*, No. 4-18-0240, 2018 WL 4361042, at *10–11 (Ill. Ct. App. Sept. 10, 2018) (unpublished op.) (concluding that a choice-of-law clause required application of Nebraska arbitration law).

30. *LRN Holding, Inc. v. Windlake Capital Advisors, LLC*, 949 N.E.2d 264, 271 (Ill. App. Ct. 2011) (relying on *Mastrobuono*).

31. *See id.* at 271–72 (discussing *Preston v. Ferrer*, 552 U.S. 346 (2008)).

32. *Marschel v. Dean Witter Reynolds, Inc.*, 609 So. 2d 718, 721 (Fla. Dist. Ct. App. 1992).

33. *Hialeah Automotive, LLC v. Basulto*, 22 So. 3d 586, 589 (Fla. Dist. Ct. App. 2009). The court emphasized the fact that there was a *substantive* conflict with the FAA, which tracks the reasoning of the federal decisions. However, it appeared not to contemplate the possibility that the parties could nonetheless opt into state law that conflicted with the FAA's provisions. In contrast, the federal caselaw discussed above generally allows parties to opt out of the FAA's substantive provisions as long as the agreement makes sufficiently clear that they intended to do so.

34. *See Basulto v. Hialeah Auto.*, 141 So.3d 1145, 1152–53 (Fla. 2014).

35. *Jansen Props. of Fla. v. Real Estate Assocs., Ltd. VI*, 674 So. 2d 210, 212 (Fla. Dist. Ct. App. 1996). ■

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Web site: http://www.lexisnexis.com/mealeys
ISSN 1089-2397